AFRICAN DEVELOPMENT BANK

Economic Recovery and Inclusive Development Support Programme

Country : Tunisia

APPRAISAL REPORT
October 2012

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<td>Ammar Kessab, Economist, Young Professional, ORNA</td>
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<tr>
<th>Sector Director</th>
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<tr>
<td>Country Director:</td>
<td>Jacob Kolster, Director, ORNA</td>
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Fiscal Year
January to December

Currency Equivalents
(September 2012)

UA 1 = 2.4320 Tunisian Dinars (TND)
UA 1 = 1.1927 Euro (EUR)
UA 1 = 1.5422 U.S. Dollars (USD)

ACRONYMS AND ABBREVIATIONS

AfDB African Development Bank
AFD French Development Agency
ANC National Constituent Assembly
ANETI National Agency for Employment and Self-Employment
BCT Central Bank of Tunisia
CONECT Confederation of Tunisian Corporate Citizens
CSM Higher Commission for Procurements
CSP Country Strategy Paper
DGCL Directorate General for Local Government
EU European Union
EUR Euro
FDI Foreign Direct Investment
FNE National Employment Fund
FNS National Solidarity Fund
GBS General Budget Support
GDP Gross Domestic Product
IMF International Monetary Fund
INS National Institute of Statistics
JORT Official Gazette of the Republic of Tunisia
LGT Local Government Tax
MAS Ministry of Social Affairs
MDR Ministry of Regional Development
MESRES Ministry of Higher Education and Scientific Research
MF Ministry of Finance
MFPE Ministry of Vocational Training and Employment
MI Ministry of Interior
MICI Ministry of Investment and International Cooperation
MICOM Ministry of Trade
MPCI Ministry of Planning and International Cooperation
MPDR Ministry of Planning and Regional Development
MRA Ministry in charge of Relations with the Assembly
NGO Non-Governmental Organisation
PAE Active Employment Programme
PAGDI Governance and Inclusive Development Support Programme
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>PARDI</td>
<td>Economic Recovery and Inclusive Development Support Programme</td>
</tr>
<tr>
<td>PCR</td>
<td>Project Completion Report</td>
</tr>
<tr>
<td>PDAI</td>
<td>Integrated Agricultural Development Programme</td>
</tr>
<tr>
<td>PEE</td>
<td>Employment Incentive Programme</td>
</tr>
<tr>
<td>PM</td>
<td>Prime Minister's Office</td>
</tr>
<tr>
<td>TND</td>
<td>Tunisian Dinar</td>
</tr>
<tr>
<td>TOFE</td>
<td>Table of Government Financial Operations</td>
</tr>
<tr>
<td>UA</td>
<td>AfDB Unit of Account</td>
</tr>
<tr>
<td>USD</td>
<td>U.S. Dollar</td>
</tr>
<tr>
<td>UTICA</td>
<td>Tunisian Union of Industry, Trade and Handicraft</td>
</tr>
<tr>
<td>WB</td>
<td>World Bank</td>
</tr>
</tbody>
</table>
Loan Information

Client Information

BORROWER : Republic of Tunisia
EXECUTING AGENCY : Ministry of Investment and International Cooperation

Financing Plan

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
<th>Instrument</th>
</tr>
</thead>
<tbody>
<tr>
<td>AfDB</td>
<td>EUR 387.6 million</td>
<td>AfDB Loan</td>
</tr>
<tr>
<td>World Bank</td>
<td>USD 500 million</td>
<td>IBRD Loan</td>
</tr>
<tr>
<td>European Union</td>
<td>EUR 107 million</td>
<td>Grant</td>
</tr>
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</table>

Information on ADB Financing

<table>
<thead>
<tr>
<th></th>
<th>USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan Currency</td>
<td>USD</td>
</tr>
<tr>
<td>Type of Interest Rate</td>
<td>Floating interest rate</td>
</tr>
<tr>
<td>Base rate (floating :) LIBOR</td>
<td>Method of fixing: at any time at the Borrower’s request</td>
</tr>
<tr>
<td>Interest Rate Margin</td>
<td>0.60%</td>
</tr>
<tr>
<td>Financing Margin</td>
<td>Variable, recalculated every six months and passed on to clients</td>
</tr>
<tr>
<td>Commitment Fee</td>
<td>Commitment fee ranging from 0.25 to 0.75% applicable to the undisbursed amount according to the schedule specified in the loan agreement</td>
</tr>
<tr>
<td>Period</td>
<td>20 years</td>
</tr>
<tr>
<td>Grace period</td>
<td>5 years</td>
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Indicative Schedule

<table>
<thead>
<tr>
<th>Activity</th>
<th>Timeline 2012</th>
<th>Timeline 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Loan Agreement Negotiations</td>
<td></td>
<td></td>
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<tr>
<td>2 Board Presentation</td>
<td></td>
<td></td>
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<tr>
<td>3 Effectiveness</td>
<td></td>
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<tr>
<td>4 Disbursement of the single tranche</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Supervision</td>
<td></td>
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<tr>
<td>6 Completion Report</td>
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</tbody>
</table>
**Programme Summary**

| Programme Overview | The Economic Recovery and Inclusive Development Support Programme (PARDI) is a general budget support programme in continuity with the previous Governance and Inclusive Development Support Programme (PAGDI) approved by the Bank in May 2011, the achievements of which will be consolidated. PARDI's main objective is to help restore socio-economic stability. The programme aims to meet the immediate needs expressed by popular demand from the Revolution such as the fight against unemployment and regional disparities, and greater transparency in public affairs management. The country needs assistance from its development partners, particularly the Bank, to meet its financing needs and implement its socio-economic reform programme. PARDI will be implemented over 12 months and will be disbursed in December 2012 in a single tranche, the precedent conditions of which will be met before Board presentation. |
| Programme Outcomes | The expected outcomes will contribute to: (i) the reduction of regional disparities and the fight against exclusion (Component 1); (ii) the promotion of inclusive growth, employability and competitiveness (Component 2); and (iii) the enhancement of transparency, accountability and citizen participation (Component 3). To facilitate this change, the Bank undertook a broad consultation with civil society and the private sector during the preparation of this programme in May and August 2012. |
| Programme Beneficiaries | Programme beneficiaries are the Tunisian population as a whole, especially disadvantaged regions. |
| Needs Assessment | The programme is essential to address current economic and social challenges. These challenges relate to: (i) a need for significant additional financing to meet the economic and social consequences of the Revolution; (ii) an urgent need for social and economic stabilization to secure and lend credibility to the transition process; and (iii) mobilization of the international community to build external confidence in the process. |
| Bank’s Value Added | The Bank's value added consists of: (i) on-going dialogue with the authorities; (ii) the experience drawn from the previous operation (PAGDI), lessons of which are built into this intervention; (iii) the Bank's leadership regarding the regional development theme and active engagement on other programme themes such as micro-finance; and (iv) the Bank's ability to meet needs and concerns through technical studies and consultations with Tunisian partners, including civil society and the private sector. |
| Institution Building and Knowledge Development | The analytical work and technical assistance accompanying the programme and its components contribute to institutional development and knowledge building. |
EXPECTED RESULTS-BASED LOGICAL FRAMEWORK

Country and Project Name: Economic Recovery and Inclusive Development Support Programme  
Project Goal: Respond to the country's urgent needs in terms of reduction of regional disparities, inclusive growth and job creation with further enhancement of transparency and participation.

<table>
<thead>
<tr>
<th>RESULTS CHAIN</th>
<th>PERFORMANCE INDICATORS</th>
<th>MEANS OF VERIFICATION</th>
<th>RISKS/ MITIGATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>IMPACT</td>
<td>Indicator (including ISC)</td>
<td>Baseline</td>
<td>Target</td>
</tr>
<tr>
<td>Economic recovery and inclusive growth</td>
<td>Annual GDP growth rate (%)</td>
<td>-1.8% Growth in 2011</td>
<td>2.5% in 2012 (AfDB) 3.5% in 2013</td>
</tr>
<tr>
<td></td>
<td>Unemployment rate</td>
<td>18.3% in 2011</td>
<td>17.3% in 2012 17% in 2013</td>
</tr>
</tbody>
</table>

| Outcome 1 | Socio-economic disparities between coastal regions and the interior of the country reduced. | Share of the investment budget allocated to regions | 44% in 2011 | 80% in 2012 ¹ | MF Reports MPDR, MI, MAS |
| | | Share of resources from local taxation | 16% in 2011 | 30% in 2012 | MI, MF |

| Outcome 2 | Jobs created by economic recovery | Number of jobs created | 38,446 in 2011 (of which 26.7% are women) | 50,000 jobs (including 30% of women in 2012). Half of these jobs (25,000) are in the civil service, particularly in the social sectors. | MFPE Report UTICA/CONECT Reports |
| OUTCOMES | | | | |

| Outcome 3 | Increased citizen transparency for improved public services rendered | Institutionalization of publication of fiscal information | Closed budget preparation process | Decision on the publication of detailed budget information (TOFE draft budget) taken in 2012 | PM/DRE |
| | | Increased access to information | Absence of transparent mechanisms for querying information and lodging complaints in 2011 | Order establishing procedures and forms for information requests and electronic claims (horizon 2012 (website)) | |
| | | More efficient and transparent procurement system | Procurement system not sufficiently transparent | Approval of the System Modernization Action Plan | |

¹ The goal seems ambitious but the Government's programme provides that the share of investment budget allocated to regions shall reach 80% in 2012. The post-revolution context (delays in transfers, strikes, demonstrations and lack of officials in the Municipalities) accounts for the low rate of investment (44%) achieved in 2011 in the regions.
### Component 1: Reduction of Regional Disparities and Fight against Exclusion

<table>
<thead>
<tr>
<th>Output 1.1: Boosting Regional Development</th>
<th>Level of revenue due to lifting of the TCL ceiling</th>
<th>TND 15 million in 2011</th>
<th>TND 45 million in 2012</th>
<th>Publication of tax revision in the supplementary Finance Law for 2012 MPDR/MI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output 1.2: Consolidation and strengthening of social protection programmes to reduce social exclusion</td>
<td>Single database on social protection programmes</td>
<td>Variety of databases in 2012</td>
<td>Unified database on beneficiaries of social protection programmes designed and regularly updated in 2012</td>
<td>Circular of the Ministry of Social Affairs on the information system MAS</td>
</tr>
<tr>
<td>Output 1.3: Improvement of access to basic healthcare in disadvantaged regions</td>
<td>Rate of satisfaction with care quality</td>
<td>50% of users are satisfied with the quality of care received in 2011</td>
<td>60% of users are satisfied in 2012</td>
<td>Report of the Ministry of Health and the National Healthcare Accreditation Authority MOH</td>
</tr>
</tbody>
</table>

### Component 2: Promotion of Inclusive Growth, Employability and Competitiveness

<table>
<thead>
<tr>
<th>Output 2.1: Improvement of the business climate and support to investment</th>
<th>Investment Code</th>
<th>Framework unattractive and unfavourable for business</th>
<th>Cost reduction and improved transparency in the administration</th>
<th>Decree of the Head of Government to launch a reform aimed at simplifying administrative formalities CM/MPRD/MICO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output 2.2: Development of micro-finance</td>
<td>The Investment Capital Facility is operational as financing leverage</td>
<td>Unfavourable regulatory mechanism</td>
<td>Improvement of financing tools and support to businesses.</td>
<td>Decree of Implementation of the 2011 Capital Investment Law MF/BCT</td>
</tr>
<tr>
<td>Output 2.3: Improvement of youth employability</td>
<td>Number of people with access to micro-finance services</td>
<td>260,000² in 2011</td>
<td>300,000 in 2012, of which 55% women</td>
<td>Implementing decree of the Law establishing a Micro-finance Regulatory Authority, MF/BCT</td>
</tr>
<tr>
<td>Number of people targeted by PEE</td>
<td>144,300 for the AMAL programme in 2011</td>
<td>Non-existent</td>
<td>80000³ for the new PEE</td>
<td>Decree establishing National Employment Fund programmes MFPE/ANETI Report</td>
</tr>
<tr>
<td>Evaluation, accreditation and quality assurance mechanisms in place are functional</td>
<td>National Evaluation, Accreditation and Quality Assurance Authority established</td>
<td>National Evaluation, Accreditation and Quality Assurance Authority established</td>
<td>National Evaluation, Accreditation and Quality Assurance Authority established</td>
<td>Decree establishing the Authority MES/MFPE</td>
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</tbody>
</table>

### Component 3: Enhancement of Transparency, Accountability and Citizen Participation

<table>
<thead>
<tr>
<th>Output 3.1: Better access to information</th>
<th>Information enquiry and claims-handling mechanisms operational</th>
<th>Number of claims received and processed</th>
<th>60% of the claims received are processed</th>
<th>Head of Government's Circular specifying the terms of implementation of the Decree on Access to Information (Prime Minister's Office)</th>
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</thead>
</table>

² European Union Study, April 2011
³ Beyond the quantitative objective, it is expected that there will be better targeting of beneficiaries of such programmes (equity) and qualitative improvement through improved support.
<table>
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<tr>
<th>Activities</th>
<th>Outputs</th>
<th>Components</th>
<th>Resources</th>
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<tbody>
<tr>
<td><strong>Output 3.2:</strong> Enhancement of public financial information accountability to citizens</td>
<td>Publication of fiscal information by the Ministry of Finance</td>
<td>The action plan arising from the evaluation report according to OECD/DAC methodology is approved</td>
<td>Note from the Minister of Finance instructing services to publish detailed budget information at end 2012. MF</td>
</tr>
<tr>
<td></td>
<td>Information on budgetary decisions unpublished</td>
<td>The procurement system is not quite consistent with international standards</td>
<td>Approval of the procurement system evaluation report and plan of action by the Council of Ministers</td>
</tr>
<tr>
<td></td>
<td>Financial information published</td>
<td>Approval of the procurement system evaluation report and plan of action by the Council of Ministers</td>
<td></td>
</tr>
<tr>
<td><strong>Output 3.3:</strong> Enhancement of transparency, efficiency and effectiveness of budget execution</td>
<td>The action plan arising from the evaluation report according to OECD/DAC methodology is approved</td>
<td>Approval of the national procurement evaluation report. PM</td>
<td></td>
</tr>
<tr>
<td><strong>Components</strong></td>
<td><strong>Activities</strong></td>
<td><strong>Resources</strong></td>
<td></td>
</tr>
<tr>
<td>Component 1: Reduction of Regional Disparities and Fight against Exclusion</td>
<td></td>
<td>AfDB: EUR 387.6 million</td>
<td></td>
</tr>
<tr>
<td>Component 2: Promotion of Inclusive Growth, Employability and Competitiveness</td>
<td></td>
<td>World Bank: USD 500 million</td>
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REPORT AND RECOMMENDATION OF MANAGEMENT OF THE AFRICAN DEVELOPMENT BANK GROUP TO THE BOARD OF DIRECTORS CONCERNING A PROPOSAL TO GRANT A LOAN TO TUNISIA TO FINANCE THE ECONOMIC RECOVERY AND INCLUSIVE DEVELOPMENT SUPPORT PROGRAMME

I. PROPOSAL

1.1 The proposal submitted for Board approval concerns a loan of EUR 387 600 000 to Tunisia to finance the Economic Recovery and Inclusive Development Support Programme (PARDI). This is a general budget support programme to be implemented over 12 months from October 2012. The AfDB loan will be disbursed in a single tranche, in the same manner as the USD 500 million World Bank support. This programme follows a request by the Government in April 2012. Conducted in August 2012, the appraisal was the fruit of steady dialogue with the Tunisian authorities and other co-financiers begun in April 2012.

1.2 PARDI falls within the framework of the Economic and Social Programme (PES) adopted by the Government in April 2012, and is in continuity with the Governance and Inclusive Development Support Programme (PAGDI), whose achievements will be consolidated. It is also consistent with the Interim Country Strategy Paper (CSP 2012-2013) approved in February 2012. The Government's recovery programme and the Letter of Development Policy (see Annex I) were deemed satisfactory by the Bank, the World Bank and the European Union, PARDI’s key stakeholders.

1.3 The programme's design took into account the principles of the Paris Declaration on Aid Effectiveness and good practice principles for the application of conditionality. It was jointly prepared with other co-financiers to ensure complementarity with the actions of other donors and with other Bank operations.

1.4 The main objective of the programme is to help restore socio-economic stability still affected by the January 2011 Revolution, with a view to supporting economic recovery in Tunisia. In the short term, the country faces major economic and social challenges, compounded by the economic slowdown and popular demands. It needs assistance from its development partners, particularly the Bank, to meet its financing needs and implement its socio-economic reform programme.

1.5 This programme initiates a package of reforms for a new Tunisia. The expected outcomes will contribute to: (i) the reduction of regional disparities and the fight against exclusion (Component 1); (ii) the promotion of inclusive growth, employability and competitiveness (Component 2); and (iii) the enhancement of transparency, accountability and citizen participation (Component 3). To facilitate this change, the Bank undertook a broad consultation with civil society and the private sector during programme preparation in May and August 2012.

II. COUNTRY AND PROGRAMME CONTEXT

2.1 Government's Strategy and Priorities

2.1.1 The Transitional Government’s Economic and Social Programme (PES), covering the 2012-2013 period, mainly targets high priority areas for economic recovery, namely: (i)
The programme has five main thrusts (see Box 1). PARDI was designed to support the Government's programme. It will be complemented by technical assistance from the Bank.

<table>
<thead>
<tr>
<th>STRATEGIC THRUSTS</th>
<th>MEASURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>SECURITY</td>
<td>A prerequisite for any activity by natural and legal persons.</td>
</tr>
<tr>
<td>EMPLOYMENT</td>
<td><strong>Measure 1</strong>: The new Employment Incentive Programme (PEE)</td>
</tr>
<tr>
<td></td>
<td><strong>Measure 2</strong>: Public interest programmes in the regions</td>
</tr>
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<td></td>
<td><strong>Measure 3</strong>: An exceptional public service recruitment programme to</td>
</tr>
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<td></td>
<td>make up for shortages in skilled human resources in social services and a</td>
</tr>
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<td></td>
<td>recovery plan.</td>
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<td>SUPPORT TO THE ECONOMY AND ITS</td>
<td><strong>Measure 4</strong>: Business climate improvement support programme and</td>
</tr>
<tr>
<td>FINANCING</td>
<td>investment development</td>
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<tr>
<td></td>
<td><strong>Measure 5</strong>: Restructuring of the micro-credit and SME financing</td>
</tr>
<tr>
<td></td>
<td>mechanism</td>
</tr>
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<td></td>
<td><strong>Measure 6</strong>: Fiscal and financial measures for national economic</td>
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<tr>
<td></td>
<td>recovery.</td>
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<td></td>
<td><strong>Measure 7</strong>: Infrastructure projects to stimulate investment and bridge</td>
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<tr>
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<td>the basic equipment gap for the least equipped regions.</td>
</tr>
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<td><strong>Measure 8</strong>: Pilot information and communication technology (ICT)</td>
</tr>
<tr>
<td></td>
<td>projects.</td>
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<td>REGIONAL DEVELOPMENT</td>
<td><strong>Measure 11</strong>: Implementation of major ICT projects and pilot projects in</td>
</tr>
<tr>
<td></td>
<td>the regions.</td>
</tr>
<tr>
<td>MULTIDIMENSIONAL AND INCLUSIVE</td>
<td><strong>Measure 12</strong>: Improvement of health and education systems as well as</td>
</tr>
<tr>
<td>HUMAN DEVELOPMENT</td>
<td>scientific research.</td>
</tr>
<tr>
<td></td>
<td><strong>Measure 13</strong>: Social promotion</td>
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2.2 Recent Political, Economic and Social Developments, Outlook, Constraints and Challenges.

2.2.1 In October 2011, Tunisia experienced the first democratic polls since independence during the election of the Constituent Assembly. The elections moved the country into a new transition phase devoted mainly to the preparation of a new constitution. This is a delicate phase given the challenges that the country faces to ensure public security and social stability, reduce unemployment and boost the economy. Meeting these challenges is key to the success of the democratic transition in providing a tangible response to the legitimate demands and aspirations expressed by the entire society, especially the youth.

2.2.2 The January 2011 Revolution brings hope but its short-term macroeconomic consequences remain severe. The fundamentals of the Tunisian economy have generally deteriorated and the Gross Domestic Product (GDP) growth rate has declined, recording a negative value for 2011 (-1.8%), mainly due to political uncertainties and the slowdown in economic activity (see Figure 1). Tourism has shrunk sharply (-32.8%), the productive capacity (e.g. phosphates, oil and gas) has been paralysed in several sectors and Foreign Direct Investment (FDI) has fallen sharply (-26%).
2.2.3 **The Libyan conflict also had an impact on the Tunisian economy.** It brought about a decline in trade with and remittances from that country, and Libyan investments in Tunisia. These trends were partially offset by strong domestic demand, which continues to drive national economic growth, particularly stimulated by good agricultural harvests, availability of consumer credit (3% in 2011) and measures to support household purchasing power.

2.2.4 **Tunisian authorities are working to resolve the crisis through a combination of fiscal and monetary policies.** In 2011, an additional expenditure of about 5% of GDP was undertaken to stimulate the economy, and in 2012, the Government will continue its expansionary fiscal policy. In addition, the Central Bank reduced the reserve requirement ratio while providing a substantial amount of liquidity to banks to encourage lending to businesses. The interest rate was also reduced to stimulate access to credit and investment. Whereas the average inflation remained at 3.5% in 2011, the inflation rate over 12 months seems to have risen in April 2012 to 5.8% relative to the previous year and may stabilize at an estimated average of 4.9% in 2012. The Tunisian Dinar which was relatively stable relative to the Euro in 2011, has depreciated successively vis-à-vis the U.S. dollar, the Euro and the Yen. This may push up inflation. These trends led to a reduction in foreign exchange reserves from about USD 9.5 billion at end-2010 (4.7 months of imports) to USD 7.5 billion (3.5 months of imports) in 2011.

2.2.5 **Despite these difficulties in the transition phase, Tunisia's economic outlook in the medium term remains positive.** Although investors showed some reluctance in 2011, signs of a rebound in economic activity appeared in early 2012. The first quarter GDP grew in real terms by 4.8% (year by year) and tourism and FDI are on the rise. A resumption of GDP growth in real terms would also be sustained by a major fiscal expansion. The level of external public debt will reach 48.4% of GDP in 2012, compared to 44.5% in 2011, consequent on the required financing needs, and will stabilize at about 53% of GDP by 2017. The debt sustainability analysis by IMF, conducted during the August 2012 consultations under Article IV with Tunisia (see Annex II) shows that the debt is sustainable in the medium term. However, there are short-term risks to be faced: (i) a worse-than-expected recession in Europe likely to weigh heavily on exports; (ii) an increase in social tensions likely to discourage FDI; and (iii) capacity constraints and financing delays likely to hamper the planned fiscal stimulus to support growth. Rapid stabilization of the situation in Libya could also restore investor confidence. Growth potential in the medium term remains favourable. Achieving stronger and more inclusive growth in the medium-term is necessary to reduce high unemployment, especially among the youth, and lower social and regional disparities.

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4 AfDB, 2012, Impact of the Libyan Conflict on the Tunisian economy, Quarterly Analytical Note, July 2011
2.2.6 The real GDP growth rate will exceed 2.5% in 2012, given the signs of recovery noted during the first 5 months of 2012\(^5\). Indeed, FDI increased by 40.8% and investment intentions in the services sector rose by 79.2%. Similarly, during the same period, there was a substantial increase in agricultural production and a rebound in key tourism activity indicators compared to 2011. Growth prospects in the medium term remain positive. GDP could rise by approximately 3.7% in 2013 and 4.9% in 2014 due to the continued rebound in exports, tourism and FDI. According to the IMF, growth in real terms is expected to gradually reach 6% in 2017, assuming there is continued macroeconomic stability, business climate improvement, and labour market and education system reforms. The country has undoubted assets: trained human resources, a dynamic private sector and an advantageous geographic position bordering on Europe and the rest of the African continent. Reforms have accelerated since January 2011 particularly regarding employment programmes, regional development and transparency in public affairs management.

2.2.7 Significant socio-economic disparities persist despite considerable poverty reduction and improved social indicators over the last two decades. In December 2011, the INS undertook a comprehensive review and update of its poverty assessment methodology in collaboration with the African Development Bank and the World Bank. The poverty rate was estimated at 15.5% in 2010, against 23.3% in 2005 and 32.4% in 2000. A household is defined as poor if its consumption is below the poverty threshold set at TND 1277 per year per capita in major cities and TND 820 per year per capita in rural areas. The extreme poverty rate was estimated at 4.6% in 2010 compared to 7.6% in 2005 and 12% in 2000. This threshold is set at TND 757 per year per capita in major cities and TND 571 per year per capita in rural areas. The decline in the poverty rate between 2000 and 2010 can be ascribed to the growth in consumption, which was higher during this period among less affluent deciles of the population.

2.2.8 Regarding gender equity, Tunisian legislation and the 1956 Personal Status Code place Tunisia in the vanguard with regard to the situation of women in society. Tunisia is ranked 108 of 135 countries\(^6\). The Gender Inequality Index stands at 0293 (45\(^{th}\) out of 146 countries). In recent decades, women have enjoyed a significant improvement in education with 61.2% of university enrolment, parity in pay levels in the public service and expanded access to reproductive health services which has reduced the total fertility rate to two children per woman. However, illiteracy remains high (31%) and the unemployment rate stands at 39.9% against 31% for men. In addition, 75% of women work in the manufacturing sectors in positions characterized by insecurity. The presence of women in decision-making remains below 30% (both in the civil service and among elected officials) and the current government has only two women.

2.2.9 The decline in the poverty rate has not been felt in the country's various regions, where the disparity has increased compared to the rest of the country over the last decade. Overall, inequalities have declined at the national level with a Gini index that fell from 0.37 in 2000 to 0.35 in 2010 (attributable to the decrease in intra-regional inequalities, which dropped from 0.21 in 2000 to 0.17 in 2010). However, inter-regional inequalities increased from 0.16 in 2000 to 0.18 in 2010. The increase in polarization from 77.7 in 2000 to 103.2 in 2010 confirms that citizens' feelings of identification with and alienation from disadvantaged governorates rose during the 2000-2010 period\(^7\).

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\(^6\) Global Gender Gap Report, World Economic Forum, 2011. The index shows gap relative to equity
\(^7\) Measurement of poverty, inequality and polarization in Tunisia 2000-2010, INS, September 2012
2.2.10 With an average unemployment rate of 18.3% in 2011 (30.9% among young graduates), the employment challenge rose to the forefront of the social and political priorities revealed by the Revolution. According to the INS, the number of unemployed stood at 704,000 by end-2011 compared to 492,000 at end-2010. The effect of recession combined with the massive return of Tunisians from Libya account for the increase in the number of unemployed. The unemployment rate among higher education graduates rose to 43.8% in 2011 for women and 23.7% for men. This unemployment (see Figure 2), which tends to be structural, stems from a mismatch both quantitative (between higher education and private sector needs) and qualitative (graduates do not have the required skills to join the labour market). Therefore, this situation calls for innovative employment policy strategies. However, the latest INS report (June 2012) shows a slight drop in the unemployment rate in 2012, which now stands at 17.6%.

![Figure 2: Qualifications do not protect against unemployment](image)

Source: INS, MFPE

2.3 Status of Bank Portfolio

2.3.1 Tunisia's active portfolio is the Bank's third largest and does not include any risk operations. In September 2012, the net commitment stood at UA 1.3 billion. The AfDB portfolio includes 12 sovereign operations, 7 non-sovereign operations and 14 technical assistance projects. The total amount of net commitments stands at UA 1,294.28 million, including UA 244.44 million for the private sector (19% of the total). Road infrastructure takes up 38% of the amounts approved, 10% for energy, 10% for the financial sector, 8% for water and sanitation, 2% for agriculture, 4% for the social sector and 28% for multi-sector reforms. The average project age is 3.3 years and the disbursement rate is approximately 47%. The last review in February 2012 showed that Tunisia's portfolio was performing soundly8. Such a performance stems from improved project management control by project implementation units as well as better monitoring of the Bank's portfolio. The main recommendations of the last portfolio review focused on disbursement delays and procurement procedures. The application of ex-post procurement review is being implemented.

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8 An overall score of 2.7 points on a scale of 3 in 2011 against 2.53 in 2005
III. RATIONALE, KEY ELEMENTS OF PROGRAMME DESIGN AND SUSTAINABILITY

3.1 Linkages with CSP, Assessment of Country Readiness and Underlying Analytical Elements

3.1.1 Linkages with the CSP. The proposed programme aims to consolidate the achievements of the previous operation on governance and inclusive development (PAGDI). The operation under consideration will help to support the country in its economic and inclusive growth. The measures identified are aligned on the pillars of the 2012-2013 Interim CSP, namely: (i) growth and economic transition; and (ii) inclusion and reduction of regional disparities. The programme’s sustainability is demonstrated by the Government’s commitment to implement and pursue the reforms (see paragraph 2.1.1), with a view to obtaining results that will put the country on a path to inclusive and sustainable development.


3.1.3 Country Readiness Assessment. Tunisia fulfils the eligibility criteria for budget support operations as set forth in the “Bank Group Policy on Program-Based Operations”, March 2012 (see Technical Annex V). The Government has adopted the PES. Despite transition-related difficulties, there are signs of macroeconomic recovery (see paragraph 2.2.4) and Tunisia has a stable macroeconomic framework. The fiduciary risk is moderate and the existing programme is the outcome of close collaboration among development partners. Lastly, this operation is essential to contribute towards economic recovery and ultimately reduce unemployment and regional disparities.

3.1.4 Analytical Work and Elements. The programme design is founded on a solid analytical base, thanks to the existence of several recent works covering the programme’s target areas and prepared by both the Bank and other partners. Among others, these works analysed the major causes of unemployment and inequalities that the programme covers. The programme provides support to economic recovery.

3.2 Collaboration and Coordination with Other Donors

3.2.1 Coordination with the partners was carried out in the spirit of the Paris Declaration on Aid Effectiveness. Although there are no formal coordination mechanisms between the partners and the Government, the partners: (i) shared their analytical work; (ii) fielded joint identification/preparation (March-April 2012) and appraisal (July-August 2012) missions resulting in joint aide-mémoires; (iii) prepared a matrix of joint measures (see Annex II); and (iv) engaged in joint dialogue. The Bank also consulted with the World Bank and the European Union concerning the conditions and schedule of the respective budget support operations. Lastly, the programme supervision missions will be conducted jointly.

3.3 Outcomes of Past Similar Operations and Lessons

3.3.1 Lessons from past programmes are reflected in the programme design. Prior to the January 2011 Revolution, the Bank had financed 7 budget support operations from 1999 to 2007. Three competitiveness support programmes (PAC I, PAC II and PAC III) were also
implemented to support the macroeconomic reforms, the business environment and the financial sector. In 2009, an Integration Support Programme (PAI) backed reforms related to commercial integration, improvement of the business climate and access to financing. The completion reports prepared on these programmes concluded that the economy performed well and that the authorities had assumed ownership of the agreed measures. However, they also underscored the need to accelerate deep structural reforms to facilitate job creation, lift the many restrictions on economic activity in the national market and improve the relevance and effectiveness of the education and training system. The PAGDI completion report reveals mixed results on both the macroeconomic and sector fronts. The outcomes may be summarized as follows:

- **Regarding the reduction of regional disparities:** 80% of the allocations of the emergency plan budget amounting to TND 254 million were allocated to the 14 most disadvantaged governorates to address the most pressing needs. Over 7.5% of the population (i.e. 185,000 families) was provided with access to the assistance programmes for needy families, i.e. up two percentage points compared to 2011.

- **Concerning the job creation and protection component:** 39,000 jobs were created, including 20,000 in the civil service; 15,000 threatened jobs were also saved, thanks to PAGDI. However, the management of the National Employment Fund (21-21) and the effectiveness of the Active Employment Programmes (PAE) remain PAGDI’s weak points. Indeed, only 6,700 out of over 144,300 graduates of the AMAL programme have found a job. This programme has not created any job momentum among the beneficiaries. Aware of these shortcomings, the Government has initiated new PAE reforms backed by this programme. It has also adopted the microfinance law and intends to strengthen the venture capital mechanism as a financing tool.

- **With regard to transparency, accountability and citizen participation:** procedures for registering associations were simplified, resulting in the registration of 8,320 associations, i.e. four times more than in 2010. Mechanisms were established to assess public service delivery in the social sectors by citizens and provisions made for access to information. The Government has shortened the procurement cycle and system and made it mandatory to declare bidding results. Despite this progress, the e-government and procurement systems are non-compliant with international standards. Moreover, the budget information access mechanisms must be strengthened. These challenges are addressed by this programme.

### 3.3.2 The lessons learned from PAGDI also highlighted the importance of consultation among partners to implement the programme, against a backdrop of economic recovery.

The following lessons were learned: (i) alignment on Government’s priorities and convergence of donors’ views remain key factors for programme success; (ii) the context of urgency and democratic transition (National Constituent Assembly [ANC] elections, employees’ demands, strikes, insecurity and problems on the border with Libya) is a constraint on programme implementation; (iii) the lack of a cohesive Government communication plan and programme monitoring mechanisms are constraints to satisfactory implementation. Consequently, PARDI will have to be responsive to the evolving transitional context and address the challenges. Therefore, the lessons learned have been taken into account in PARDI’s detailed design in terms of component selection, implementation arrangements, evaluation, monitoring and more sustained effort with regard to communication.
3.4 Linkages with Other Bank Operations

3.4.1 PARDI is a continuation of the Governance and Inclusive Development Support Programme (PAGDI), the achievements of which will be consolidated. It also strengthens the achievements of the following projects: Médenine – Rasjedir Highway, Rural Drinking Water Supply (through Access to Basic Services and Reduction of Regional Disparities), Wastewater Quality Improvement, Line of Credit to SMEs and Road Project VI. The Bank is planning a series of technical assistance projects in the form of grants to support the Government to implement the reforms identified. (see Technical Annex XII).

3.5 Bank’s Comparative Advantage

3.5.1 The Bank has a real comparative advantage and value added in implementing this operation. This advantage stems from: (i) sustained dialogue with the authorities, civil society actors and the private sector; (ii) the Bank’s capacity to conduct targeted technical studies to support the reforms and engage in continuing dialogue with the partners; (iii) experience gained from the previous year’s operation, lessons of which have been reflected in this operation; and (iv) the Bank’s leadership on both regional development and microfinance.

3.6 Application of Good Practice Principles on Conditionality

3.6.1 Good practice principles on conditionality were taken into account in programme design. In this regard, programme measures were retained based on the following criteria:

- **Ownership by the authorities.** The Government has assumed full ownership of PARDI, which reflects its orientations (See Annex I).

- **Coordination, harmonization and alignment.** PARDI provides an appropriate mechanism for development partners who jointly agreed with the authorities on the urgency of implementing the necessary actions to initiate structural reforms - a pre-requisite for inclusive and sustainable development.

- **Selectivity of key actions as a disbursement condition.** The disbursement triggers were defined by mutual agreement with the authorities and development partners.

3.7 Application of the Bank’s Non-Concessional Lending Policy

3.7.1 The Bank ensures strict compliance with good practices in the application of its non-concessional lending policy. Coordination with the other donors was mainly carried out during project preparation. In addition, in view of the post-revolution context marked by priorities and strong social demand in all sectors, the Bank has confirmed the short-term feasibility of the measures as well as their potential impact on the long-term development objectives.
IV. THE PROPOSED PROGRAMME

4.1 Programme Goal and Objective

4.1.1 The programme’s goal is to revive the economy and foster the conditions for inclusive growth. It aims to address the claims arising from the Revolution in terms of reducing inequalities and unemployment as well as improving transparency.

4.1.2 The programme’s specific objective is to contribute to the restoration of socioeconomic stability to support the democratic transition in Tunisia. The programme will also address the claims made by the population regarding access to quality services, job creation and enhancement of transparency and participation.

4.2 Programme Components, Operational Objectives and Expected Outcomes

The Programme aims to address the immediate challenges related to Tunisia’s economic recovery. The objectives include: (i) reducing regional disparities and combating exclusion; (ii) boosting inclusive growth, increasing employability and competitiveness; and (iii) strengthening citizen participation, accountability and transparency. These components are consistent with the pillars retained by the World Bank and the European Union. Programme measures are set out in the matrix in Technical Annex II.

4.2.1 Component 1: Reduce Regional Disparities and Combat Exclusion

Despite a significant reduction in poverty and an improvement in the social indicators, wide disparities remain. This component aims to consolidate PAGDI’s achievements, as mentioned in paragraph 3.3.2. Its actions will also seek to: (i) strengthen the resource mobilization mechanisms with a view to increasing income and boosting investments, especially in favour of disadvantaged regions; (ii) enhance the effectiveness and coverage of social protection programmes through the establishment of a consolidated information and continuing monitoring system of 235,000 families benefitting from social protection programmes in 2012; and (iii) improve the quality of healthcare services through the establishment of a hospital accreditation system.

4.2.1.1 Objective 1-a. Strengthen Resource Mobilization Mechanisms at Local Level

Context and Challenge: local governments are faced with rising debt and a significant reduction in their fiscal resources estimated at about 50% for 2011, even though they are required to finance three-quarters of their operating budget. Moreover, local governments carry additional burdens following the 2011 salary increases, while meeting the required investments amounting to TND 241 million for the 2012-2014 period. In this context, the Local Municipality Tax (TCL), which targets about a thousand large companies, provides resources not affected by economic trends (at a relatively low amount of 0.2% of turnover, capped at TND 100,000). In this context, the contribution of commercial and industrial enterprises to local budgets is fairly modest. Furthermore, the existence of a ceiling favours large enterprises over the others. Therefore, the measure aims to restore some form of fiscal equity and solidarity.

Reform Measure: abolition of the ceiling on the tax on industrial, commercial or professional establishments.

Expected Outcomes: for large enterprises, the measure aims to ensure a more proportionate contribution in relation to their tax capacity. The financial impact of the removal of the ceiling
on the TCL is estimated at TND 45 million in 2012, compared to TND 15 million in 2011. This will increase the relative share of the municipalities in investments in the regions of the interior.

**4.2.1.2 Objective 1-b: Enhance the Effectiveness of Social Protection Programmes**

**Context and Challenge:** Tunisian social assistance comprises: (i) monetary allocations under the National Assistance Programme to needy families and issuance to them of free healthcare cards (0.5% of GDP); (ii) direct subsidies for basic foodstuffs (1.7% of GDP); (iii) transport (0.7% of GDP) and fuel (2% of GDP); (iv) healthcare at reduced cost; and (v) regional development programmes to improve the poverty situation in the areas served. In January 2012, the Government provided financial assistance to 235 000 needy families (i.e. 9% of the population) and subsidized health insurance cards for 558 000 beneficiaries (22% of the population). Moreover, there was a 2.5 increase in the number of people covered by social transfers between 2011 and 2012. However, the household surveys show that the less needy families tend to take more advantage of social programmes. Similarly, in the absence of an efficient strategy for exiting the social assistance programme, several families that no longer meet the criteria continue to receive social security benefits. The Government is aware that, on the whole, the existing social protection system is not equitable or financially sustainable, and intends to embark on comprehensive reforms to improve its effectiveness. Thus, as a first stage, the Ministry of Social Affairs wishes to establish a database for monitoring the PAPFN beneficiaries and the recipients of free or reduced-rate healthcare cards. Subsequently, a subsidy system reform is envisaged and should be established in the medium term.

**Reform measure:** adoption of a circular establishing a social protection programme information system.

**Expected outcomes:** preparation of a single database for social protection systems to ensure better targeting of beneficiaries and constant monitoring of new entrants.

**4.2.1.3 Objectives 1-c: Improve Access to Basic Healthcare in Disadvantaged Regions**

**Context and Challenges:** despite the existence of 34 regional hospitals, 21 university hospitals and 118 local municipality hospitals in Tunisia, health disparities among regions persist, particularly in terms of financial and geographic access to healthcare as well as health indicators. The unsatisfactory quality of public sector healthcare is a major obstacle to the improvement of the population’s health status. Indeed, almost 50% of users of public health services say they are dissatisfied with the quality of the treatment received and deplore the lack of drugs, the obsolescence of equipment and the lack of cleanliness. Against this backdrop, the introduction of an external evaluation procedure would confirm whether all the hospitals, including those in disadvantaged regions, comply with certain national and/or international quality standards. This should also support Tunisia in its health services export development strategy through medical tourism for which a good reputation and compliance with quality standards are essential.

**Reform measure:** adoption of the decree establishing the National Health Accreditation Board and fixing its responsibilities, administrative, scientific and financial organization as well as its operating modalities.
**Expected outcomes:** the expected outcome is an increase in the rate of user satisfaction of healthcare establishments through an increase in the number of hospitals providing high quality services.

### 4.2.2 Component 2: Promote Inclusive Growth, Employability and Competitiveness

This programme seeks to revive the economy based on the following thrusts: (i) improve the business climate; (ii) develop microfinance; and (iii) increase youth employability by improving the effectiveness and strengthening the governance of the Active Employment Programmes (PAE), by raising the profile of higher education graduates through tighter control of higher education quality.

#### 4.2.2.1 Objective 2-a: Improve the Business Climate and Sustain Investments

**Context and challenges:** although Tunisia has made significant progress in improving the corporate regulatory environment, the country continues to suffer from a regulatory environment dissuasive to investors. With intensified competition within the region to obtain contracts and foreign direct investment, much progress remains to be made to make the country more attractive. Discretionary power and unfair competition remain the major challenges for Tunisia’s private sector, which is faced with an environment marked by the slow pace of reform implementation and a cumbersome procurement process.

**Reform measure:** adoption of a decree establishing a participatory process for the evaluation and revision of administrative procedures governing economic activities. The reform aims to rationalize and simplify the formalities for entry into and or operation of the private sector by reducing excessive requirements, procedures, discretionary power and administrative charges burdening the private sector.

**Expected Outcomes:** effective procedures and regulations should have the following impact: (i) cost reduction for the private sector to fulfil the formalities; (ii) reduction in discretionary powers and improved transparency in the administration; and (iii) increase in private sector investment and job creation.

#### 4.2.2.2 Objective 2-b: Develop Microfinance

**Context and Challenge:** the Tunisian Government has in a concerted manner prepared a strategic vision for microfinance in Tunisia, in addition to adopting a law establishing the relevant regulations. While significant, these measures will not enable the 2011 reforms to bear fruit unless the Control Authority is established.

**Reform Measure:** adoption of the decree establishing the operating modalities of the Microfinance Control Authority.

**Expected Outcomes:** the completion of the institutional and regulatory landscape will result in the redeployment of microfinance in Tunisia by allowing the entry of new actors, the restructuring of existing ones and the emergence of new microfinance products.
4.2.2.3 Objective 2-c: Promote Venture Capital to Foster the Development of SMEs

**Context and Challenge:** in 2011, the Tunisian Government adopted a major law on venture capital aimed at making its taxation more attractive and paving the way for eligible investments. However, there are no implementing texts adapted to the spirit of the law to render it fully operational.

**Reform measure:** adoption by the Council of Ministers of the implementing decrees relating to investment companies and mutual collective investment undertakings. These reforms will contribute to the consolidation of the venture capital sector as a driver of growth, development and job creation. They will confirm venture capital as a key regional development tool because of its ability to establish companies in regions of the interior.

**Expected Outcomes:** the completion of the regulatory mechanism will provide the profession with all the rules of the game and consequently enable it to engage further in its activities of financing the economy and providing support to enterprises.

4.2.2.4 Objective 2-d: Improve the Effectiveness and Governance of Active Employment Policies (PAEs)

**Context and challenges:** the PAEs set up to reduce unemployment lack visibility and effectiveness. First the AMAL programme established in 2011 was adopted in the face of an urgent difficult political and social situation, and was mostly confined to a transfer mechanism encouraging its beneficiaries to adopt a wait-and-see attitude. Moreover, the increase in the number of existing PAE programmes makes it difficult for employment agencies to manage them. Lastly, the PAEs are still not subject to systematic evaluation. The monitoring indicators mainly concern activities while accurate data on effectiveness, efficiency and impact of the PAEs are lacking.

**Reform measure:** adoption of a decree amending and complementing the decree of 9 February 2009-349 establishing the programmes of the National Employment Fund (21/21 Fund) and conditions/modalities for eligibility. The reform aims to address these challenges first through the establishment of the Employment Incentive Programme (PEE) to replace the AMAL Programme. This will allow better targeting of the most vulnerable unemployed and reduce the number of PEE beneficiaries from 144 300 to 80 000 in 2012, thus ensuring closer supervision of ANETI to improve results in terms of integration. The second component of the proposed reform is the consolidation of the PAEs into a single training mechanism to ease ANETI’s administrative workload. The final thrust of the reform concerns the institutionalization of a monitoring and evaluation framework with adequate organs, including a dialogue, formal and regular evaluation mechanism.

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9 (i) Decree No. 2012-890 of 24 July 2012 implementing the provisions of Article 22 of Act No. 88-92 of 2 August 1988 on investment companies as amended and complemented by subsequent texts, in particular Decree No. 011-99 of 21 October 2011, on the amendment of legislation relating to venture capital companies and to joint venture capital mutual funds and relaxation of the conditions governing their interventions; (ii) Decree No. 2012-891 of 24 July implementing the provisions of Article 22, Section 3 and Article 22 Section 4 of the Mutual Funds Organization Code promulgated by Law No. 2001-83 of 24 July 2001, as complemented and amended by subsequent texts in particular Decree No. 2011-99 of 21 October 2011 relating to the amendment of the laws on venture capital companies and joint venture capital mutual funds, and easing of the conditions governing their interventions.
Expected Outcomes: these reforms will help to: (i) ensure better targeting of the number of unemployed to be integrated; (ii) strengthen programme performance monitoring; and (iii) improve the output of the PAEs through greater integration of unemployed graduates.

4.2.2.5 Objective 2-e: Strengthen the Control and Quality of Higher Education.

Context and challenges. Over the past decade, the quality and effectiveness of higher education in Tunisia has deteriorated dramatically with, in particular, high failure and wastage rates in the first year and a graduate unemployment rate reaching 30.5% in 2011. This situation is largely due to the high numbers involved, delays in establishing infrastructure and equipment programmes, and the deterioration of teaching and learning conditions. Furthermore, the lack of quality assurance affects the professional mobility of graduates, regional integration regarding the mutual professional recognition of degrees and certificates, as well as youth employability. Aware of this situation, the country in 2008 adopted the decree establishing the ‘National Evaluation Authority’ as a control and accountability mechanism for higher education.

Reform measure: adoption of the decree determining the composition of the National Evaluation Authority, quality assurance and accreditation, and its operating modalities.

Expected outcomes: the establishment of this Authority will result in: (i) higher quality of supply, the fostering of excellence in accordance with international standards and improved Shanghai ranking; and (ii) the accountability of academic institutions to citizens and the labour market regarding the quality of their products.

4.2.3 Component 3: Strengthen Transparency, Accountability and Citizen Participation.

In the wake of the Revolution, the transitional government initiated a series of reforms to foster citizen participation and greater transparency in the management of public affairs. The component aims to support these changes, through concrete and visible measures for the population in terms of participation in the preparation and monitoring of budget execution, and access to budget and financial information.

4.2.3.1 Objective 3-a: Strengthen Budget and Financial Transparency

Context and challenges: the budget preparation process remains fairly restricted. The public is only informed of budget priorities once the Budget Law has been enacted and published in the Official Gazette. Similarly, Parliament’s role in budget preparation was mainly confined to the vote on the Executive’s draft budget. The budget execution reports are produced but not systematically published. Even though Tunisia subscribes to the International Monetary Fund’s Special Data Dissemination Standard, the Ministry of Finance does not appear to have a proactive budget and financial information communication policy, especially on its website.

Reform Measure: adoption of a decision by the Minister of Finance instructing his/her services to publish the following information/reports: (i) a budget framework document (TOFE) and the perspectives and assumptions retained for the budget, upstream from the budgetary process; (ii) the draft budgets of the Government, Ministries and Agencies before submission to Parliament; (iii) monthly and end-of-year budget execution reports; (iv) a citizen’s budget (a popular version of the budget); and (v) the audited budget law for Year 1 accompanying draft budget n+1. This measure aims to strengthen budget and financial transparency, which constitutes an eligibility
criterion for the multilateral Open Government Partnership and also enshrines the public’s right to information.

**Expected outcomes:** the dissemination of public finance orientations and perspectives upstream of the budget preparation process strengthens Parliament’s role by allowing it more time to prepare amendment proposals and the Government to incorporate them. Similarly, informing citizens, including through simplified versions of documents, enables them to express their opinions either directly or through their representatives in Parliament.

### 4.2.3.2 Objective 3-b: Strengthen Budget Execution Transparency, Efficiency and Effectiveness

**Context and challenges:** public procurement in Tunisia is governed by the decree of 17 December 2002. Before the Revolution, this decree was complemented and amended by several subsequent texts\(^{10}\), albeit without producing the expected results. The strong demand for transparency in the wake of the Revolution demonstrated the need for a comprehensive reform of the national procurement system to improve its effectiveness and transparency in two phases. The first phase entails identification of rapid amendments to certain provisions of the 2002 decree to enhance the effectiveness of the system and strengthen its transparency. This first phase culminated in Government signing of the decrees revising the Public Procurement Code on 23 May 2011 and 2 June 2012. The second phase of the reform will aim to initiate a global and structural reform of the national procurement system following self-assessment using OECD/DAC methodology.

**Reform measure:** Government approval of the national procurement system assessment report prepared using OECD/DAC methodology as well as the ensuing action plan.

**Expected outcomes:** Government’s adoption of the action plan will provide the country and financial partners with reform actions ready to be financed. In the long term, their implementation will enable Tunisia to modernize its procurement system and bring it more in line with international standards.

### 4.2.3.3 Objective 3-c: Improve Access to Information

**Context and challenges:** Decree No. 2011-41 on access to administrative documents of public organizations was adopted on 26 April 2011 and reinforced in June 2011. This Decree defines the principles and scope of application of the law to all public organizations, and also specifies the main categories and information to be proactively disseminated by the Government. It provides for the establishment of a procedure for information requests and complaints, and defines the legal exceptions to the dissemination of information. Its effective implementation requires the communication of specific rules to civil servants responsible for providing information as well as the establishment of clear, standard procedures both within the administration and for the public (request and complaint form and procedure). Civil society and the media severely criticize the lack of results from this policy and the absence of clear and transparent rules and regulations.

**Reform measure:** adoption of a circular from the Head of Government specifying the provisions of Decree No. 2011-41 of 26 May 2011 on access to administrative documents of public organizations. This measure aims to effectively implement the new policy on transparency and access to information, which is also an eligibility criterion for the multilateral Open Government Partnership.

**Expected outcomes:** implementation of this measure will result in: (i) the preparation of clear procedures and forms to enable citizens to request information or submit complaints in the event of no reply or unjustified refusal; (ii) issuance to civil servants of the necessary instructions to implement the law; and (iii) proactive dissemination of information on Government websites.

### 4.3 Prior Actions

4.3.1 The Government has committed to implement 40 joint measures\(^{11}\), including 11 prerequisite measures envisaged under the proposed budget support. The 11 measures identified will be carried out prior to the presentation of the program to the Board of Directors. The authorities will provide the Bank with proof of the fulfillment of these conditions precedent. The remaining measures must be implemented before 31 December 2012. **Seven of the** eleven pre-conditions are required jointly with the World Bank and the European Union.

<table>
<thead>
<tr>
<th>Table 1</th>
<th>Actions Prior to Presentation of PARDI to the AfDB Board and Proof</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PRIOR MEASURES (all these actions have been completed)</strong></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Remove ceiling on Tax applied to industrial, commercial or professional establishments (par. 4.2.1.1). <strong>Proof:</strong> Official Journal of the Republic of Tunisia (JORT)</td>
</tr>
<tr>
<td>2</td>
<td>Adopt a circular establishing an information system relating to social protection programs (par. 4.2.1.2). <strong>Proof:</strong> Minister of Social Affairs’ Circular</td>
</tr>
<tr>
<td>3</td>
<td>Adopt a decree establishing the National Health Accreditation Authority and stating its functions, administrative, scientific and financial organization, as well as terms of operation (par. 4.2.1.3). <strong>Proof:</strong> JORT</td>
</tr>
<tr>
<td>4</td>
<td>Adopt a decree establishing a participatory process for evaluation and review of administrative procedures governing the conduct of economic activities (par. 4.2.2.1). <strong>Proof:</strong> JORT</td>
</tr>
<tr>
<td>5</td>
<td>Adopt a decree establishing the terms of operation of the microfinance oversight body (par. 4.2.2.2). <strong>Proof:</strong> JORT</td>
</tr>
<tr>
<td>6</td>
<td>Adopt Decrees No. 2012-890 and No. 2012-891 of 24 July 2012 modifying the legislation concerning venture capital investment companies and venture enterprise investment funds, and easing the conditions for their intervention (par. 4.2.2.3). <strong>Proof:</strong> JORT</td>
</tr>
<tr>
<td>7</td>
<td>Adopt a decree modifying and supplementing Decree 349-2009 of 9 February 2009 establishing the programs of the National Employment Fund, and laying down the terms and conditions for its assistance (par. 4.2.2.4). <strong>Proof:</strong> JORT</td>
</tr>
<tr>
<td>8</td>
<td>Adopt a decree concerning the composition of the National Evaluation, Quality Assurance and Accreditation Authority, and laying down its terms of operation. (par. 4.2.2.5). <strong>Proof:</strong> JORT</td>
</tr>
<tr>
<td>9</td>
<td>Adopt the Public Finance Data Publication Note. <strong>Proof:</strong> Note of the Minister of Finance</td>
</tr>
<tr>
<td>10</td>
<td>Government approval of the report on assessment of the National Procurement System using the OECD/DAC methodology, and the ensuing plan of action. (par. 4.2.3.2). <strong>Proof:</strong> Letter of the Government Secretary-General</td>
</tr>
<tr>
<td>11</td>
<td>Adopt a circular issued by the Head of Government, stating the provisions of Decree No. 2011-41 of 26 May 2011 concerning access to administrative documents of public organizations (par. 4.2.3.3). <strong>Proof:</strong> Adoption of a Circular issued by the Head of Government</td>
</tr>
</tbody>
</table>

---

\(^{11}\) Technical Annex II: Joint Matrix (AfDB, WB, EU)
4.4 Financing Needs and Arrangements

4.4.1 The social and economic impact of the transition phase have had major repercussions on the State budget. The Government has adopted the Supplementary Budget Law for 2012, factoring in these repercussions. In light of the fiscal stimulus measures intended to revive the economy and by the same process ensure political and social stability, the partners’ financing is essential to provide the fiscal space needed for the action planned under the Government emergency program (Box 1). The external financing needs are estimated at TND 4330 million. Considering the urgent need for these reforms, the Government’s own resources will not suffice to bridge the 2012 budget financing gap. Thus, the AfDB loan will make it possible to cover approximately 15% of this gap. In addition, the authorities have decided to continue seeking external official funding for 2012 and 2013, and turn to the international capital market. In addition to the budgetary support to be provided by the three development partners involved in this operation, the country obtained a loan of USD 500 million from Qatar in April 2012. The US Treasury has also guaranteed a new bond issue to the tune of USD 475 million.

Table 2

<table>
<thead>
<tr>
<th>Financing Needs and Sources of Financing (in TND million)</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Revenue</strong></td>
<td>13575</td>
<td>14504</td>
<td>16438</td>
<td>19504</td>
<td>18033</td>
</tr>
<tr>
<td><strong>Total expenditure and net lending, of which:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current expenditure</td>
<td>15164</td>
<td>15125</td>
<td>18275</td>
<td>22472</td>
<td>21415</td>
</tr>
<tr>
<td>Capital expenditure</td>
<td>10644</td>
<td>11274</td>
<td>13816</td>
<td>16206</td>
<td>16028</td>
</tr>
<tr>
<td><strong>Budgetary balance (incl. grants and privatizations)</strong></td>
<td>3866</td>
<td>4144</td>
<td>4735</td>
<td>6252</td>
<td>5287</td>
</tr>
<tr>
<td><strong>Debt repayment</strong></td>
<td>1589</td>
<td>621</td>
<td>1837</td>
<td>2968</td>
<td>3187</td>
</tr>
<tr>
<td><strong>Financing needs</strong></td>
<td>2062</td>
<td>2465</td>
<td>2407</td>
<td>2789</td>
<td>1962</td>
</tr>
<tr>
<td><strong>FINANCING NEEDS of which:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net domestic (including net variation of State cash balances)</td>
<td>3651</td>
<td>3086</td>
<td>4264</td>
<td>5757</td>
<td>5149</td>
</tr>
<tr>
<td>Net external</td>
<td>2490</td>
<td>2861</td>
<td>1800</td>
<td>1427</td>
<td>1250</td>
</tr>
<tr>
<td><strong>Financing gap</strong></td>
<td>1161</td>
<td>1225</td>
<td>2464</td>
<td>4330</td>
<td>3889</td>
</tr>
<tr>
<td>Source: Tunisian authorities and IMF Article IV, 2012</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4.5 Program Beneficiaries

4.5.1 The end program beneficiary is the Tunisian population as a whole, whose conditions of life can improve through the investments made possible by the enhanced business climate, improved access to quality care, jobs created and greater access to information and citizen accountability. The main intermediary beneficiaries are: (i) public and private sectors to be supported by the measures making up the Government’s program; (ii) people in under-served regions, who will have better access to social services; (iii) young graduates and long-term unemployed, who will have greater job opportunities; and (iv) the civil population, which will benefit from a higher degree of citizen voice and accountability in public affairs.

4.6 Impact on Gender

4.6.1 The employment and social assistance reforms under PARDI will in particular benefit working women, young women graduates and women in precarious circumstances. Women make up 28% of the working population and account for 42% of the medical profession and 31% of lawyers, while over 10 000 of them are business leaders. Women household heads
make up a particularly vulnerable segment representing 51% of beneficiaries of the programs for assistance to vulnerable families (PAFN). The action, aimed at improving their employability and competitiveness, as well as their access to social services will directly impact the employment of young women, maternal and infant health and access to information.

4.7 Impact on the Environment

4.7.1 This program falls under Category III and is not expected to have a negative impact on the environment.

V. IMPLEMENTATION, MONITORING/EVALUATION

5.1 Implementation Arrangements

5.1.1 Institution Responsible: The Program will be implemented by the Ministry of Investment and International Cooperation (MICI), which has successfully implemented the previous programs. It will work closely with the key sector ministries concerned by the program measures. These sector ministries have the means and the competent human resources to implement the program.

5.1.2 Disbursement. The EUR 387.6 million loan will be disbursed in a single tranche following approval by the Board, subject to fulfilment of the relevant general and specific conditions. At the request of the Borrower, the Bank will disburse the funds into a special account opened at the Central Bank of Tunisia. The Borrower will ensure that, once the deposit has been paid into the said account, the local currency equivalent is transferred to the Treasury current account which serves as the State budget account. The loan shall be managed under the responsibility of the Ministry of Finance. The Ministry of Finance will provide the Bank, within 30 days, with a letter of confirmation of the transfers, substantiating that the total loan amount has been received, converted and paid into the single Treasury account. Furthermore, the Bank reserves the right to request an audit of the financial flows of the operation, in the event that it does not obtain sufficient evidence of the execution of this transaction as described.

5.1.3 Procurement of Goods and Services. As the program entails general budget support, the resources expected will be integrated into Government resources. They will be used in paying for goods, works and services procured in accordance with the national procedures in force. The Bank conducted an evaluation of the legal and regulatory framework for procurement in 201112, concluding that there was an acceptable level of satisfaction and moderate risk. Furthermore, the proposed programme takes account of Government’s approval of the national procurement system evaluation report prepared in line with the OECD/DAC methodology, which will pave the way for pursuit of reforms.

5.1.4 Financial Management, Audits and Financial Reports: The Ministry of Finance will be responsible for the administrative, financial and accounting management of the loan resources. Owing to the nature of the operation, resources will be used in accordance with the national regulations governing public finance. The fiduciary risk is deemed moderate (Annex VIII). Moreover, the proposed programme includes a measure for increased budgetary transparency, specifically the adoption of a Ministry of Finance decision requiring the relevant

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12 Report on evaluation of national procurement procedures for national competitive bidding under ADB-financed projects.
services to publish detailed budget information as at 2012. Thus, the public expenditure circuit will be fully exploited and the rules for internal control of the public expenditure system will be applied. As the funds are fungible within the government budget, the external audit on the use of program resources will be covered through the Tunisian Court of Accounts’ review of the Audited Budget for 2012, which will be made available in 2013.

5.1.5 Evaluation of country fiduciary risk conducted in keeping with March 2011 guidelines as well as the new Bank policy of March 2012 concerning the Bank. For the purposes of appraisal of this program, the Bank in September 2012 updated the country’s fiduciary risk evaluation initially conducted in September 2011 as part of the CSP. Based on this evaluation, (details in Technical Annex VII), the fiduciary risk is considered moderate on the whole, and in light of the most recent diagnoses of public financial management, procurement and corruption perception. Given the overall moderate level of the fiduciary risk, the programme will be supervised in collaboration with other donors and in close consultation with MICI. To ensure appropriate supervision for the programme duration, the quarterly budget execution reports will be sent to the partners.

5.2 Monitoring/Evaluation Arrangements

5.2.1 Institution Responsible: MICI will be responsible for programme monitoring and evaluation, working closely with the other key ministries to implement the required measures. MICI has been involved in the satisfactory monitoring and evaluation of previous programs. It also has competent human resources and is adequately equipped for monitoring and evaluation. The technical assistance to CSOs will help to facilitate the interaction and collaboration with the Government.

5.2.2 Monitoring and Evaluation of Outcomes. The matrix of measures agreed jointly between the co-financiers and the authorities will form the common framework for PARDI monitoring and evaluation. MICI will be responsible for collecting data and coordinating monitoring/evaluation, and will make information available to the Bank and the co-financiers. The latter plan to field a joint supervision mission to assess progress achieved based on the indicators of the Matrix of Measures. At the end of the programme, a completion report will be prepared jointly with the Government. A tentative timeline is provided under the Loan Information section (Page v).

5.2.3 The Bank will also conclude several Technical Assistance (TA) contracts in the programme areas of intervention, in order to support the Government in implementing programme prerequisite measures in a tangible manner. (see Technical Annex XII)

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VI. LEGAL INSTRUMENTS AND LEGAL AUTHORITY

6.1 Legal Instruments. The legal instrument to be used for this Programme is the Loan Agreement. The parties to this Agreement are the African Development Bank and the Tunisian Government.

6.2 Conditions for Bank Group’s Intervention and Conditions for Disbursement:

<table>
<thead>
<tr>
<th>Conditions precedent to presentation of the programme to the Boards:</th>
<th>The Government has agreed to implement measures required prior to presentation of the programme to the Bank Board of Directors. These conditions are listed in Table 1.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conditions precedent to loan effectiveness:</td>
<td>Effectiveness of the loan shall be subject to fulfilment of the conditions stipulated in Section 12.01 of the General Conditions Applicable to Loan Agreements.</td>
</tr>
<tr>
<td>Conditions precedent to disbursement of the total loan amount:</td>
<td>In addition to evidence of loan effectiveness, disbursement in a single tranche will be subject to provision by the Borrower of evidence of the opening of a special foreign exchange account at the Central Bank of Tunisia, to receive the loan resources.</td>
</tr>
</tbody>
</table>

6.3 Compliance with Bank Group Policies

6.3.1 The programme complies with Bank Group policies and no waiver has been requested with respect to the applicable guidelines contained in this proposal. The key Bank Group guidelines and other guidelines for this Program are the following: (i) Guidelines on Bank Group policy for programme-based Support Operations (2008); (ii) Guidelines on Development Budget Support Loans (2004); and (iii) Guidelines on Product and Pricing Flexibility for MICs (2009).

VII. MANAGEMENT OF POTENTIAL RISK

7.1 The key risks arising from the proposed programme relate to the political context, the uncertain economic prospects and Bank portfolio exposure with regard to Tunisia.
<table>
<thead>
<tr>
<th>DESCRIPTION OF RISK</th>
<th>MITIGATION</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Risk of Political instability:</strong> The preparation and adoption of the new constitution at end-2012 and the complexity of the organization of elections planned for June/July 2013 could affect the reform implementation process.</td>
<td>Moderate</td>
</tr>
<tr>
<td><strong>Uncertain economic outlook:</strong> Economic recovery will likely be slow in 2012. That will depend on the improvement of the economic results in the Euro zone, as well as the effects of the anti-cyclical public policy on growth.</td>
<td>Moderate</td>
</tr>
<tr>
<td><strong>Risk relating to Bank portfolio exposure in Tunisia:</strong> With 13.9% of the overall Bank portfolio being allocated to Tunisia as at 31 December 2011, the Institution's engagement in Tunisia is relatively significant, considering the vulnerability with regard to deterioration of the quality of credit to Tunisia. Currently, the leading rating agencies have adjusted their ratings concerning Tunisia downwards.</td>
<td>Moderate</td>
</tr>
</tbody>
</table>

**VIII. RECOMMENDATION**

It is recommended that the Board of Directors approve the granting of an African Development Bank loan not exceeding EUR 387.6 million to the Government of Tunisia for the purposes and subject to the conditions stipulated in this report.
Ministry of Regional Development and Planning
Forecasting Directorate
04-09-2012

Letter of Development Policy
-Recovery Support Programme 2-

1. Context and Issues

Tunisia is entering a new phase of its historical process of transition triggered by the Revolution of 14 January 2011, having successfully completed the stages of National Assembly elections and formation of a new Government and thus laid the bases for restoring the legitimacy of its institutions, once the new Constitution has been adopted and national and municipal elections organized.

The main challenge facing Tunisia is that of ensuring economic and social stability, given the unfavourable regional and international contexts (persistent European Union crisis and instability in Libya).

The country is indeed going through an unprecedented period of transformation, raising new challenges as well as opportunities for its economy. The imperative is to resume a positive pace of economic growth, following the contraction in the range of 2% witnessed for the first time in 2011, and given the need to reduce social tensions, aid job creation and boost efforts to restore regional balance by addressing the pressing needs of under-served regions.

In this context, the development action underway in Tunisia since 2011 is marked by its urgent nature and strategic dimension: the Government is required to take up the challenge of achieving revival in the short term, while preserving the country’s macroeconomic stability over the medium term, and initiate a process of structural reforms to underpin a new development model. This is the fundamental condition for the country’s successful democratic transition.

2. Macroeconomic Focus and Strategy

In the economic context, since the start of the political transition, priority has been accorded to reviving activities and restoring a climate of confidence that will give impetus to national and foreign investments. Following the 2011 contraction representing about 2% of GDP, 2012 began with promising signs of economic recovery. However, the effects of the Eurozone crisis and rising commodity prices began dampening the progress from the second quarter of 2012. While GDP growth averaged 3.3% in the first semester, it clearly slowed during the second quarter (2.1%, down from 4.6% in the first quarter). Whereas the agriculture and tourism sectors recorded strong performance, the export manufacturing industry sectors, particularly the textile and the mechanical and electrical industries, reflected the contraction in their activities during the second quarter of 2012 by 8.6% and 8.2%, respectively. With a 2012 growth target of 3.5%, the Government is aiming at higher levels that would be compatible with the unemployment rate reduction, and envisages growth of 4.5% for 2013, followed by 5.2% and 6.3% for 2014 and 2015, respectively.

At the same time, the commodity price hike resulted in inflationary pressure at the end of 2011 and inflation reached 5.6% year-on-year in August 2012, against 3.2% one year prior. Since the Revolution, the Central Bank has continued to support the economy through massive cash injection and the lowering of the interest and mandatory reserve rates. To counter the inflation, the monetary authorities raised the interest rate from 3.5% to 3.75% at end-August 2012.
Export sectors that were hard hit in 2011 benefitted from the recovery measures, particularly the tourism, transport, phosphate and energy sectors; for example, a 40% increase in tourism receipts was recorded during the first eight months of 2012. While most sectors showed recovery, the manufacturing export sector was progressively affected by the Eurozone economic recession, particularly from the second quarter of 2012. Furthermore, the increased volume of imports was aggravated by the rising prices of petroleum and food products, combined with the effects of the dinar depreciation. Thus, the trade deficit widened by over 50% during the first eight months of the year. The current account deficit, which had already attained 7.3% in 2011— one the highest levels recorded for Tunisia— represented 5.6% of GDP by the end of August 2012 (up from 3.9% a year earlier). This brought the foreign reserves down to TND 9.8 million (96 days of imports) at end-September 2012, against TND 10.5 million (113 days of imports) a year earlier. The Government plans to gradually bring the current account deficit to a more sustainable level, from 7.4% in 2012 to 5.4% in 2015, notably by stepping up export sector activity. With the European economy revival, real growth of goods and service exports should record a sustained rate of 6.1% from 2013, and reach 8.1% in 2015. According to projections, the external financing needs will remain at around TND 7.5 billion up to 2015.

With regard to budgetary strengthening, the 2012 Budget Law adopted in May 2012 has set out major revival and social stabilization measures entailing a 22% rise in expenditure. This expenditure increase, provided for under the 2012 budget, is due to the 17% rise in current expenditure and the 30% rise in public investments. The positive performance of tax and non-tax receipts, in response to the exceptional financing arrangements adopted, such as utilization of privatization receipts, proceeds from the sale of unlawfully acquired property, voluntary contributions, etc., will make it possible to contain the budgetary deficit at 6.6% of GDP (against 3.5% for 2011) in line with the 2012 Supplementary Budget Law. In the medium term, in order to achieve efficient and sustainable management of public finances, the Government intends to initiate major reforms relating to the clearing system, recapitalization of public banks, the pension fund and arrears to public enterprises. These reforms will contribute to gradually reducing the deficit to a more sustainable level, from 5.9% of GDP in 2013 to 4.1% in 2015, with priority focus on the social inclusion and economic revival dimensions. In the same vein, the public debt is expected to be contained in the medium term, albeit with a temporary rise from 46% to 48% between 2012 and 2014.

3. Government Development Strategy

Aware of the need to deepen and accelerate structural reforms so as to consolidate the resumption of economic activity, the Government has formulated a development strategy dovetailing with the emergency plan of action, and presenting a new vision for Tunisia’s future entailing a new concept of the society, seen as global, inclusive and balanced.

This strategy envisages a series of medium- and long-term structural reforms creating the conditions for growth acceleration and job creation with the aim of achieving regional balance. It has 5 pillars: economic and social reforms; infrastructure modernization; regional rebalance; strengthening of social sectors, education and employment; promotion of sustainable development taking into account the natural resources.

3.1 Economic and social reforms

The aim is to achieve the conditions for more transparent and effective governance, improve public financial management, strengthen the business climate and thereby favour investments as well as international partnerships.

Enhanced business environment. This should include strengthening domestic market competitiveness, reducing regulatory obstacles and improving the intervention of public support and supervision agencies,
and furthering public/private sector partnership. The reforms also involve review of the investment incentives code to ensure greater transparency, entrepreneurial facilitation and freedom, as well as review of the tax and customs systems.

The economic reforms will seek to further the process of external liberalization. The country’s move to open itself up represents a strategic choice aimed at speeding up growth, creating new jobs, ensuring the transfer of technology, and tapping the appropriate financing towards development. The liberalization process will be consolidated by deepening cooperation with the European Union for privileged partnership.

The financial sector. Rationalization efforts will also be directed at the private sector. The process of liberalization of capital movements will be pursued gradually, in order to guarantee the economy the necessary external financing and improve the attraction of Foreign Direct Investments in all sectors of the economy. The key actions will involve raising the effectiveness of banking intermediation by cleaning up bank portfolios, consolidating the banks’ financial and technical capacity and modernizing their management and governance modes as well as diversifying banking services (e.g., Islamic financing). The reforms also concern sectors such as microfinance, capital investment and financial market investment.

3.2 Infrastructure modernization

To integrate the Tunisian economy into the global economy, particularly the European Union and the Maghreb region, as well as ensure an enhanced business climate and more balanced development of the regions, there is need to improve and modernize the infrastructure, particularly the logistics (deep water port, rail transport and energy networks …)

Modernization of telecommunications infrastructure will be geared towards extension of the coverage and connection capacity, amendment of the regulatory framework and reorganization of the internet sector and optimum management of technological and virtual space.

3.3 Restoring regional balance

More equitable distribution of wealth and growth potential among the different regions of Tunisia is essential, as the imbalance was one of the sources of the Revolution. This requires efforts not only with regard to governance-- including the decentralization/devolution process-- but also to the physical infrastructure (roads, water, sanitation, energy), investing in human capital (education, higher education, health), and improving telecommunications.

The reduction of disparities between regions will be facilitated by equitable distribution of public investments in accordance with objective criteria, in addition to formulation of regional development programs adapted to the specific situations and resource levels of each region, and increasing the effectiveness of integrated development programs.

The reform measures will also encourage productive investments in the hinterland and seek to upgrade their comparative advantages. Particular efforts will be deployed to modernize rural infrastructure and ensure the existence of utilities throughout the regions of the country, so as to improve the living conditions and meet the needs of the new regional dynamic.
3.4 **Strengthening of social, education and employment sectors**

The Government will focus on the social and education sectors, from the improvement of the quality and governance of the facilities through to their physical modernization. For education, the objective is to achieve a system (basic education/vocational training/ higher education) that would be adapted to the country’s demographic trends and enable support to higher value-added sectors and enterprise competitiveness. Quality and effectiveness in these sectors will be improved, particularly through greater autonomy within of the structures and further emphasis on the quality of services supplied.

The Government will also continue reformulating the active employment policy, and encouraging independent work and the social security system reform.

3.5 **Promotion of sustainable development, taking into account the country’s natural resources**

The aim is to preserve the ecosystems, particularly marine systems, and stave off desertification; increase action to prevent pollution, be it waterborne - through the sanitation program-- solid or atmospheric; bolster energy efficiency and the development of renewable energy.

4. **Specific reforms undertaken in 2012**

To implement the measures and programs contained in this strategy, the Government is devoting efforts to concretize the measures adopted in the first Recovery Support Program of 2011, towards the formulation of an ambitious reform program for 2012. The list of reforms and Government commitments can be found online in the form of a matrix, on the Tunisian Government website: [http://www.tunisie.gov.tn/index.php?option=com_content&task=view&id=1883&Itemid=518&lang=fr](http://www.tunisie.gov.tn/index.php?option=com_content&task=view&id=1883&Itemid=518&lang=fr).

This reform program, implemented in tandem with the short-term budgetary revival measures, has three broad public policy objectives: growth and job creation; regional development and social protection; good governance.

**Thrust 1: Growth and Job Creation**

*Business Climate and Competitiveness*

The reform programme is linked to fiscal expansion, which is partly based on public investment. Therefore, the first action concerns accelerating the implementation of investment programmes. The public procurement process has always been cumbersome as regards procedures and implementation. Hence, the Government has embarked on simplifying and clarifying the public procurement process, and taken steps to accelerate execution of the capital budget. This led to the adoption of Decree No. 2012-515 of 2 June 2012 regulating public procurement and Circular No. 2012-41 of 22 June 2012 of the Head of Government reducing the time and procedures for disbursing commitment credits for public investment projects in 2012. Similarly, the Government has summarized public investment commitments by sector and governorate, so as to give greater visibility and ensure accountability of all stakeholders. The Government has also embarked on improving the business environment, which until the Revolution was marked by lack of transparency and prevalence of anti-competitive situations. The aim is to reduce constraints and administrative authorizations, limit the possibilities of discretionary decisions, enhance the transparency of investment procedures, and reduce monopoly or oligopoly.
Accordingly, the Head of Government has issued a decree to **simplify administrative procedures in the business environment** (in all areas relating to investment and private sector activity) and reduce the discretionary powers of the administration in applying them.

This decision is the first step in a thorough review of the regulations that will entail **revision of the investment incentives code to align it with international standards**. The revision, which will be a complete overhaul of Law No. 93-120 of 1993, will particularly aim to streamline tax and non-tax incentives, and reduce disparities between the "offshore" and "onshore" sectors of the economy.

To promote and increase local and international investments, the Government wants to encourage the **development of public-private partnerships (PPP)*** that will improve the quality and diversity of services, while reducing costs for the State. Therefore, it would be necessary to review the regulations so as to broaden PPP terms, which are currently limited to concessions. **Accordingly, a new law on PPPs will be adopted and the implementing decrees harmonized.**

The reform programme also includes actions to reform the conditions for competition between economic actors. Many sectors of activity are subject to excessive regulation, which constitutes a major obstacle to investment. Consequently, the Government is committed to **reforming the law on competition (Law No. 91-64 of 29 July 1991)** to reduce its discretionary application and increase transparency of the activities of the Competition Council. Competition will also be enhanced by **extending automatic approvals of foreign franchises**, particularly in the food sectors.

Resumption of growth could be accelerated by increasing competition in particular sectors that currently have a negative impact on the competitiveness of the Tunisian economy, especially the **telecommunications and air transport sector**.

In the **telecommunications sector**, with the exception of mobile telephony, low competition between actors in data exchange and international telecommunications leads to very high price levels. Similarly, the infrastructure in the country is not used optimally. **Measures must be taken quickly to open access to the landing stations of international telecommunications of Tunisie Telecom.** ATl's role will also be reviewed. **Alternative infrastructure operators (STEG, SNCFT, etc.) could rent their excess capacity and provide cross-border connectivity.** New international licenses will be granted. Lastly, the INT will take action to impose gradual and significant reduction of international rates for Internet exchanges and international calls. The Government will clarify the roles and responsibilities of various actors, especially the National Telecommunications Authority and the ATI.

In the **air transport sector**, the restrictive licensing system limits the country's tourism potential by raising transport costs. Liberalization of the transport sector is thus an important competitiveness issue, and is included in the Tourism Strategy 2016 adopted by the Government. Therefore, the Government wishes to move towards opening up its airspace, and will embark on **negotiations to bring regulations closer to the EU body of legislation, towards the "Open Skies" agreement with the European Union.** Through these actions, the Government intends to create conditions conducive to private investment and growth. However, within a context of economic recession and depressed international environment, some sectors need to be supported in a crisis exit process.

The Tunisian economy is primarily **an SME economy**. A large number of SMEs have been severely affected by the crisis, and need to be restructured. Improving the business environment requires a **reform of the regulations for companies in difficulty**; this will facilitate their restructuring, reduce their debt burden, and free financing margins for healthy companies.
The tourism sector, which takes a large portion of non-performing bank loans, should be treated in a special manner with strong commitment of the State, banks and industry professionals. The structural crisis in this sector for the past several years has been compounded by the aftermath of the Revolution, with a 35% decline. If the least profitable hotels remain in operation, they will have a negative impact on the image of the sector and reduce its competitiveness, as well as weaken the banking sector. To address the situation in the sector, the Government is preparing to create an Asset Management Company by end-2012 to restructure unprofitable hotels.

Financial Sector

Resumption of sustained growth also requires a stabilized, rehabilitated and diversified financial sector. The Government will continue its efforts in this direction, based on reforms initiated in 2011 in the banking sector, diversification of financing tools (markets, deposit fund), and development of microfinance and capital investment. Actions in the financial sector will help to consolidate the financial situation of public banks, refine risk analysis, ensure financial stability, develop the regulatory framework and improve the functioning of capital markets in accordance with best practices and international standards.

The first challenge is stability of the banking sector, whose problems go beyond the tourism sector alone. Indeed, due to weak governance and many political pressures, the sector, especially State-owned banks, has accumulated large stocks of non-performing loans, with excessively low provisioning rates. Significant actions should be taken to enable it to once again finance development and growth. State-owned banks are particularly concerned. The first steps were taken in 2011, with the introduction of stress tests by the Central Bank and changes to governance rules. The Government will pursue its efforts, in coordination with the Central Bank.

By launching three strategic audits of STB, BNA and BH, whose call for interest was published in August 2012, the Government intends to embark on a major restructuring of the public banking sector, including their recapitalization. Already, it has decided and authorized the first recapitalization of STB to enable it to achieve its 8% solvency ratio by December 2012.

Financial stability should be strengthened, and prudential rules should gradually move closer to international standards. That is why an amendment to BCT Circular No. 91-24 has been published to strengthen key aspects of the prudential regulations (such as the solvency ratio, the processing of equity participation in other financial institutions, large exposure ratios, etc.).

In addition to strengthening the stability of the sector, the financing tools of the economy must be diversified, from the financing of VSEs to access to capital markets:

- The microfinance sector will continue to be promoted through effective establishment of the required regulatory framework (adoption of implementing decrees of the microfinance law to determine licensing conditions and establishment of a regulatory authority).

- Capital investment, which is particularly useful for supporting companies in their growth and development, will also see its regulatory framework enriched with the adoption and publication of the implementing decrees of the 2011 law on capital investment.

- Lastly, the Government wants to give more importance to the capital market by fostering the emergence of a secondary market. Accordingly, actions will be taken to
facilitate the emergence of a real yield curve by allowing new actors to intervene (which requires an amendment to the 2003 Law on repo agreement and the BCT implementing circular).

Labour market, short-term employment programmes and higher education. Employment is a major issue in Tunisia. It can be completely solved only in the medium term, and requires a series of structural reforms, in addition to supporting the private sector - the only way of creating high value added content positions to absorb higher education graduates, and women in particular. In addition to supporting the private sector, action should be taken to further reduce barriers to the labour market.

The Government has therefore launched national dialogue with social partners (UTICA, UGTT) to ultimately sign a new social contract for the country in January 2013; this will be the first step towards reform of the Labour Code (labour relations and decent work; employment and vocational training policies; safety net and income/compensation policies, wage bargaining and regional development policies).

Reform of the labour market seeks to enhance effectiveness of the active labour market policy in terms of improving the stability and quality of jobs created for youths, attractiveness of jobs, supervision of employment programme performance, and improvement of the capacity of employment services as regards the time taken to look for employment and fill job offers. The reforms will centre particularly on:

- Revision of Decree No. 349-2009 organizing programmes of the National Employment Fund (Fund 21/21) to consolidate and improve the effectiveness and governance of Active Employment Policies (PAE), including the consolidation of integration programmes (SIVP, CIDES ILRC, CAIP, SCV) and the establishment of a legal and institutional framework for monitoring and evaluating PAEs. Meanwhile, the Government is preparing to reorganize the ANETI.

- Adoption of measures relating to flexibility of working hours in the public sector, to facilitate women’s participation in the labour market. Regulations on public service working hours have been modified to include flexitime and the 5-day working week. The Government is also exploring reform options to preserve and strengthen women’s role in economic and social life in Tunisia (e.g. harmonization of public and private sector regulations on maternity leave).

The Government also wishes to underscore the need to enhance the quality of higher education. As the first step towards greater autonomy for higher education institutions and universities, the Government has, by decree, established the National Higher Education Assessment, Quality Assurance and Accreditation Authority.

Second Thrust: Regional Development and Performance of Social Services

The objective of the proposed reforms in this respect is to reduce regional imbalances and promote social services, including health and social security programmes.

Regional Development and Local Government. The first lever of action concerns the strengthening of local government financing mechanisms and debt reduction, while ensuring consistency between local taxation and sector policy guidelines. The Government has, since the amended 2012 Finance Law, decided to remove the LGT tax ceiling applied to businesses at local government level. Secondly, in 2013, the local tax code will be amended to boost the resources of municipalities and tax fairness.
Social Protection Programmes and Performance of Social Services. The second lever concerns the effectiveness and performance of social protection programmes and the performance of social services. From the social standpoint, the expected outcomes of the reforms include the enhancement of accountability and quality of public services and investments particularly in disadvantaged areas, with emphasis on the participatory evaluation of services offered with, in view, the certification of such services including health, education and strengthening of the information system and verification of the recipients of social transfers.

Reform actions planned relate to:

- Institutionalization of participatory auditing of the General Public Services Control through the adoption of a decree establishing the transparent and participatory performance audit of public services in the General Public Services Control mission. This will improve the transparency and, thereby, the accountability of public services, particularly in the most disadvantaged regions.

- Establishment of a consolidated information system for security programmes and social protection based on a unique identifier, and adoption of a system for verification and refined targeting of beneficiaries. This measure will be essential in determining the actual beneficiaries of all social programmes and in improving targeting and effectiveness.

- In the same manner as in higher education, strengthening health services quality monitoring arrangements through the adoption of a Decree establishing an independent body for the accreditation/certification of health facilities and services.

Third Thrust: Good Governance

From 2011, the authorities launched a vast reform programme in this area (freedom of association, access to information, publication of statistical data, etc.). These public policies should now be widely disseminated. Simplification actions should also continue.

The reforms planned in this respect aim to enhance transparency and accountability principles by reinforcing administrative and financial control, improving public procurement regulation, facilitating access to information as part of open government and reforming the judiciary and the media. They concern all aspects of governance and the fight against corruption.

Public Finance: adopting a proactive and transparent public finance policy based on information dissemination is likely to build public confidence in the Government, foster fruitful debate on public decisions and increase public participation directly or indirectly, through Parliament, in national guidelines, choices and priorities.

One of the Government's measures in 2012 was to inform all administrative bodies, through a Government Circular and under the multilateral "Open Government" partnership, of the terms of implementation of the Decree adopted in April 2011 on access to the administrative documents of public agencies. As part of this partnership, departments of the Ministry of Finance were instructed to publish key documents such as the budget framework, the Government's draft budget and budget execution reports.
Regarding procurement, essential both for the revival of public investment and the fight against corruption, the current Government will continue the efforts embarked on to review the regulatory framework, in compliance with international standards and the OECD/DAC recommendations, and determine the ensuing action plan in December 2012.

Lastly, the Government will continue the review of all control mechanisms to limit ex ante control based on the proposals of the Administrative and Financial Control Modernisation Committee. The Government will establish a process of streamlining the control function within the framework of a roadmap approved by the Inter-ministerial Council. In parallel, the Government is initiating a diagnosis of the governance of public corporations with the same objective of streamlining and strengthening the administration's performance.

Judicial Sector and Anti-Corruption. The governance reform programme will continue with a view to strengthening all aspects of transparency and accountability in particular, through the development of the judicial system and an operational anti-corruption framework.

In November 2011, the Government established the Anti-Corruption Authority whose chairperson was appointed in May 2012. Members of this Authority are being appointed. Strengthening of the system has now translated into the adoption by Government and submission to the NCA of a draft law on a transitional judicial body replacing the CSM.

More specifically, to fight corruption in financial matters and build judicial capacity, the Ministry of Justice established a legal arm specializing in economic and financial issues. This unit will investigate complex corruption cases with the creation of a group of specialized judges, and participate in enhancing the transparency and competitiveness of the economy.

The scope of reform actions under the Recovery Support Programme clearly demonstrates Government's commitment to engage in a new process of concrete and effective change in all its development effort, which is the sole guarantee of a real democratic transition that should help raise the growth rate to levels commensurate with the challenges of job creation and radical transformation of the country’s regional outlook.

Technical assistance and financial support to this reform effort are key conditions for overcoming current and future constraints facing Tunisia.

As was the case in the first programme, the Tunisian Government is committed to implementing all the reforms in this second recovery support programme to ensure the success of the transition phase and smoothen progress towards democracy and inclusive development. In this regard, it is requesting substantial and rapid financial support from Tunisia's partners namely the World Bank, the African Development Bank and the European Union.
IMF EXECUTIVE BOARD CONCLUDES 2012 ARTICLE IV CONSULTATION WITH TUNISIA

On July 25, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Tunisia.1

Background

The January 2011 revolution marked the beginning of an historical era for Tunisia. Following the overthrow of the former President, Tunisia has moved steadily forward with its democratic transition. The successful elections of a Constituent Assembly in October 2011 were a milestone. A new coalition government, led by the Islamic Party (Ennahda) with two secular parties, was formed. The constituent assembly is now preparing a new constitution, on the basis of which new general elections are scheduled to take place in March 2013.

While the political transition has continued to progress, Tunisia experienced a severe recession in 2011 amid domestic and regional turmoil. Real GDP contracted by 1.8 percent, reflecting a sharp decline in tourism and foreign direct inflows. As the result of the economic downturn and the return of Tunisian workers from Libya, unemployment soared to 19 percent in 2011, with youth unemployment at 42 percent. Tunisia’s external position weakened, with the current account deficit widening substantially to 7.3 percent of GDP in 2011 and official reserves declining from US$9.5 billion at end-2010 to US$7.5 billion at end-2011. After decelerating to 3.5 per cent in 2011, inflation accelerated to 5.7 per cent in April 2012 (year-on-year).

The authorities implemented an expansionary policy mix to address social demands and support the economy. With an increase in current budget spending owing to an increase in the wage bill, larger food and energy subsidies, and new social measures, as well as increased capital spending, and notwithstanding a significant increase in revenue, the overall fiscal deficit widened to 3.5 per cent of GDP in 2011 from 1.1 per cent in 2010. As a result, following a decline in the last decade to 40 per cent of GDP in 2010, the public debt ratio increased to 44.5 per cent of GDP at end-2011. Monetary policy has been supportive of bank credit, with large liquidity injection and a reduction in the policy interest rate. The economic downturn, particularly in the tourism sector, deteriorated the quality of the banks’ portfolio. In response, the central bank relaxed its regulatory requirements to allow banks to reschedule loans for companies affected by the recession and injected large amount of liquidity in the banking system to help banks in an environment of declining assets performance. As a result, most banks became heavily dependent on central bank’s refinancing.

Signs of a rebound have emerged in early 2012, with real GDP increasing by 4.8 per cent (year-on-year) in the first quarter and tourism and FDI picking up. A recovery in real GDP growth would also be supported by a sizable growth-supporting fiscal expansion. However, risks to the short-term outlook are large and tilted to the downside, including a worse-than-anticipated recession in Europe which would depress exports, an escalation of domestic social tensions which would hamper foreign and domestic investment, and capacity constraints and delays in financing which could curb the envisaged growth-supporting fiscal stimulus. On the upside, a rapid stabilization of the situation in Libya could bolster investors’ confidence.

Tunisia’s medium-term economic growth potential remains favourable, but unleashing it requires a comprehensive package of structural reforms to foster private investment. Achieving higher and more inclusive growth over the medium term will be necessary to reduce high unemployment, especially among the youth, and address social and regional disparities. Real growth would gradually reach 6 per
cent by 2017 in a baseline scenario which assumes continued macroeconomic stability, improvement in governance and the business environment, reforms of the labour market and education system to address the labour skills mismatches, and a strengthening of the financial sector. Achieving higher growth will also require that large external financing, including FDI inflows and borrowing by the government and corporate sectors, can be mobilized.

**Executive Board Assessment**

Executive Directors noted that following Tunisia’s political transition, the country faces pressing economic and social challenges, including elevated unemployment and regional disparities. Directors stressed the need to lay the ground for transforming the economy and promoting stronger and more inclusive growth. With the economic recovery facing risks from the unsettled political situation and the weak global environment, Directors saw a need to support economic activity while safeguarding macroeconomic stability.

Directors saw room for fiscal policy to support growth and employment in the short term. They generally considered the planned targeted expansion in public investment—while containing current spending—to be appropriate. In this regard, they welcomed the authorities’ efforts to streamline public procurement and improve investment execution. Directors emphasized that fiscal consolidation should resume over the medium term to preserve fiscal and debt sustainability, and highlighted the need for a clear consolidation plan. They supported planned tax reforms to strengthen revenue and make the tax system more equitable and supportive of growth. They also emphasized the need to control medium-term public expenditures, including the wage bill, and to reform the subsidy and pension systems.

Directors supported the tightening of monetary policy to contain inflation, and welcomed the central bank’s readiness to increase the policy rate if inflationary pressures persist. They underscored the importance of strengthening the institutional framework for monetary policy, as well as the coordination of monetary and exchange rate policies. Directors noted that greater exchange rate flexibility can help preserve foreign reserves. Directors emphasized the need to ensure the central bank’s independence for the conduct of monetary and exchange rate policies, as well as for banking supervision.

Directors encouraged the authorities to press ahead in addressing the banking sector vulnerabilities identified in the FSSA. They emphasized the need to decisively address high NPLs and bank recapitalization issues, as well as improve the governance of public banks. They also stressed the importance of aligning banking supervision with international standards. Directors encouraged the central bank to develop an exit strategy to unwind gradually its large liquidity support to banks while continuing to meet banks’ liquidity needs.

Directors considered that comprehensive structural reforms are needed to reorient the Tunisian economy and harness its potential for higher and more inclusive growth. With the need to reduce unemployment, reform of the labor market and the education system will be key. Improving the business environment and governance will also be important to increase private sector investment. The development of high-value-added sectors will help absorb skilled labor. Directors highlighted the need to prioritize reforms while improving implementation capacity.