PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

May 27, 2016
Report No.: AB7851

Operation Name	Business Environment, Entrepreneurship, Financial Inclusion and Fiscal Sustainability (BEFF) for Inclusive Growth and Social Stability
Region	Middle East and North Africa
Country	Tunisia
Sector	General public administration sector (20%); Central government administration (10%); Trade and Competitiveness (30%); Banking and Finance (30%);Other (10%)
Operation ID	P158111
Lending Instrument	Development Policy Financing
Borrower(s)	Government of Tunisia
Implementing Agency	Ministry of Development, Investment and International Cooperation
Date PID Prepared	May 27, 2016
Estimated Date of Appraisal	August 1, 2016
Estimated Date of Board Approval	September 15, 2016
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Key development issues and rationale for Bank involvement

While poverty incidence was halved between 2000 and 2010 (from 32.5 percent to 15.5), considerable disparities exist among regions and age groups, and household vulnerability to falling into poverty remains considerable. The latest poverty estimates, based on revised poverty thresholds in line with international standards, show that poverty rates surpass 30 percent in the most disadvantaged regions of Tunisia (notably the predominantly rural Western part of the country), according to the quantitative assessment undertaken by the National Statistical Institute (INS) with support by the Bank in 2012. Just as importantly, the data suggests that the gains realized over the past decade remain fragile, as many households remain slightly above the poverty threshold, making them vulnerable to exogenous shocks such as the loss of employment or hikes in the prices of essential goods.

For the next five years, Tunisia faces the urgent need to boost economic growth and make growth more inclusive than in the past which is critical for social stability. Growth has been inadequate to generate sufficient jobs to absorb new entrants. As a consequence the unemployment rate has remained stubbornly high (15.4 percent in 2015), especially among women (22.6 percent), young university graduates (31 percent) and the population of the interior regions (26.6 percent in the South-East and 22.3 percent in the South-West compared to 7 percent in the Greater Tunis).

Demographic trends suggest that unless the pace of growth accelerates substantially, unemployment will worsen over the next decade. The large protests in early 2016 was a reminder that tackling unemployment, especially of youth and in the interior regions, which triggered the 2011 revolution is critical for social stability.

Since 2011, the Government has responded to these challenges by raising public sector hiring and salaries. Rather than solving the employment situation, this has contributed to significantly weakening Tunisia's fiscal situation within a challenging macroeconomic environment. The wage bill has increased from 10.7 percent in 2010 to 13.5 percent of GDP in 2015 and represent over 60 percent of tax revenues. Between 2010 and 2013, the government recruited 37,950 new employees. The number of workers in central government stood 616,000 (2015) plus an estimated additional 180,000 workers in public enterprises The twin deficit is high, at respectively 4.7 percent of GDP and 8.9 percent of GDP for the fiscal and current account in 2015. Public debt has risen markedly in the post-revolution period (from 40 percent of GDP in 2010 to 53.9 percent of GDP in 2015) even if it remains reasonable by international standards.

Going forward, the private sector will have to be the source for the necessary job creation; and this will require a dynamic private sector and a conducive business environment. Improving the business environment, promoting competition and opening more space for the private sector remain key challenges for Tunisia and are critical to unleash faster and more inclusive private sector-led growth and job creation). The coalition government that took office in early 2015 renewed the reform momentum, especially on statutory reforms that are critical for private investment (e.g. competition law, the bankruptcy law, the Central Bank law, the PPP law etc.). At the same time some longstanding reforms that seek to open the economy and eliminate rents and capture have faced strong opposition leading to reform dilution and delays. In addition, moving forward, a lot of effort should be put on effective reform implementation to translate statutory reforms into measurable impact on the investment climate both economy-wide and in key sectors (in particular backbone services sectors).

Following the 2014 presidential and parliamentary elections, President Essebsi appointed a President of Government who led the preparation of a concept note for the 2016-2020 development plan, the "*Note d'Orientation Stratégique*". The Note outlined Tunisia's development vision and strategic orientation for the next five years. Its main premise is that Tunisia will maintain its strong partnerships with the international community and (a) rely on the private sector to lead economic growth and job creation, and at the same time (b) promote a vibrant civil society. Technical ministries are in the process of preparing the detailed five-year plan based on this vision. MDCI promised to share the draft version of the five-year plan as soon as ready (expected in one-two weeks after the PCN Review Meeting). The five-year plan will detail specific projects, for which financing will be sought during an international donor conference in 2016.

The *Note d'Orientation Stratégique* presents a new development model that aims at achieving more "economic efficiency based on innovation and partnership, social inclusion and sustainable development." Achieving these objectives requires improvement of the business environment and progress in the implementation of major reforms, including modernization of the administration, revision of the procurement system, promulgation of a new investment code, improved equity of the tax regime, and implementation of a proactive policy to boost public-private partnerships. The Note has five pillars:

- ***Pillar 1 - Good governance:*** The Note acknowledges that Tunisia is at a turning point in changing its development model and formulating a new social contract for fair and equitable growth based on inclusion, shared prosperity and voice. In order to increase its chances of success and accelerate this shift, the first pillar focuses on governance issues such as fighting corruption and easing administrative barriers to economic participation, and to increase opportunities for success to all citizens.
- ***Pillar 2 - Shifting from an economy characterized by low value-added productivity and low-wage jobs to a "hub economy":*** This would require linking the economy to global value chains, building larger-scale infrastructure and logistics capabilities, fostering innovation, promoting investment, increasing productivity for competitiveness, and promoting employment. This pillar seeks to put private sector investment at the heart of growth and job creation while strengthening the efficient delivery of public services.
- ***Pillar 3 - Promoting human development and social inclusion:*** Quality of education is a key priority to improve employability and help match skills to labor demands. Strengthening women's rights will also be critical, especially in terms of female participation in economic and political activity. From a social inclusion perspective, actions will be taken to improve health outcomes (especially in lagging regions), improve living conditions through social housing, institute a state-of-the-art social protection system, and make pension and health insurance schemes more sustainable.
- ***Pillar 4 - Tackling regional disparities between internal and coastal regions and ensuring development ambitions of internal regions:*** The Government is committed to attracting investments in lagging regions by building infrastructure, including roads, ports, railways. In parallel, considerable efforts will be made to support micro-finance institutions and entrepreneurship in lagging regions, while also scaling up skills enhancement programs for young would-be entrepreneurs. Government is working on a regional development funding mechanism. Most importantly, efforts are underway to prepare for local government elections as a means of improving living conditions and the regional and local level – this process is underway with the delineation of regional and municipal boundaries.

  Pillar 5 - Promoting green growth for sustainable development: The Government's first objective under this pillar is to ensure that development is not only spatially balanced but also environmentally sustainable. The sound utilization of natural resources will be a key consideration, with emphasis on rationalizing water and energy consumption while promoting modern agricultural systems that guarantee food security.

The reform momentum has generally accelerated, and the focus should now shift to implementation. Since the fall of 2015, the *"Assemblée des Représentants du Peuple"* (ARP) has approved multiple pieces of legislation, namely the law on access to information, the competition law, the PPP law, the law governing the Central Bank, and the law on collective procedures. A longer set is awaiting finalization before the ARP summer break, including the banking law, the investment code, the organic budget law and, more generally, the overall five-year plan of the government. The challenge now is implementation, and the translation of such reforms into reality felt by the people on the ground.

Building on the strong role that civil society played during the transition period, continuing the dialogue between the Government and civil society to build consensus around reforms is key. For example, the Government has launched a social dialogue process with the main trade union ("*Union Générale Tunisienne du Travail"*, UGTT) and the main business confederation ("*Union Tunisienne de l'Industrie, du Commerce et de l'Artisanat"*, UTICA), with the support of the International Labor Organization (ILO). A 'new Social Contract' was signed in January 2013, a form of consensual action plan which can pave the way for key reforms in the social sector (social security reform, subsidy reform, vocational training reform, etc.). Following the January 2016 protests, the steering committee of National Dialogue on Employment came with a list of urgent measures to address the unemployment challenge. Going forward, it will be important to institutionalize such platforms, and encourage the dialogue around medium/long-term solutions, rather than respond to emergency situations like January 2016 events.

II. Proposed Objective(s)

The proposed Development Policy Financing will support the Government of Tunisia's efforts to boost Business Environment, Entrepreneurship, Financial Inclusion and Fiscal Sustainability (BEFF) for Inclusive Growth and Social Stability in Tunisia. The proposed DPF (JEFF-1), in the amount of US$500 million equivalent, would be the first in a programmatic series of single-tranche multi-sector operations to support the Tunisian Government to kick-start key areas of reform in the Government's upcoming five-year plan for 2016-2020 and to complete the economic reforms that were initiated during the political transition, and whose implementation is essential for achieving the economic and social objectives of the new Government, and. The objective of the DPF is to help Tunisia achieve stronger and more inclusive growth, and job creation led by the private sector, particularly by stimulating entrepreneurship. The operation is strongly linked to Pillars 1 and 2 of the *Note d'Orientation*, putting the private sector at the heart of growth and job creation agenda, improving governance and creating a level playing field for competition. The operation also contributes to the goals of Pillar 3 in terms of promoting entrepreneurship and financial inclusion.

III. Preliminary Description

In the current context, improving fiscal sustainability (pillar 1 of the proposed DPF) is a prerequisite to restarting investment and growth. The twin deficit is high (at respectively 4.7 percent of GDP and 8.9 percent of GDP for the fiscal and current account in 2015) as growth has slowed down and recurrent spending have risen sharply, including the wage bill which is above 60 percent of revenues. Public debt has risen markedly in the post-revolution period (from 40 percent of GDP in 2010 to 53.9 percent of GDP in 2015) even if it remains reasonable by international standards. Pillar 1 of the proposed DPF seeks to strengthen fiscal sustainability and is complementary to the new IMF Extended Fund Facility with Tunisia which seeks as a key objective to consolidate macroeconomic stability by containing the wage bill and laying the ground of the civil service reform, by advancing tax reform and energy subsidies reform, by simplifying the existing capital account regulations and furthering exchange rate flexibility and reducing its overvaluation. To further fiscal sustainability pillar 1 of this DPF will support; (i) the reform of the budget framework to make it more results-oriented, credible and transparent; (ii) the reduction of tax expenditures and the distortive impact of tax incentives; (iii) the strengthening of the public investment framework to improve projection preparation, selection, execution and monitoring and evaluation; (iv) and the improvement of the public debt management strategy and operational capacity.

Improving the business environment, promoting competition and opening more space for the private sector remain key challenges for Tunisia and are critical to unleash faster and more inclusive private sector-led growth and job creation (pillar 2 of the proposed DPF). The coalition government that took office in early 2015 renewed the reform momentum, especially on statutory reforms that are critical for private investment (e.g. competition law, the bankruptcy law, the Central Bank law, the PPP law etc.). At the same time some longstanding reforms that seek to open the economy and eliminate rents and capture have faced strong opposition leading to reform dilution and delays. In addition, moving forward, a lot of effort should be put on effective reform implementation to translate statutory reforms into measurable impact on the investment climate both economy-wide and in key sectors (in particular backbone services sectors). Pillar 2 of this DPF will support: (i) the strengthening the competition framework and improving market access through the adoption and implementation of the investment code, implementation of the competition law, and design and operationalization of a common firm identifier; (ii) improvement of the business environment of SMEs, and promotion of the development of backbone services by tackling existing delays for VAT reimbursement and public contract payments to SMEs, adopting and implementing the new Digital Economy Law; (iii) and the improvement of trade and transport services through the digitization of port procedures and simplification of procedures for road transport licenses, and the signing of open skies agreements.

Accelerating job creation and promoting inclusion and shared prosperity in Tunisia also entails supporting entrepreneurship and deepening financial inclusion (pillar 3 of the proposed DPF). The existing private sector has been unable to create enough jobs, a situation that has been accentuated in the post-revolution period by the deterioration of the economic situation. The privileged segment of the established private sector and workers unions have also opposed reforms to improve competition, reduce rents and capture, and open up the economy. As a result and compounding the jobs challenges, very few new firms enter the market each year, the overwhelming majority enter as small firms and remain small or exit within three to five years (Jobs or Privileges regional report 2015, Tunisia Development Policy Review 2014). Resolving these challenges through appropriate support to the promotion of entrepreneurship, both financial and non-financial, will contribute to improving private sector growth and job creation. Furthering financial inclusion will not only relax constrains on access to finance and reduce financial transaction costs (through more inclusive payment systems) but will also promote economic inclusion and shared prosperity through the renewal of the social contract. Pillar 3 proposes to support these reforms by: (i) reforming financial and business services support to entrepreneurs; (ii) adopting and implementing the Credit Bureau Law allowing ultimately the entry of a private credit bureau which should provide credit scoring, notably to young firms; (iii) promoting the development of mobile banking and non-bank payment services to individuals and firms; (iv) strengthening the microfinance sector; (v) improving access to low income housing finance; (vi) and reforming the insurance sector to deliver a wide range of products supporting the resilience and the income security of Tunisian households and contributing to capital market development.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

The poverty and social impacts of the policies supported by the proposed operation are expected to be positive through improved growth, investment and job creation. A full Poverty Social Impact Assessment is under preparation. The Systematic Country Diagnostic identifies macroeconomic stability as a pre-requisite to growth, job creation and the promotion of the twin goals. The investment climate and competition measures are expected to yield direct benefits in terms of consumer welfare, improved competitiveness of Tunisian companies and increased attractiveness investors. The restructuring of financial and business development services for entrepreneurship will improve job creation through the creation of new firms and the survival and growth of existing young firms. In addition greater financial inclusion through the development of mobile banking will reduce firms' transaction costs while the establishment of private credit bureau will further promote access to finance including of new or young firms. Similarly the relaxation of lending interest rates and the restructuring of micro-credit associations will improve microcredit intermediation and financial access in particular by women and young entrepreneurs and in lagging regions but could also increase individual and firm indebtedness in the short to medium-term. A full PSIA is under preparation to fully document the effects associated with the specific policies supported, especially on the poor people and vulnerable groups, and the borrower's systems for reducing adverse and enhancing positive effects.

Environment Aspects

Over the last years, Tunisia has confirmed a consistent, high level, and long-term commitment for environment protection. The Tunisian Constitution explicitly addresses the need to safeguard a healthy environment and to tackle climate change. The Government's Note d'Orientation Stratégique which outlines Tunisia's development vision for the next five years consists of five pillars, the fifth one is dedicated to promoting green growth for sustainable development. The 2016-2020 Strategic Development Plan involves a number of key challenges, including the implementation of key aspects of sustainable development, to provide a balanced territorial development and integrate all regions, while respecting the environment. The action plan implementation depends on a rational use of natural resources, better environmental protection and greater control of the consumption of energy.

The implementation of the policy actions supported by the proposed DPF is not likely to have significant impact on environment, forests, and natural resources. However, if negative environmental impacts from the DPF-supported reforms may result from identified priorities, Tunisia has strong and well-defined institutional, legal and regulatory frameworks concerning the management of social and environmental impacts of investments. The reduction of adverse effects, and the enhancement of positive effects. According to the national Environmental Impact Assessment (EIA) system, all activities likely to have a significant effect on the environment are subject to an environmental impact assessment which must take place before licensing and investing activities. EIA is mandatory for any industrial, commercial or agricultural project, which could generate significant environmental impacts.

The Ministry of Environment and Sustainable Development (MEDD) is the key player in the definition and implementation of environmental policies and strategies. It proposes the policy environment, ensures the coordination and monitoring of actions by the state and local authorities for the protection of nature and the environment, the fight against pollution and nuisances, and the improvement the quality of life. It publishes an annual report on the state of the environment, and action plans are implemented to address various environmental problems (on water, solid waste, biodiversity, natural resources, urban planning, etc.).

Key recommendations within the proposed DPF concern improved forms of partnership and collaboration between MEDD and different national institutions in charge of environmental issues, such as: National Agency for the Protection of the Environment (*Agence Nationale de Protection de l'Environnement, ANPE*); National Sanitation Office (*Office National de l'Assainissement, ONAS*); Tunis International Center of Environmental Technologies (*Centre International des Technologies de l'Environnement de Tunis, CITET*); and National Agency for Wasteland Management (*Agence Nationale de Gestion des Déchets, ANGeD*). Other recommendations concern the revision of projects screening methods (based on the new list of investments projects established by EIA in 2005) as well as improved procedure for stakeholder's consultations. The P4R Urban Development and Local Governance is supporting the Government to proceed with these improvements.

V. Tentative financing

Source:		($m.) 500
Borrower/Recipient: Republic of Tunisia		
IBRD		
Others (specifiy)		
	Total	500

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