

**PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE**

Report No.: AB6237

Operation Name	TUNISIA - Integration and Competitiveness DPL 2
Region	MIDDLE EAST AND NORTH AFRICA
Sector	General industry and trade sector (60%);Other industry (20%);Micro- and SME finance (15%);Banking (5%)
Project ID	P122875
Borrower(s)	REPUBLIC OF TUNISIA
Implementing Agency	MINISTRY OF ECONOMIC DEVELOPMENT
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1. Key development issues and rationale for Bank involvement

Tunisia's global integration strategy has allowed it to gradually become a fairly diversified and open economy. Tunisia is a relatively small country, with a population of around 10 million, whose economy is open to FDI since the early 1970s, when the government established an attractive offshore regime with the aim of boosting exports and reducing the anti-export bias in its then protectionist policy stance. As a result, FDI increased steadily from an average 2.2 percent of GDP in 1996–2000 to a record 6 percent of GDP in 2008. Since the mid-1990s, the country has accelerated its openness to trade and today goods trade with the EU, the Greater Arab League partners and a large number of bilateral partners is duty-free.

Trade integration has been a key driver of technical progress and structural transformation in Tunisia. Through easier access to technology-intensive equipment and machinery, greater penetration of new markets and enhanced competitive pressure, trade integration has led to a gradual structural transformation of Tunisia's production and export. The change in the production structure also led to an upward trend in productivity. The role of total factor productivity has increased constantly since the mid-1990s, becoming, in a context of sluggish private investment, an important contribution to growth and helping Tunisia reach a 5 percent average growth in the period 1996-2008.

The development model that Tunisia pursued over the past two decades has served the country well, but it has shown to be increasingly inadequate to reduce unemployment and promote the growth of high value-added sectors. Despite the good growth track record, the Tunisian economy has not generated sufficient jobs to employ the growing and better educated labor force. Unemployment has been persistently high in Tunisia, reaching 13.3 percent in 2009, with the burden mostly falling on young and educated individuals. The high level of unemployment reflects an imbalance between the demand for labor, tilted towards the unskilled, and a growing supply of skilled labor where 57 percent are graduates of tertiary education. In addition, the insufficient creation of businesses in knowledge-intensive sectors has also contributed to keep employment of the educated workforce low. On the other hand, the profile of labor supply positions Tunisia well to changing the structure of its economy toward more skill-intensive sectors and higher productivity in the long-run.

The country now faces two interrelated challenges. First, it needs to grow at a much faster rate than in the past to reduce the high unemployment. Tunisia's second challenge is the need to accelerate the structural transformation of the economy from a low-wage, labor-intensive economy to knowledge-based, skill-intensive and technology-based economy. For a small economy, meeting both challenges requires deeper global integration, i.e. finding niches in global market for Tunisian products, tapping on global knowledge, technologies and investment, and further reducing protection at home to enhance resource allocation and efficiency.

The reforms program supported by this proposed loan is focused on assisting Tunisia tackle these challenges. The program is focused on strengthening the innovation systems in order to open also to global

knowledge and technology and facilitating growth of the services sectors, which are considerably less integrated than the manufacturing sectors. These are regarded by the authorities as strategic choices to accelerate growth by improving the productivity and competitiveness of Tunisian firms in international markets, and accelerating economic growth. Since the benefits of greater economic integration and improved support for innovation can be realized only if there is a favorable business environment, this program will also support a further improvement to business environment for firms. The proposed reforms program has therefore been structured along the three following pillars: (i) strengthening of the innovation system; (ii) further integration of services; and (iii) improving the business environment.

The proposed program has been designed in the context of an ongoing dialogue with the Tunisian government, which has been described in the Country Partnership Strategy FY10-13(CPS) approved by the Board of Executive Directors in December 2009, which also frames the context in which other Bank support operates in the country. The CPS proposes three strategic pillars: (i) employment, growth and competitiveness; (ii) sustainable development and climate change; and (iii) improving the quality of service delivery.

The proposed 2ICL DPL supports the implementation of the first pillar of the CPS, focusing on the results area that addresses the growth and composition of the demand for labor by deepening global integration, enhancing the environment for private sector (especially SMEs) and financial sector development, as well as opening space for the development in Tunisia of a knowledge economy through greater global integration of services and improved conditions for existing business to innovate. The 2ICL DPL complements the lending portfolio, particularly in the area of growth and competitiveness. The 2ICL also benefits from significant synergies with the Bank's technical assistance activities in the area of trade, innovation, finance and services

2. Proposed objective(s)

The 2ICL will support reforms in the context of the XII National Development Plan aiming at strengthening the integration of Tunisia into the global economy and aiding the structural transformation of the economy towards high value added/knowledge driven sectors.

This PDO is to be achieved by pursuing three objectives: (i) strengthen the National Innovation System; (ii) deepen global integration of the services sectors; and, (iii) foster a business environment more conducive to innovation and competitiveness. The 2ICL supports Pillar I of the Country Partnership Program: "Growth, competitiveness and employment", by accompanying reforms aimed to create the basis in Tunisia for a knowledge economy, through a stronger innovation system, greater global integration of services and improved conditions for existing business to innovate.

3. Preliminary description

The proposed Integration, Innovation and Competitiveness DPL 2 (2ICL) is a two-tranche operation supporting the implementation of the XII National Development Plan. The main overall objective of the program will be to support reforms in the context of the XII National Development Plan aiming at strengthening the integration of Tunisia into the global economy and aiding the structural transformation of the economy towards high value added/knowledge driven sectors. In general terms, the proposed 2ICL operation is a continuation of the previous ICL1 operation, in that it will continue to support the competitiveness and integration of the Tunisian economy into the global economy. In line with the XII development plan, however, the program supported by the proposed 2ICL operation is more focused on the development of high value-added sectors and only supports measures to foster innovation and support greater economic integration of services sectors. In this context the program focuses on strengthening the innovation systems and fostering the growth of services sectors. These are regarded by the authorities as strategic choices to accelerate growth by improving the productivity and competitiveness of Tunisian firms in international markets, and facilitating the transformation of the economy towards sectors with greater value added. The benefits of greater economic integration and improved support for innovation can be realized only if there is a favorable business environment. In this context, the reforms program has been structured along the following three pillars: (i) strengthen the National Innovation System; (ii) further

integration of services into the global economy; and (iii) improve the business environment with a focus on innovating firms and high-value added sectors. Hence, as intermediate outcomes the 2ICL operation supports:

- (i) **Strengthening the National Innovation System:** the 2ICL will help Tunisia address a number of important challenges to convert the country's considerable R&D capacity and human capital into an asset for an innovation-driven economy. The objectives of this pillar are to: (a) enhance governance efficiency of the Tunisian National Innovation System (NIS) by improving coordination of cross-sectoral policies and programs and their alignment with strategic priorities; (b) improve financing of R&D and innovation by rationalizing public financing, and improving incentives and support mechanisms for private financing; and, (c) improve the supply of R&D, skills and competencies relevant for the needs of the Tunisian economy through increased flexibility of public research and aligning the education curricula and vocational training with demand for skills by the private sector.
- (ii) **Integration of Services in the Regional and Global Economy:** The program will help consolidate and deepen institutional reforms to foster Tunisia's integration in regional and global services trade. In particular, the measures recommended in the 2ICL aim at: (a) improving coordination among ministries and with other actors in the elaboration and implementation of a national trade strategy in the services sector; (b) prompting reforms and initiatives facilitating the development of the services sector; (c) developing a clear strategy and program of reforms agreed across ministries and agencies to meet the objectives of the XII development plan; and, (d) fostering trade integration in sectors where Tunisia has a comparative advantage and offensive interests.
- (iii) **Improving the Business Environment with a Focus on Innovating Firms and High-Value Added Sectors:** Support the growth in value added sectors by reducing the excessive regulation constraining business activities. In particular, the 2ICL aims to: (a) simplifying and rationalizing the investment regime; (b) supporting cross-border partnerships, technology transfer and access to foreign expertise; and, (c) improving firms' access to finance, in particular innovative firms and services providers.

The Integration, Innovation and Competitiveness DPL has been jointly prepared by the World Bank, the African Development Bank (AfDB), the French Development Agency (AFD), and the European Union (EU). All preparatory missions have been jointly conducted even if some flexibility was needed to respond to different internal processes. The EU, the AFD and the AfDB have asked the Bank to play a leading role in the four institutions' communication with the government and in elaborating a macro framework for this program.

4. Environment Aspects

The reforms supported in this DPL operation are not expected to have significant positive or negative effects on the environment, forest and other natural resources. The DPL supports policy actions that create the enabling environment to support poverty reduction, and which by themselves do not have an environmental impact. It is expected, however, that regular private and public investment activities which may result from such policy actions, could have impacts on the environment. This also includes the potential effects from increasing exports. Nevertheless it is not expected that there will be need to introduce special measures since all activities to be carried out are subject to the Tunisian legal framework for the protection of the environment. Thus, neither specific environmental studies nor environmental impact management measures are anticipated.

5. Tentative financing

Source:	(\$m.)
Borrower	0
International Bank for Reconstruction and Development	300
Total	300

6. Contact point

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