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PROJECT PERFORMANCE ASSESSMENT REPORT

REPUBLIC OF TUNISIA

ECONOMIC COMPETITIVENESS ADJUSTMENT LOAN
(Loan No. 4069 TUN)

SECOND ECONOMIC COMPETITIVENESS ADJUSTMENT LOAN
(Loan No. 4461 TUN)

THIRD ECONOMIC COMPETITIVENESS ADJUSTMENT LOAN
(Loan No. 7094 TUN)

December 27, 2004

Country Evaluation and Regional Relations Group
Operations Evaluation Department

Currency Equivalents
(Annual Average; Tunisian Dinar per US$)
(Source: IMF, *International Financial Statistics*)

Year	**Tunisian Dinar (TD)**	**Year**	**Tunisian Dinar (TD)**
1988	0.86	1996	0.97
1989	0.95	1997	1.11
1990	0.88	1998	1.14
1991	0.92	1999	1.19
1992	0.88	2000	1.37
1993	1.00	2001	1.44
1994	1.01	2002	1.42
1995	0.95	2003	1.29

Abbreviations and Acronyms

AfDB	African Development Bank
BCT	Central Bank of Tunisia
BDET	Economic Development Bank of Tunisia
BNA	National Agricultural Bank
BNTD	National Tourist Bank of Tunisia
BTEI	*Banque de Tunisie et des Emirates d'Investissement* (The Tunisian-Emirates Investment Bank)
CGA	General Insurance Council
CPI	Consumer Price Index
ECAL	Economic Competitiveness Adjustment Loan
EFRSL	Enterprise and Financial Reform Support Loan
EUAA	European Union Association Agreement
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GSM	Global System for Mobile Communications
ICR	Implementation Completion Report
ICOR	Incremental Capital Output Ratio
IMF	International Monetary Fund
ITPAL	Industry and Trade Policy Adjustment loan
MFN	Most Favored Nations
NPLs	Non Performing Loans
ODESYPANO	*Office de Développement Sylvo-Pastoral du Nord-Ouest*
PPAR	Project Performance Assessment Report
REER	Real Effective Exchange Rate
RER	Real Exchange Rate
SAL	Structural Adjustment Loan
SNDP	*Société Nationale de Distribution de Pétrole*
STB	*Société Tunisienne de Banque*
TD	Tunisian Dinar
TTN	Tunisia Trade Net
VAT	Value Added Tax
UIB	*Union International des Banque*
WTO	World Trade Organization

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OED Mission: Enhancing development effectiveness through excellence and independence in evaluation.

About this Report

The Operations Evaluation Department assesses the programs and activities of the World Bank for two purposes: first, to ensure the integrity of the Bank's self-evaluation process and to verify that the Bank's work is producing the expected results, and second, to help develop improved directions, policies, and procedures through the dissemination of lessons drawn from experience. As part of this work, OED annually assesses about 25 percent of the Bank's lending operations. In selecting operations for assessment, preference is given to those that are innovative, large, or complex; those that are relevant to upcoming studies or country evaluations; those for which Executive Directors or Bank management have requested assessments; and those that are likely to generate important lessons. The projects, topics, and analytical approaches selected for assessment support larger evaluation studies.

A Project Performance Assessment Report (PPAR) is based on a review of the Implementation Completion Report (a self-evaluation by the responsible Bank department) and fieldwork conducted by OED. To prepare PPARs, OED staff examine project files and other documents, interview operational staff, and in most cases visit the borrowing country for onsite discussions with project staff and beneficiaries. The PPAR thereby seeks to validate and augment the information provided in the ICR, as well as examine issues of special interest to broader OED studies.

Each PPAR is subject to a peer review process and OED management approval. Once cleared internally, the PPAR is reviewed by the responsible Bank department and amended as necessary. The completed PPAR is then sent to the borrower for review; the borrowers' comments are attached to the document that is sent to the Bank's Board of Executive Directors. After an assessment report has been sent to the Board, it is disclosed to the public.

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Relevance of Objectives: The extent to which the project's objectives are consistent with the country's current development priorities and with current Bank country and sectoral assistance strategies and corporate goals (expressed in Poverty Reduction Strategy Papers, Country Assistance Strategies, Sector Strategy Papers, Operational Policies). *Possible ratings:* High, Substantial, Modest, Negligible.

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Efficiency: The extent to which the project achieved, or is expected to achieve, a return higher than the opportunity cost of capital and benefits at least cost compared to alternatives. *Possible ratings:* High, Substantial, Modest, Negligible. This rating is not generally applied to adjustment operations.

Sustainability: The resilience to risk of net benefits flows over time. *Possible ratings:* Highly Likely, Likely, Unlikely, Highly Unlikely, Not Evaluable.

Institutional Development Impact: The extent to which a project improves the ability of a country or region to make more efficient, equitable and sustainable use of its human, financial, and natural resources through: (a) better definition, stability, transparency, enforceability, and predictability of institutional arrangements and/or (b) better alignment of the mission and capacity of an organization with its mandate, which derives from these institutional arrangements. Institutional Development Impact includes both intended and unintended effects of a project. *Possible ratings:* High, Substantial, Modest, Negligible.

Outcome: The extent to which the project's major relevant objectives were achieved, or are expected to be achieved, efficiently. *Possible ratings:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Bank Performance: The extent to which services provided by the Bank ensured quality at entry and supported implementation through appropriate supervision (including ensuring adequate transition arrangements for regular operation of the project). *Possible ratings:* Highly Satisfactory, Satisfactory, Unsatisfactory, Highly Unsatisfactory.

Borrower Performance: The extent to which the borrower assumed ownership and responsibility to ensure quality of preparation and implementation, and complied with covenants and agreements, towards the achievement of development objectives and sustainability. Possible ratings: Highly Satisfactory, Satisfactory, Unsatisfactory, Highly Unsatisfactory.

Contents

Ratings and Responsibilities

Economic Competitiveness Adjustment Loan (Loan No. 4096)		
	ICR Review	***PPAR***
Outcome	Satisfactory	Satisfactory
Sustainability	Likely	Likely
Institutional Development	Not rated	Modest
Bank Performance	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory

Second Economic Competitiveness Adjustment Loan (Loan No. 4461)		
	ICR Review	***PPAR***
Outcome	Satisfactory	Satisfactory
Sustainability	Likely	Likely
Institutional Development	Modest	Modest
Bank Performance	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory

Third Economic Competitiveness Adjustment Loan (Loan No. 7094)		
	ICR Review	***PPAR***
Outcome	Satisfactory	Satisfactory
Sustainability	Likely	Likely
Institutional Development	Substantial	Modest
Bank Performance	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory

Key Project Responsibilities

Project	Staff	Appraisal	Completion
ECAL I	Task Manager	Maria Pigato	Linda Likar
	Division Chief/Director	Christian Delvoie	John Page
	Country Director	Daniel Ritchie	Christian Delvoie
ICR prepared by Auguste Kouame.			
ECAL II	Task Manager	Denis Lionel Chaput	Stephanie Gober
	Sector Director	Deane Jordan (Acting)	Deane Jordan (Acting)
	Country Manager	Christian Delvoie	Christian Delvoie
ICR prepared by Stephanie Gobier.			
ECAL III	Task Manager	Hamid Alavi	Hamid Alavi
	Sector Director	Emmanuel Forestier	Emmanuel Forestier
	Country Manager	Christian Delvoie	Theodore O. Ahlers
ICR prepared by Jean Pesme.			

Preface

This is a Project Performance Assessment Report (PPAR) of the three economic competitiveness adjustment loan projects (ECALs) in Tunisia:

- The Economic Competitiveness Adjustment Loan (L 4096) in the amount of US$75 million equivalent, comprising a US$37.5 million tranche and a French Franc 193.9 million tranche was approved on July 25, 1996. Final disbursement took place by June 30, 1998, and the loan was closed on June 30, 1998, six months after the original closing date. Parallel coordinated financing was provided by the European Union in the amount of US$150 million.
- The Second Economic Competitiveness Adjustment Loan (L 4461) in the amount of US$159 million equivalent was approved on April 20, 1999. The disbursement of the second tranche took place on March 6, 2001, six months after originally projected. The loan was closed on schedule on June 30, 2001. Parallel financing was provided by the EU in the form of a Euro 80 million equivalent grant and by the African Development Bank (AfDB) with a loan of US$140 million equivalent.
- The Third Economic Competitiveness Adjustment Loan (L 7094) in the amount of US$282.5 million equivalent was approved on December 20, 2001 when a first tranche of US$130 million was disbursed. The floating tranche concerning the strengthening of the financial sector in the amount of US$45 million equivalent was released in September 2003, and the floating tranche supporting the private investment climate in the amount of US$45 million equivalent was released in December 2003. The Bank allowed the third floating tranche to lapse and the loan closing date was revised from June 30, 2003 to December 31, 2003. The AfDB and European Union (EU) co-financed this loan with Euro 216 million and Euro 80 million, respectively.

The PPAR is based on the findings of a mission by the Operations Evaluation Department (OED) that visited Tunisia between 14 to 29 September, 2003, in parallel with the OED Country Assistance Evaluation mission. The findings draw on interviews with beneficiaries, staff in charge of implementing the three operations, other officials of the Government of Tunisia and Bank and International Monetary Fund (IMF) staff. The mission also met with representatives of the co-financiers—the AfDB and EU. Annex D contains a list of the people interviewed. The collaboration of these persons contributed importantly to this report. In addition, the PPAR made use of appraisal documents, implementation completion reports, IMF reports and other background documents and data.

The three ECALs were selected for review as they provide a coherent framework for assessing progress in building competitiveness through targeting the real exchange rate, as influenced mainly by structural domestic reforms to provide incentives and an enabling environment for factors of production to shift in support of export-led growth. Also, this cluster of projects was selected to provide inputs to the OED's FY04 Country Assistance Evaluation for Tunisia.

Comments from the Bank's Regional Management have been taken into account. A draft report was sent to the Government of Tunisia and no comments were received.

This report was prepared by Richard M. Westebbe (Consultant), with Fareed M. A. Hassan as Task Manager. Gonzalo Salinas and Janice Joshi provided statistical information and administrative support.

Summary

1. This is a Project Performance Assessment Report prepared on the three Economic Competitiveness Adjustment Loans (ECALs) in Tunisia. ECAL I (US$75 million) was approved on July 25, 1996 and was closed on June 30, 1998, six months after the original closing date. ECAL II (US$159 million) was approved on April 29, 1999 and was closed on schedule on June 30, 2001. ECAL III (US$283 million) was approved on December 20, 2001 and the closing date was extended by six months to December 31, 2003. Although the Government issued a second Global System for Mobile Communications license (GSM—wireless telecommunications), the ECAL III associated tranche (US$45 million) was not disbursed because the Bank did not receive the documentation required to demonstrate that the GSM license was tendered following a competitive and transparent process.

2. The three ECALs constitute a continuum of operations with the basic objective of increasing growth and improving the competitiveness of the economy through a series of macro and structural reforms, following the bold decision of the authorities to sign in 1995 an association agreement with the European Union (EUAA). The EUAA provides for a phased establishment of a free trade zone in manufacturing over a 12-year period. By exposing the economy to the full force of EU competition, the aim was to induce an adjustment in Tunisia's productive sectors as a basis for achieving a high and sustainable increase in the growth rate, with substantial poverty reduction impacts.

3. Maintaining sound macroeconomic and fiscal frameworks and adopting international trade and investment procedures would accelerate the implementation of the EUAA. In addition, the ECALs sought to enhance the soundness, efficiency and competitiveness of the banking system, and promote the development of capital and insurance markets by modernizing the legislative and institutional framework for the financial sector. Finally, the loans sought to improve opportunities for the private sector through privatization and improved regulations. The ECALs' objectives conformed to Tunisia's development objectives outlined in its Ninth Development Plan (1997-01) as well as the Tenth Development Plan (2002-2006), and the Bank's country assistance strategy.

4. With timely and effective support of the Bank and other donors, Tunisia maintained a solid record of macroeconomic stability and remarkable economic progress. The ECAL programs successfully promoted policy reforms. Substantial financial sector reforms were achieved, as well as the removal of some of the disincentives for investment and the privatization of public enterprises and banks. The implementation of the EUAA led to an economy considerably more open to the outside world.

5. At the macro level real GDP growth exceeded ECAL targets, although some slowdown occurred in exports due to slower European growth. The management of the real exchange rate together with well targeted policy and structural reforms were the basis for the 5.2 percent real growth rate between 1997-2001 and its resumption in 2003. With sustained growth, the poverty rate declined from 8 percent in 1995 to 4 percent in 2000. Other indicators of social and economic well-being improved significantly. The main areas of structural reform supported by the ECALs contributed critically to the long run competitiveness of the Tunisian economy. Liberalization led to productivity growth and diversification, particularly in the offshore industries based on the EU market. Export of

manufactured products was the real engine of growth, rising by 8 percent annually. It is a model that stresses deliberate progress over speed, based on security and stability, as the Tunisian authorities put it. OED's ICR Review for ECAL I and II rated outcome as satisfactory, sustainability as likely, institutional development impact as modest and Bank and borrower performance as satisfactory. The PPAR largely agrees with the ICR review ratings and rates ECAL III similarly.

6. The main lessons are:

- Tunisia's successful economic performance has been due to three attributes: ownership and broad political consensus, a well-developed human resource base, and a stable macroeconomic environment.

- Experience in privatization and the financial sector shows the need for the Bank and the development partners to stay the course and show flexibility in their support, provided there is evidence of genuine and sustained reform efforts. For example, by accepting partial reforms in some areas, and building on partial successes to deepen them in subsequent operations, the support from the Bank and other partners was ultimately effective. Patience, perseverance and flexibility paid off.

- An important lesson for other small emerging countries seeking to lay the foundations for sustainable growth and poverty reduction is the success of Tunisia in creating a competitive economy by the coordinated use of macro and structural policies and reforms.

Gregory K. Ingram
Director-General
Operations Evaluation

1. Introduction

1.1 The three competitiveness ECALs were selected for evaluation as they represent a continuous series of key operations in the Government's strategy to create a fully competitive economy in a liberalizing world through a coordinated use of macro and structural policies and reforms. As such the Tunisia experience will hold important lessons for other emerging countries attempting to lay the foundations for sustainable growth and poverty reduction. The ECALs were a major part of the Bank's assistance program during the period evaluated by the Country Assistance Evaluation.

1.2 Tunisia has had one of the fastest growing economies in North Africa and the Middle East since the mid-1980s. It has progressed from being a lower to a middle-income country with a per capita income of US$2240 (World Bank Atlas Method, 2002). Since independence in 1956, real per capita incomes have grown two and a half times, while social and economic well-being has improved significantly. The incidence of poverty has dropped from 40 percent in 1970 to 13 percent by 1985, to 7 percent by 1990, and further to 4 percent by 2000. Almost all children attend primary school and life expectancy has grown from 50 to 70 years. Women now comprise a third of the labor force.

Competitiveness: Phase I

1.3 Since l986, following a decline in export earnings and excessive public investment spending, the Government has pursued a program of macro stabilization and adjustment, supported by the Bank and IMF. The reforms aimed at liberalizing the tightly controlled economy, removing tax and subsidy distortions, improving resource allocations, and reducing the role of the public sector. In spite of drought, the Gulf war and the slow growth in Europe, real GDP growth increased from a 3 percent annual rate during l980-86 to more than 4 percent during l987-94. Efficiency was increased by comprehensive structural reforms with particular benefit to the private sector. Despite a sharp reduction in public investment, the rapid growth in output and improvements in productivity brought the incremental capital-output ratio (ICOR) down from 12.4 in l980-86 to 6.6 in l987-94. The share of private non-financial enterprises in value added rose. The share of private investment in total investment rose from 48 percent in 1990 to 51 percent in 1998 (2000 Private Sector Assessment, p.3).

1.4 Monetary and fiscal policies contributed to restoring macro stability. A positive real interest rate and a reduction in the fiscal deficit contributed to a rise in gross domestic savings from 19.5 percent in l986 to 21.9 percent in l994. These policies were supported by adjustments in the exchange rate; the real effective exchange rate depreciated by a total of 30 percent in 1986-89, appreciated through 1992 and then leveled off until it depreciated modestly after the mid 1990s. Tunisia follows a constant real exchange rate rule by which the authorities periodically adjust the nominal exchange rate to maintain the real exchange rate constant. This policy requires prudent monetary and fiscal policies, managed capital flows, and structural reforms.

1.5 Growth in this first period of reform was export-led. The volume of manufactured exports increased on average by more than 8 percent per year and total exports by 5 percent annually in real terms between 1989 and 1994. Export growth financed the rise in imports of capital and intermediate goods, which were the basis of investment and income growth. Exports of goods and services rose from 30 percent of GDP in l986 to 43 percent in l994. The structure of exports shifted remarkably; primary products exports fell from 17 percent in l980 to 4 percent of the total in 1994 and manufactured exports rose from 10 percent to 15 percent. During this period textile exports rose from 47 percent to 55 percent of manufactured exports. Europe absorbed 75 percent of exports. This market and product concentration increased the vulnerability of the economy to shocks. The l990-92 decline in the European market contributed to almost all of the 50 percent fall in the growth rate of exports.

1.6 Despite the progress, much remained to be done in areas such as inefficient public enterprises, protected high cost domestically oriented firms, high transport costs, inefficient port and customs facilities, and incomplete trade liberalization.

Competitiveness: Phase II—A Bold Step Forward

1.7 In l995 Tunisia decided to embark on a dramatic new phase of development in the realization that its small market could never provide the basis for long-term sustained growth with improved standards of living for the bulk of its population. Tunisia became the first country in the region to sign an association agreement with the European Union (EUAA), which complemented agreements under GATT. The objectives of EUAA were to conduct a phased integration of the Tunisian and EU economies through the free movement of goods and legislative, social and financial cooperation. Under the EUAA, tariffs on EU's imports (excluding agricultural goods) would be progressively eliminated over a 12-year period, starting with capital and intermediate goods and ending with consumer goods. ECALs I through III were designed to support Phase II of the competitiveness strategy.

1.8 The ratification of the EUAA was required before July l997, but the Government started implementing the trade liberalization program in the l996 Finance Law, which included reductions in tariffs on equipment. The l997 Finance Law included the tariff reductions scheduled for the second year of application of the EUAA. A phased reduction in tariff surcharges also began in l996.

1.9 The opening of the Tunisian economy to the highly competitive European markets was a bold move, even though phased over a period of years. The private sector received a clear signal that protection would no longer shelter them. Firms would be forced to increase efficiency and allocate resources in relation to Tunisia's comparative advantage. The improved regulatory environment would attract foreign investors. Trade diversion would be minimal as Europe already absorbed three quarters of Tunisia's foreign trade. While total liberalization would come later (with the full implementation of the 12-year EUAA), the Government aimed at providing a credible anchor for economic reforms, including product standards, a legal framework, anti-dumping agreements, and the promise of substantial financial and technical assistance.

1.10 The cost of the EUAA would not be negligible. One third of enterprises were estimated not to be able to sustain competition with Europe and would have to be restructured. The fear of increased unemployment, estimated at 16 percent of the labor force at the beginning of the period, was the main reason for the gradual tariff reduction under the EUAA. The benefits of the EUAA were also estimated to be considerable. It would allow five or six years for private firms to adjust to the new competitive environment. It would eliminate the dualistic structure of the economy, with protected firms producing at high cost for the domestic market (onshore) and exporting firms producing under subcontracting agreements in low-wage garment industries (offshore). With the phasing-out of the Multifiber Agreement, these firms would need to compete with Eastern European and Asian producers in any event.

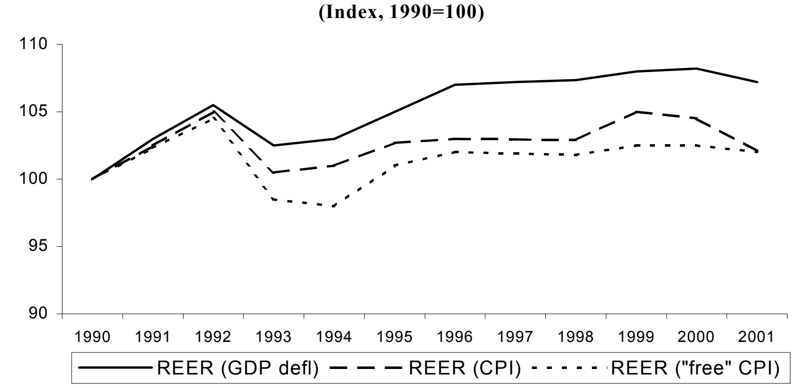
1.11 The main issue for development strategy is to pursue policies to raise productivity and reform structural rigidities. Tunisia is too small to grow within closed borders and must therefore adopt policies to liberalize internal markets and access to external trade. Hence, the strategy must be based on export-led growth. This was essentially the goal of targeting the real exchange rate.

The Policy Framework Targets the Real Exchange Rate

1.12 Tunisia followed a policy of targeting a constant real exchange rate (RER) to expand exports and hence drive growth. As the RER depreciates the economy becomes more internationally competitive as the price of non-tradable goods and services falls relative to tradable goods. For the purpose of evaluating the three ECALs, it is important to note that the RER is sensitive to impediments that inhibit factors of production from moving in response to price incentives, including price and wage controls, large public sector ownership of assets, and tax and other policies inhibiting investment.

1.13 Changes in the RER are commonly measured by the real effective exchange rate (REER), which is based on consumer prices, GDP deflators, and the relative prices of non-tradable to tradable goods. Tunisia's exchange rate policies have managed to maintain overall stability since 1996 (Figure 1.1).

Figure 1.1: Tunisia-Real Exchange Rate Indicators, 1990-2001 (Index, 1990=100)



Source: IMF Selected Issues (2002).

Note: A nominal effective exchange rate index represents the ratio (expressed on base 1990=100) of an index of the period average exchange rate of the currency in question to a weighted geometric average of exchange rates for the currencies of selected countries. A real effective exchange rate index is defined as a nominal effective exchange rate index adjusted for relative movements in national price or cost indicators of the home country and selected countries. The national price indicators include, GDP deflation and CPI. REER can be calculated on 3 different price indices, including GDP deflation and consumer prices.

1.14 The following part of this report contains a discussion of the main policies and structural reforms addressed by the ECALs, and progress achieved in the macro framework (including growth and exports), trade liberalization, the enabling environment, privatization, and the financial sector.

2. Policies and Structural Reforms Addressed by the ECALs and Progress Achieved

2.1 The three ECALs constitute a continuum of operations with the basic objective of increasing growth and improving the competitiveness of the economy through a series of macro and structural policy measures and institutional reforms following the bold decision of the authorities to sign in 1995 an association agreement with the European Union (EUAA). The EUAA provides for a phased establishment of a free trade zone in manufacturing over a 12 year period. By exposing the economy to the full force of EUAA competition, the aim was to induce an adjustment in Tunisia's productive sectors as a basis for achieving a high and sustainable increase in the growth rate, with substantial poverty reduction impacts. ECAL I introduced wide-ranging measures, including first generation actions aimed at promoting private sector development. ECAL II supported improvements in the soundness, efficiency and competitiveness of the banking system. ECAL III introduced a broad range of second-generation measures to enhance the international competitiveness of the economy: further promoting private investment, strengthening the financial sector, and liberalizing the information and communications technology sector, while maintaining a stable macroeconomic framework. A full discussion of the objectives of the three ECALs may be found in annex A, and a complete list of conditionality and outcomes in annex C, table 8.

2.2 The ECALs' objectives were relevant to and aligned with both Tunisia's 5-year development plan and the Bank's country assistance strategy.[1] The 9th Development Plan (1997-2001) was aimed at opening up the economy to competition while maintaining macroeconomic stability and strengthening the social agenda and environmental management. The 10th Development Plan of 2002 to 2006 also aims to strengthen competitiveness, embrace the knowledge economy and meet the jobs challenge.

2.3 The ECALs were the key instruments used by the Bank to support Tunisia's policy of internationally integrating its economy through the unique opportunity provided by the EUAA. In essence, the operations aimed at accelerating the pace of structural reforms, particularly in the areas of trade liberalization, enhancing the enabling environment for investment, opening investment activities to the private sector, and reforming the financial sector. They also supported the Tunisian policy of redefining the role of the State in the economy by strengthening its actions in the provision of public goods and the management of scarce resources, while shifting emphasis to a higher level of both domestic and foreign investment. The Bank's strategy aimed at the timely implementation of economic integration while maintaining social stability by focusing on key areas suitable for immediate policy actions (1996 and 2000 country assistance strategies).

[1] At the 2000 Country Assistance Strategy design, it was expected that ECAL III would either advance financial sector reform or support measures to enhance private sector development and participation in the provision of infrastructure, depending on the readiness of the Government. As approved, ECAL III was an ambitious program, covering three broad sectors with the following aims: strengthen the financial sector, promote a business environment conducive to private investments, and liberalize the telecommunication sector, while maintaining a stable macroeconomic framework.

Macroeconomic Stabilization and Growth

2.4 All of the ECALs as well as earlier policy-based loans—the1987 Industry and Trade Policy Adjustment Loan (ITPAL), the 1988 Structural Adjustment Loan (SAL), and 1991 Enterprise and Financial Reform Support Loan (EFRSL)—have included the maintenance of a stable macroeconomic environment as a primary component and, therefore, have supported underlying fiscal, monetary and exchange rate policies that have been successfully implemented. As discussed below, they have also supported structural reforms in the external, financial, and private sectors. Tunisia's prudent macroeconomic management and cautious yet determined structural reforms have led to improving economic performance, essentially across the entire spectrum of standard indicators: sustained economic growth; declining inflation; a stable real exchange rate; a sound and stable fiscal position; controlled monetary aggregates; and a stable and manageable balance of payments position. Table 2.1 reflects progress in macroeconomic performance, while annex C, tables 6 and 7 show more details.

Table 2.1: Tunisia's Main Macroeconomic Indicators

Indicators	*1986-90*	*1991-95*	*1996- 00*	*2001*	*2002*	*2003*
GDP growth (% p.a., real GDP at market	2.9	3.9	5.6	4.9	1.7	5.5
Inflation (%, CPI Index)	7.1	5.8	3.4	2.7	2.3	2.1
REER Index (1990=100)	107.9	102.6	104.2	100.9	99.7	--
Budget Deficit (% GDP)	3.8	3.7	3.7	3.5	3.5	3.1
Current Account Deficit (% GDP)	3.9	5.8	3.1	4.7	3.5	3.1
Foreign Direct Investment (% GDP)	0.8	1.6	2.6	2.2	3.8	2.1
Total Public Debt (% GDP)	62.0	60.7	59.4	60.2	64.3	60.2
Gross Foreign Reserves (months of imports c.i.f)	1.9	1.8	2.9	2.5	2.9	2.9

REER refers to real effective exchange rate.
Source: Calculations based on data from the World Bank and IMF reports.

2.5 Prudent macro policies were reflected in the fiscal deficit, which was reduced from an average 4 percent of GDP in 1991-95 to 3 percent in 2003, despite tariff reduction under EUAA. Tax revenues were boosted by strong import growth, rising economic activity and better collection procedures. The growth of monetary aggregates was brought into line with nominal GDP growth. Inflation continued to decline from an average 6 percent during l991-95 to 2 percent in 2003. The Central Bank shifted financing of the banks to the emerging money market. By using the flexible management of the exchange rate and capital controls the authorities were able to prevent a significant appreciation of the real exchange rate. With rising total factor productivity, and no major terms of trade shock, Tunisia should be able to maintain a competitive real exchange rate for the foreseeable future.

2.6 This successful performance was based on sound macro and structural policies aimed at export-led growth with prudent monetary and fiscal policies supporting the targeting of a constant real exchange rate while restricting capital mobility. The sustainable and high growth was coupled with remarkable poverty reduction; the incidence of poverty fell from 13 percent in l980-85 to 4 percent in 2000. Nevertheless, a characteristic of this generally favorable performance was the intractability of the unemployment rate, which hovered around 15 percent.

2.7 Exports are one of the best measures of the success of the competitiveness campaign. Real export growth averaged 4.9 percent annually from 1990-1994, became negative in l996 and then averaged 8 percent annually through 2001, exceeding ECAL targets in most years (annex C, table 7). Exports fell by 2.3 percent in 2002 and rebounded by an estimated 4 percent in 2003 (annex C, table 7). Total exports rose from 28.5 percent of GDP in l990 to 33 percent in 2001. Manufactured exports to Tunisia's main trading partners, France, Germany and Italy, rose as a share of total manufactured exports from 67 percent in 1990-91 to 78 percent in 1996–2000.

2.8 The manufactured export base has also diversified. The main manufactures consist of apparel/clothing, electrical equipment, textiles and footwear. The main increases in export shares were in textiles and mechanical and electrical equipment, which grew by 12 and 14 percent respectively during 2000-2001. Although exports were the principal engine of growth, domestic demand grew at 5.2 percent in 2001. Import growth closely paralleled that of exports, reflecting tariff reductions and private investment growth. The external current account deficit remained virtually unchanged, hovering around 3-4 percent of GDP. External reserves fell to an average of 2.5 months of imports during 2001 but rose to nearly 3 months by the end of the year with the disbursement of the US$130 million first tranche of ECAL III.

2.9 A significant feature of the Tunisian export economy was the establishment of the offshore sector designed to offset the anti-export bias of the protected domestic economy. Offshore enterprises consisted of some 1900 enterprises in l998 according to the 2000 Private Sector Assessment. They export 80 percent of their production, accounting for 80 percent of manufactured exports. More than 60 percent of manufactured exports are textiles and garments, half of which are produced by offshore enterprises through subcontracting by foreign investors. The offshore firms operate under specific incentives and rules and are exposed to much more external competition than other enterprises in the onshore sector.[2] The offshore sector is not well integrated in the domestic economy and thus has not acted as a catalyst for raising domestic efficiency and competitiveness. The low level of FDI in the economy, despite its key role in the offshore sector, reflects the constraints on domestic private investment including the investment code, foreign exchange restrictions and administrative interference (detailed analysis is provided in the enabling environment subsection below). With the progressive application of the EUAA, onshore firms will be at a disadvantage to offshore producers as they are subject to more restrictions and an inefficient duty drawback and customs clearing system amongst other impediments. The introduction of the Tunisia Trade Net system[3] will substantially

[2] A strategic objective of the 2004 CAS is to improve the incentives framework and transparency and predictability of the regulatory framework. Key options would include further reforming the incentives system with the aim of leveling the playing field between onshore and offshore firms as of 2007, revising the investment code, and reducing restrictions to majority capital ownership by foreign investors. The strategy proposes to assist the Government through analytical work and follow-up adjustment loans such as ECAL IV and ECAL V.

[3] In 2000 a semipublic agency, Tunisie Trade Net (TNN), was established to operate a value added network that provides electronic data interchange (for stakeholders) and to expedite flows and processing of trade documents.

improve the efficiency of the clearance process. It will be important to level the playing field for onshore firms by applying a common regime to all exporters.[4]

2.10 The economy successfully weathered the shocks of September 11, 2001, a terrorist attack at Djerba, and a fourth year of drought. GDP growth slowed sharply from 4.9 percent in 2001 to 1.7 percent in 2002 mainly because of an 11 percent decline in agriculture, particularly in the production of olive oil and cereals, and the slow growth in Europe, which absorbs 80 percent of Tunisia's exports. Growth recovered to about 5.5 percent in 2003. Non-manufacturing mainly in energy and communications rose by 3.4 percent in 2002 versus 5.9 percent a year earlier. Manufacturing fell to a 1.9 percent growth rate in 2002 compared with 6.9 percent in 2001 due to lower growth in textiles, shoes and mechanical and electrical industries.

2.11 Private direct foreign investment continued to rise in 2002 due to privatizations in telecommunications and banks. Private investment accounts for 53 percent of total investment. Despite slow growth, unemployment continued its gradual downward trend and was reported to have declined to 14.9 percent from 16 percent in 2000.[5] Tunisian Government officials explain the apparent contradiction of falling unemployment and output as due to the impact of the subsidized apprenticeship program in industry, vocational training programs, and solidarity fund financing for the unemployed starting up small enterprises.

Trade Liberalization

2.12 With regard to trade with the EU, the EUAA agreement required Tunisia to dismantle its protective regime, which shielded import competing firms and gave tax advantages to enterprises producing exclusively for export under subcontracting agreements in low skill activities such as garment assembly. These arrangements put the country at a disadvantage with competitors. The association agreement with the EU in July 1995 included phased creation of a free trade zone in manufactures. The financing provided by the ECAL I helped accelerate the implementation of the EUAA by incorporating the phased tariff reduction in the l997 budget, which conformed to ECAL I conditionality. The implementation of the EUAA began two and a half years prior to its ratification in all EU countries.

2.13 The implementation of the EUAA is on track. These trade measures have contributed substantially to the adjustment of industry to competitive opportunities in the EU and have provided Tunisian firms with access to lower cost imports. The prospect is good for the full adjustment of tariffs by 2008, as provided in the EUAA. The dismantling of import monopolies is being studied except for tobacco and alcohol, which will be excluded in view of the large revenues they produce. The study has already provided initial analysis and will further examine each import monopoly separately. The Bank and the authorities have agreed to continue the analysis and to take up the issue in the context of ECAL IV.

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[4] As indicated earlier, proposed follow-up operations (ECAL IV-V) are expected to address these issues.
[5] This decline occurred despite the growth of the labor force.

2.14 The trade reform agenda, however successful, is not complete, as trade protection remains high even with the liberalization taking place under EUAA, because of high most favored nation (MFN) tariffs. MFN tariffs averaged 34.5 percent in 2002 compared with EU preferential tariffs of 24.3 percent. In the meantime, effective protection remains high in manufacturing, as tariffs were cut sharply on intermediate goods, but were maintained on manufactured consumer goods. It would have been preferable for Tunisia to move more forcefully to lower protection and barriers to free trade. However, in view of the importance of the EUAA, it was understandable for the Bank to go along with the requirements of that agreement while pointing out the need for Tunisia to take other measures to enhance competitiveness, such as reducing the cost of production. Such complementary measures have been slow in coming. In addition, the Bank could have helped design programs to lower the discrimination against non-EU trade in parallel with the implementation of the EUAA.

The Enabling Environment

2.15 The enabling environment reform contained in ECAL I includes the improvement of the regulatory and administrative environment in which enterprises work, adopting measures to reduce transport costs, to facilitate the passage of goods through ports and customs, and to improve the legislative framework (a list of conditionality and outcomes may be found in annex C, table 8).

2.16 ECAL III drew on the 2000 Private Sector Assessment, which noted the complex investment regime, taxation and other administrative constraints particularly affecting small and medium enterprises. Government involvement in telecommunications, transport, and banking loans was also cited as an impediment to private investment.

2.17 To facilitate the passage of goods through ports, the aim was to reduce the cost and increase the speed of shipping. A 1998 survey noted that the cost of moving a container from Tunisia to France or Germany was almost equal to transport costs from China and India. A law was approved abolishing the privileges granted to Tunisian ship-owners in chartering. The intention was to introduce full competition in the ports. EU policies on lifting the restrictions on liner shipping were adopted. By ECAL III significant progress was made in streamlining and improving customs procedures. The customs computer system was modernized and a simplified documentation system replaced a complex multiplicity of documents. The implementation of the electronic data interchange (TTN) was supported by the Bank and the EU and is already being used by 80 enterprises. A new law is being drafted to make it mandatory for importers and exporters to use the new system, which should result in important cost and time savings.

2.18 The port bottleneck was addressed in both ECALs I and III and involved reducing the time needed for goods to clear the port due in part to inefficient service and restrictive labor practices. The dockers' monopoly was addressed in the Transport Sector Project. Cargo handling was being reorganized and new conditions for access to the market will facilitate creation of private enterprises to invest in port equipment. While the reforms are still under way, substantial progress has been reported. The delay in clearing goods has been reduced from up to 18 days to an average of 4 days. Customs clearance time has also been reduced from 2-3 days to 15 minutes.

2.19 The regulatory framework has been improved with the "*guichet unique*" (one stop window) to facilitate business registration and start ups in manufacturing. However, delays still occur when a new project requires authorizations. Prior authorizations relating to environment, labor and sectoral regulations are still relatively numerous and hamper manufacturing start-ups. A December 1997 decree simplified documentation and port procedures and brought the customs code up to conformity with the EU Code. Revisions in the laws governing property rights were recommended. A competition law was enacted in l990 and amended in l995 and 1999. The law abolished margins on retail prices and created a Competition Council. The implementation of the law is still imperfect and the Council needs to be strengthened to deal with competition issues. On the other hand, the Company Law was amended in response to comments received from practitioners after the law was enacted, meeting ECAL III conditionality. Also, the authorities adopted accounting standards, satisfactory in substance to ECAL III conditionality, setting forth the rules and methodologies governing the consolidation of financial statements and the treatment of corporate conglomerates.

2.20 Tax procedures constitute an administrative burden. The VAT reimbursement procedures are cumbersome and reimbursement can take up to 6 months. Prior to the ECAL III, 15 percent advance on amounts owed firms were not sufficient to offset the liquidity problem facing firms waiting for payment. The ECAL III condition to "reduce to a maximum of 30 days VAT reimbursement" was mainly met by reimbursing 75 percent of the VAT within 30 days (annex C, table 8). Import exemptions are subject to long delays and tax administrators are arbitrary in levying taxes and penalties. Part of the problem lies with the multiplicity of tax regimes and procedures and frequent changes in the tax regimes.

2.21 Reforms were introduced to increase the flexibility of the labor market and reduce labor costs. A number of agreed actions were taken regarding submission of a draft law to the Chamber of Deputies to create a limited severance scheme to cover severance packages to workers laid off for economic reasons (annex C, table 8). This law has since been passed, although the dismissal of workers for economic reasons remains heavily regulated. Measures were taken to reduce the burden of social security contribution for employers.

Privatization

2.22 A key element in Tunisia's competitiveness policies was to address the role of the State in the economy. Following independence, the political leadership opted initially for a state-led model of development. By the mid-1980s, public enterprises (PEs) accounted for 30 percent of total value added and employment, as well as 40 percent of total investment. Due to poor management and weak performance some of the largest enterprises became highly indebted. In l987 a program of restructuring and privatization was announced and by 1989 the legal framework was established, and a Commission for

Restructuring of PEs was set up chaired by the Prime Minister with authority over divestiture.

2.23 Privatization has proceeded slowly due to the fear of excessive social costs and the lack of an adequate regulatory and institutional framework (annex C, tables 1-3). The process began with small-and medium-scale enterprises for which buyers could be found. By 1994, fifty transactions had been undertaken with proceeds equivalent to 1 percent of GDP. A program of restructuring of unprofitable enterprises reduced budgetary transfers from 7 percent of GDP in l990 to 4 percent in l994. The Government's pricing policies in cereals led such large PEs as the Grain Office and Edible Oil Office to run structural deficits financed with bank credit, which were refinanced by the Central Bank. These overdrafts were consolidated and future losses were shifted to the budget. In 1993 responsibility for privatization strategy was transferred to the Ministry of Economic Development with a view to accelerating the process. The Stock Exchange was privatized in 1994 and a new regulatory agency was set up to update prudential regulation and enforce compliance.

2.24 The three ECALs addressed the issue of privatization, as discussed below. The definition of a PE is an enterprise in which Government or a local entity (public sector commercial entity) owns more than 50 percent (34 percent for the financial sector). The number of PEs was 232, of which 98 were public entities with no commercial activity and which are, in effect, extensions of the public administration. The remaining 134 include 15 financial institutions, which in 1994 produced 11 percent of total wages and 13.7 percent of national value added.

2.25 The Government presented for ECAL I a list of 63 enterprises representing about 60 percent of those producing goods and services and having a net asset value of TD 1,413 billion. The implementation completion report cited slow progress in carrying out the program. Some small companies were removed from the list of 63 due to political or strategic reasons. Other firms were substituted in order to meet the ECAL I condition of "bring to point of sale 50 percent of agreed PE assets".[6] This allowed the two large cement companies to be sold for US$430 million, exceeding the total privatization receipts of US$400 million since 1987. The sale was made under internationally competitive conditions and the results were published in the local newspapers. The sales of these two companies were the first large-scale privatizations in Tunisia and more than compensated for the smaller firms removed from the initial list.

2.26 The process of privatization continued under ECALs II and III. Under ECAL II the settlement of non-performing bank loans to public and semi-public enterprises amounted to TD321 million (US$255 million) and involved 20 enterprises. Three of these enterprises were liquidated and the rest restructured. A 2001 Bank report concluded that government did not have the resources to monitor privatized enterprises activities[7], an issue which will become critical when concessions in the infrastructure

[6] More information is needed on the relative importance of the privatized enterprises in terms of their size in the PE sector and their contribution to employment to assess the overall impact of the program.
[7] Monitoring could include regulatory systems and commissions.

sector are awarded. The EU was supporting a program to strengthen the Directorate General of Privatization.

2.27 ECAL III targeted the liberalization of the telecom sector. Important reforms were implemented and a comprehensive timetable to accelerate and deepen liberalization was submitted to the Bank. The sector has been opened up to private participation and prices have been reduced by some 10 percent, while the number of customers grew by 242 percent between 2002 and 2003. Nevertheless, the Borrower was unable to document the transparency and competitiveness of the process for issuing the second GSM license and, as a result, the associated floating tranche was not disbursed (see paragraph 3.12 for more details).

The Financial Sector

2.28 ECAL II was narrowly targeted on the financial sector and in particular the banks. Reforms in the financial sector started in 1987 and deepened over time (1991 EFRSL and 1996-2001 ECALs). Liberalization measures included eliminating the prior authorization of the Central Bank for making banking loans, most controls on interest rates, and commercial banks obligation to finance the budget. Between l991 and 1993 prudential regulations were revised and Central Bank inspection was reinforced. In l994 the new Banking Law amended the conditions and qualifications for the ownership and operation of banks. These measures strengthened the portfolios of banks although the financial markets remained dominated by public institutions.

2.29 ECAL II aimed at upgrading the performance of the financial sector, following the l995 EUAA. Specific polices were as follows: (a) increasing the financial soundness of the banking system through a large settlement of non-performing loans to public and semi-public enterprises, (b) improving the quality of loan collateral foreclosure procedures, (c) privatizing banks and consolidating the sector, (d) modernizing the banking law and upgrading prudential regulations, (e) promoting indirect monetary control through a reform of the securities market, and (f) enhancing the regulatory framework on non-bank financial intermediation by mutual funds, securities firms, and insurance companies. A specific provision called for settling 321 million TD of non performing bank loans to 24 public and semi-public enterprises, of which 4 remain public.

2.30 Progress was made in privatizing and restructuring public financial institutions. An insurance company (*Tunisian Lloyds*) was privatized in conjunction with ECAL II and another large insurance company (*ElIttihad*) was restructured in conjunction with ECAL III. The *Union International des Banque* (UIB) privatization has been completed after the original merger with *Banque de Tunisie et des Emirates d'Investissement* (BTEI) failed, as the foreign sovereign country that co-owned this institution did not accept the merger conditions. The Bank accepted the subsequent privatization as substantially meeting the second tranche condition of ECAL II, as Government could not control the outcome of the merger. In September 2002, the French bank *Société Générale* bought for US$72 million the Government's 52 percent stake in UIB. Shares in the *Banque du Sud* have been offered for sale as of December 7, 2003, and the privatizing process is proceeding at a pace that is slower than originally envisaged. However, the outcome of the bidding process was unsatisfactory. By 2002, assets in private banks were 55 percent of total bank assets, falling below the 2000 CAS and ECAL II target of 60 percent. Eleven private leasing companies are now operating in the country and their share of financing private investment has risen from 8 percent in 1996 to 12 percent. The authorities noted that when these private leasing companies are combined with the private banks, the share of assets of all private credit institutions out of the total is about 62 percent, exceeding the target.

2.31 At present, four commercial banks remain in the public domain (with combined assets that represent 45 percent of the entire banking system) to serve "strategic" sectors (i.e., agriculture, housing, tourism and micro-credit). The quality of their portfolios was greatly improved by moving bad loans to recovery companies. The bad loan ratio fell from 54.6 percent in 2000 to 26.3 percent in 2002. The 4-year drought in agriculture led to a cessation of payments by many borrowers in this sector leading to the Government support of the BNA (National Agricultural Bank) through a guaranteed rescheduling of its credits.

2.32 The reforms under ECAL II substantially improved financial sector performance, meeting the monitoring indicators under ECAL II. The overall soundness of the banking system improved significantly, in accordance with a number of prudential ratios. Banks became more sound and their capital adequacy ratios improved; non-performing loans to public enterprise decreased, though they remained high; and returns on equity increased, indicating an increase in the efficiency of financial intermediation. For example, the average capital adequacy of the commercial banks increased from 6.3 percent in 1997 to 13.3 percent in 2000. Although the capital adequacy ratio declined to an estimated 9.8 percent in 2002, it was higher than the ECAL II target of 8 percent (annex C, table 5). Bank return on equity rose from nearly 12 percent in 1997 to 14 percent in 2001. The activity of non-bank financial intermediaries also increased. The volume of public issues on the stock market quadrupled as a proportion of national savings, from 10.6 percent in 1997 to 45.1 percent in 2001, and the volume of new leases by leasing companies almost doubled during the same period.

2.33 *Non-performing loans*. Conditions regarding the settlement of public and semi-public enterprise NPLs were substantially met. These loans were settled in a variety of ways. A few viable enterprises were offered Government guarantees. Enterprises were privatized and debt of liquidated firms was assumed by Government with 25 year payback periods to the banks at no interest. However, the outcome regarding public enterprise NPLs is not considered fully satisfactory in view of the high level of NPLs and the significant long-term cost to the banking sector (see annex C, table 4 for the setups and distribution of non performing loans). Although NPLs fell from about 36 percent in 1993 to about 19 percent in 2001, they remained high.[8] Classified or past due assets fell from 30 percent of bank's total assets in 1997 to under 26 percent between 1997 and 1999 and bank returns on equity rose slightly. By 2002 the Central Bank reported classified bank assets at 20.9 percent and 12.9 percent after provisioning (annex C, table 5). Banks' provisions cover only some 44 percent of non-performing loans, which

[8] They are believed to have increased to 20.9 percent in 2002 and 23.9 percent in 2003 due to difficult economic conditions, particularly in the tourism sector.

reflects their heavy dependence on real estate collateral, the value of which can be deducted from provision requirements. This collateral currently reflects rising real estate values but in the event of a real estate crisis the banks would be severely under provisioned. Further, the legal process for foreclosure is long and difficult, thus, making the case for effective judicial reform. The public enterprise NPLs were consolidated at 25 years at no interest but with a government guarantee. This solution provides the banks with an annual flow of funds, but does little for their profitability.

2.34 The tourism sector banks have provisioned for less than half of their NPLs, and they carry a significant risk in the form of financing for an overbuilt tourism hotel sector. Banks that finance services including tourism accounted in 2002 for TD 2.4 billion out of a total of TD 4.6 billion classified loans (annex C, table 4). Two other development banks, the BNA and the housing bank, may not be privatized as they are considered socially highly important and the Government feels there is adequate competition since private banks are not prevented from operating in these sectors. Settlement of NPLs was achieved partly through Government guarantees of principal repayments over 25 years of impaired loans of public enterprises deemed viable, and the debts of the others were transferred to the Government. The Government began addressing the NPLs root causes within the public enterprise sector, liquidating three enterprises, restructuring seven, and privatizing ten.

2.35 *Financial sector legislation and regulatory reform*. A revised banking law was presented to the Chamber of Deputies, which would increase accountability of directors, allow banks to create financial service subsidiaries, strengthen control on bank transactions, and introduce parameters for Central Bank corrective actions for banks in distress. An amended Civic and Commercial Procedures Code to facilitate the judicial process for recovering bank loans and credit took longer than planned but was finally approved by the Chamber of Deputies after the release of the second tranche of ECAL II. The Bank accepted the approval by the *Conseil Ministériel Restreint* as an irreversible step to ensure that the draft would be present to the Chamber of Deputies. In conjunction with ECAL III, these amendments were reinforced to facilitate loan recovery and real estate foreclosures. An amendment to the public enterprise law was presented to the Chamber of Deputies to require more than 50 percent instead of 34 percent Government ownership to be defined as a public enterprise (before the effectiveness of ECAL III). The purpose was to revise government administrative control of public sector banks in order to increase management and fiduciary responsibilities of public sector banks Boards of Directors.

2.36 *Reform of Government Securities Market*. The Central Bank law was amended to promote market-based Central Bank intervention. Non-bank intermediation increased with the volume of public stock market issues quadrupling between 1997 and 2001. ECAL III floating tranche (EU44.5 million) concerning strengthening of the financial sector was released at the end of September 2003. ECAL III conditions, which were met, included a dual board management structure for the STB and BNA banks and the submission of a draft amendment to the Code of Civil and Commercial Procedures, relating to loan recoveries (*Code des Procedures Civiles et Commereciales*) to the Chamber of Deputies.

2.37 The Government has completed and incorporated Bank comments on a series of studies aimed at assessing the impact of reforms under the first tranche of ECAL III on collateral recovery. The studies contain detailed baseline date on non-performing loans of the banking sector including their age and realization of real estate collateral. While the NPLs problem persists for the financial sector, no new regulatory measures to accelerate loan recovery are recommended for the time being pending the assessment of provisions of the *Code des Procedures Civiles et Commereciales*.

2.38 *Insurance company solvency*. The insurance industry suffered from basic structural weaknesses with chronic deficits in compulsory lines of automobile and group insurance and the continuing operation of capital-deficient companies. Automobile insurance accounted for 39 percent of total premiums; and health insurance 21 percent in 1996. ECAL III had conditionality on restructuring, privatization, supervision, opening the market, introducing prudential norms, raising auto premiums and promoting life insurance.

2.39 A restructuring plan was prepared that contains an action plan to ensure the viability of the automobile sub sector. Insurance supervision has been substantially improved by CGA (*Comite Generale des Assurances*) with AfDB's help. The authorities pointed out that they were ten years behind in this sector because the Bank had removed insurance reform from its earlier structural adjustment program. The Tunisian Lloyd Company was restructured and a decision taken to privatize it. At least 30 percent of the capital had to be floated on the Tunisian stock market.

2.40 Under the ECAL III floating tranche, the CGA has been significantly improved. It can now track the weaknesses of undercapitalized companies and negotiate restructuring plans. In auto insurance, premiums have been raised by 3 percent following an earlier 8 percent rise, which helped to eliminate the deficit of this branch in a manner satisfactory to the Bank. A new legal framework satisfactory to the Bank has been presented to the Chamber of Deputies, which complies with international best practice and standards. The restructuring plan of *El Ittihad* has been completed and an implementation plan to set up a new fully capitalized mutual company (*l' Assurance Mutuelle Ittiahad*) has been established. The restructuring plans of three insurance companies have been adopted in order to meet Insurance Code solvency constraints.

Summary of Progress Achieved

2.41 In conclusion, significant reforms have been implemented in conjunction with ECAL I-III, and most of the conditions have been met (see annex C, table 8 and the following section for more details). A successful stabilization program and economic growth were maintained. The Government of Tunisia's adjustment program supported by the Bank, successfully promoted policy reforms in trade, financial, and private sectors. This compares favorably to other Arab countries (Box 2.1). Tariffs were reduced and the economy is now more open to the outside world. Financial sector reform, in particular, has proceeded quite well. The soundness of the banking system has improved and its regulatory environment has been tightened considerably. The role of the private sector in finance has been on the rise, with some public banks and insurance companies recently privatized. Privatization of public enterprises also took place. Progress was made on enhancing the enabling environment for private sector development. However, because of the time needed for the privatization of SNDP, a major petroleum distribution company, a waiver was requested before the private sector development floating tranche of ECAL III was disbursed. Accordingly, a request was submitted to postpone the June 2003 closing date for the operation until the end of 2003. In view of the substantial progress made, the Bank granted the extension. Although the Government issued the GSM license and prices have been reduced, the Bank decided to allow the associated floating tranche to lapse. Basically, the Bank maintained that it had not received adequate information to verify Government's position on the process of granting the license.

Box 2.1: Tunisia's Comparative Competitiveness in the Arab World

The Arab World Competitiveness Report (2002-3) assessed the region's ability to achieve sustained economic growth over the medium to long term. This ability is severely impeded by a wide range of structural factors that explain the region's performance relative to others over the last few decades relative to other regions. The trend in the last ten years shows a decline in real incomes per capita in most Arab states. Between 1975 and 1999 economic growth averaged 3.5 percent per year, which was basically the world average. Due to high population growth rates, per capita incomes in the Arab region under performed all other regions. Some 15 percent of the region's labor force was unemployed. Tunisia achieved growth rates of close to 4 percent per year in the 1978-88 period, and 4.8 percent in 1988-98. Since then growth has been of the order of 5 to 6 percent per year.

Necessary conditions for eliminating structural impediments to moving to a steeper growth trajectory according to a UNDP Report would require removing the deficits in human rights, the empowerment of women and the consolidation of the acquisition and use of knowledge. The Competitiveness Report also cites the central role of knowledge, innovation and technology in competitiveness and growth. The Arab world suffers not only from low enrollments in schools but mainly from the low quality of education, which is unconnected to the needs of productive firms. Stress is placed on macro policy, the business environment, a liberal trade regime, functioning financial markets, adequate infrastructure and an appropriate foreign exchange regime. The Report also distinguished between the necessary conditions for growth and development and the true engines of development. Too much emphasis in the Arab world was placed on a one dimensional growth strategy making it far too reliant on capital accumulation. High investment in the region has not been accompanied by high growth. The quality of such investment has been low, which is a reflection of inadequate and inefficient private investment.

Tunisia has been one of the few exceptions. An analysis of total factor productivity between 1975 and 2000, which measures the impact of investment efficiency versus capital and labor in explaining growth, shows that Tunisia had close to a 20 percent rise in efficiency of investment versus negative rates in the rest of the Arab world, excluding Egypt, whose performance was half that of Tunisia. Tunisia's performance was ascribed to its restructuring of the economy away from a parastatal model to one based on private enterprise, the EUAA with the EU, and the removal of structural impediments. It not only maintained political stability but pursued an equality program for women and universal education amongst other supporting factors.

3. Performance Ratings[9]

Outcome

3.1 The outcomes of the three ECALs are rated *satisfactory*, in agreement with the ICR and OED's ICR review for ECAL I, II and III (see annex A and annex C, table 8 for details of the ratings for each project). The key indicators of GDP growth and exports largely met or exceeded targets and showed that the challenge of adapting Tunisian industry to the severe competitive conditions of the association agreement with the EU was being met. Of course, the real test will come in 2008 when the EUAA comes fully in force. In 2002 external shocks in the form of the EU slowdown, the terrorist threat, and the continued drought in agriculture combined to reduce the GDP growth rate to 1.7 percent. The economy reacted robustly in 2003 and resumed the targeted growth path. Fiscal policy was adjusted to compensate for revenue losses due to tariff reductions. The real exchange rate was in equilibrium and even depreciated during the implementation of the three ECALs, and provided the basis for ensuring competitive relative prices for Tunisian export and import substitutes. Under ECAL I there were delays in implementing maritime reforms and improvement in the business environment leading to two technical waivers and one partial waiver. These shortfalls were made up in the subsequent ECALs. Privatization of enterprises and banks was successfully carried out. The rapid and sustainable economic growth made possible a remarkable improvement in economic and social well-being indicators, and a decline in the poverty rate from 8 percent in 1995 to 4 percent in 2000.

3.2 The Bank made an important contribution to the formulation and implementation of the Government program[10] through its extensive and in depth economic and sector work which laid the foundation of the three ECALs. In addition the ECAL programs were prepared in collaboration with the European Union and the African Development Bank who supported the Government's program on the basis of a common action matrix. Finally, the macroeconomic framework and performance indicators for the program were defined in close collaboration with the International Monetary Fund (IMF).

3.3 Tunisia successfully implemented Bank supported stabilization and structural reforms, leading to macro stability and economic growth. GDP grew by 5.2 percent per year on average during 1997-2001, compared with 4 percent during 1987-96. Indicators of social and economic well-being have improved significantly. Liberalization resulted in productivity growth and diversification. Exports were the engine of growth, rising by 8 percent annually in real terms. Manufacturing growth was robust: the mechanical industries grew by 14 percent and textiles by 12 percent in 2001. Domestic demand was outpacing GDP growth leading to pressure on the balance of payments and foreign exchange reserves as imports rose by 14 percent reflecting tariff reductions and investment growth fueled by private credit expansion.

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[9] Details on the ratings of each project are presented in annex A and annex C, table 8 provides a list of ECALs' objectives and outcomes.

[10] Analytical work included a 1994 Private Sector Assessment, 1995 CEM and a 1996 report 'Global Integration and Sustainable Development: Strategic Choices for 21st Century'.

3.4 Fiscal policy contributed little to demand compression as the budget deficit at 3.5 percent of GDP was close to the target for 2001. Higher tax revenues were offset by expenditures particularly for the counterpart of foreign financed projects. The Central Bank tightened monetary conditions in 2001 by cutting refinancing to the banks. However, significant repayment of government debt permitted a large expansion of private credit to take place.

3.5 The Central Bank discontinued its policy of financing the liquidity needs of the commercial banks, thus encouraging them to use the inter-bank money market. The Central Bank targets credit growth with a predetermined exchange rate in which fluctuations in base money reflects balance of payments flows. Credit expansion and contraction are managed to offset the liquidity effects of foreign exchange flows. Due to the policy of maintaining a constant real effective exchange rate with fiscal consolidation, Tunisia has enjoyed balance of payments sustainability, monetary stability and low inflation. This policy supported by capital controls has prevented a significant real appreciation of the exchange rate vis-a-vis trading partners.

3.6 Inflation was kept under control as the CPI index dropped by 1.9 percent in 2001, lower than projected in ECAL III, due to higher imports financed with credit expansion, the fact that administered prices, which were not raised, represented 33 percent of the CPI, and the reduction in tariffs made imports cheaper.

3.7 The flexible exchange rate policy led to an average REER (index with 1990 at 100) depreciation by 0.6 percent in 2000 and by 2.5 percent in 2001 and 3.5 percent in the following year. The dinar fell relative to the dollar due to the weakness of the Euro. The reversal in the value of the Euro this year will also likely lead to some appreciation in the REER. A sign of the solidity of Tunisia's macro policies and efforts to restore competitiveness is the access Tunisia has enjoyed in capital markets where the ratings of its bonds has risen. The IMF estimates that the actual exchange rate of the dinar followed closely the equilibrium exchange rate. Unit labor costs moved in a relatively favorable direction compared with competitors and foreign markets. The relative profit indicator calculated by the IMF reflected the lower share of labor costs in value added, indicating a gain in competitiveness (IMF data). Labor productivity in manufacturing grew by 2.2 percent in the late l990s. The relative price of non-traded to traded goods has decreased and Tunisia increased its market share in the EU.

3.8 The extraordinary confluence of external and internal shocks led to the reported declines in the real economy in 2002 but did not interrupt the pace of reforms nor lead to public finance or balance of payments difficulties. One senior economic official said there should have been an absolute decline in real output. The return of agricultural output and the recovery of demand in Europe augur well the resumption of Tunisia's growth to a rate in excess of 5.5 percent according to the Governor of the Central Bank. Tunisian policymakers are aware of the vulnerabilities of an increasingly open economy. The ending of the multi-fiber agreement in 2005 poses an important challenge for the textile and clothing industry, which accounts for 60 percent of exports. Yet there is a good prospect that the textile and clothing industry will adjust as evidenced by the plans to set up factories by French and German entrepreneurs to make high quality clothing with which the Asian do not compete. On the other hand, the Tunisian Association of Enterprises complained about Asian dumping of blue jeans, for which they see no solution.

Sustainability

3.9 The sustainability of substantial parts of the reforms covered by the three ECALs ranges from likely to highly likely. The progress achieved in attaining and maintaining macroeconomic stability is highly likely to be sustained as there is a broad political consensus that realizes the benefits of economic stability. As Tunisia has joined WTO and signed an association agreement with the EU, trade and investment policy reforms are unlikely to be reversed. Financial sector reforms have also taken root and the privatization program has speeded up. The Government is still heavily involved in energy, water, and telecommunication. It nevertheless is pursuing a policy of gradually withdrawing when the private sector has demonstrated a capacity to take over. In strategic enterprises the Government plans to award concessions and will invite private firms to operate in a sector where one firm will remain in Government hands. The reform of the financial sector was largely carried out with regard to NPLs in public and semi-public enterprises. NPLs however, remain a problem in the public banks. ECAL III added to the sustainability of the competitiveness program by further improvements in the investment climate and reinforcement of the banking regulatory framework. The management and finances of the insurance company were put on a sound footing. Overall, sustainability of the achievements under ECALs is rated *likely*.

Institutional Development Impact

3.10 The institutional development impact of the three ECALs was *modest*. Achievements included a new tax and subsidy structure, a reformed financial system regulatory framework and structural reforms in the securities and insurance sub-sectors. On the other hand, there has been poor enforcement of regulations concerning loan recovery, and although a law that created severance scheme for laying off workers has been passed, enterprises continue to face obstacles and very complex procedures if they want to dismiss workers for economic reasons (see paragraph 2.21). For example, forceful implementations of the banking regulations, including the improved governance structure of the state-owned banks and the new risk diversification requirements, would contribute to reduce the stock of non-performing loans. However, in addition to dealing with the stock of non-performing loans, it is even more important to deal with preventing new non-performing loans by addressing the root causes within the public enterprise sector.

Bank Performance

3.11 Bank performance was *satisfactory* in the ECALs. There were supervision delays[11] in ECAL II, but in general the Bank performed well in maintaining a much appreciated active dialogue and program of forward looking studies. Unavoidable delays in implementation in some aspects of the reform (such as the privatization program) were incurred and the Bank staff showed flexibility in accepting an alternative, which was

[11] For example, a planned supervision mission was cancelled due to travel restrictions following the September 11, 2001 event.

subsequently implemented. The Bank could have been more insistent that discrimination against non-EU trade should have been dealt with more effectively in parallel with the implementation of EUAA. Close coordination was maintained with development partners. Staff of the EU delegation in Tunis feel that the cooperation with the Bank has been very good, especially during ECALs' preparations and appraisals. AfDB staff working on the ECALs commended the excellent working relationship with the Bank.

Borrower Performance

3.12 Borrower performance was *satisfactory* as it worked out bold reforms in a number of sectors with skill, and based on prior experience, while maintaining a political consensus. It resolved a complex problem of a bank merger in a manner consistent with the objectives of the reform program. Telecommunications liberalization has been achieved, the GSM (wireless telecommunications) license has been issued, and outcomes include the introduction of competition in the wireless component of the telecommunications sector, leading to greater access to mobile telephone, better services and lower prices. However, the telecom tranche of ECAL III was not disbursed because the Bank did not receive the documentation required to demonstrate that the GSM license was tendered following a transparent and competitive process.

4. Agenda for Future Reform and Lessons

Agenda for Future Reform

4.1 Structural reforms, which are critical for the longer run competitiveness and growth of the economy, contributed importantly in the financial and insurance sectors and the telecom privatizations. However, banking system reform is not yet complete as problems remain with non-performing loans, and state ownership of banks need to be reduced and the obstacles to foreign ownership removed. Although two insurance companies have been privatized, the largest one, with a 34 percent share of the entire market is likely to remain in the public sector for some time. The enforcement of judgments is likely to play a major role in establishing confidence in the system.

4.2 Rigidities remain in the economy, which will inhibit the maintenance of an equilibrium exchange rate over time. The wage bill of government at 12 percent of GDP is still heavy. New recruits are of higher caliber but more needs to be done to improve the efficiency of the public service. After initially mentioning civil service reform, the later ECALs have not incorporated it in their programs. Price liberalization remains a high priority as the extent of controls are inconsistent with a liberalized economy based on export led growth. In 2002, average (unweighted) Tunisian MFN tariffs were 34.5 percent, marginally down from 35.9 percent in 2001 and the gap applied to imports from the EU and the rest of the world has widened. The Bank should continue to support Tunisia's efforts to implement the EUAA and pursue trade openness beyond the EU. Progress should also be made in trade in services, competition rules, and treatment of state monopolies engaged in commercial activities.

4.3 As domestic savings are unlikely to be able to finance the requirements of higher investment, capital market liberalization is the next likely reform initiative. This will require opening up the economy to international investors and direct investment capital flows. The higher volatility that such capital movements can create will call for even more sophisticated monetary and exchange rate policies. The acceleration of structural reforms as advocated by ECAL III will send a strong signal to investors as it will improve the investment climate and reduce costs so that Tunisia will retain its competitive edge.

4.4 The private sector is a key factor in sustaining competitiveness and thereby the maintenance of high growth rates with significant impacts on unemployment. Tunisia's private investment has increased as a share of both total investment and GDP, rising from 46 percent (12 percent of GDP) in 1995 to 53 percent (13.5 percent of GDP) in 2002, but does not compare favorably with other high growth countries (Chile, Korea, Malaysia, Mauritius, and Thailand). The private investment ratio to GDP in these countries was about 25 percent. Further increasing the share of private investment in the Tunisian economy will require accelerating trade liberalization and privatization efforts and improving the overall policy environment and incentive framework. In the future the Bank should continue to support Tunisia's efforts to improve the regulatory climate for private enterprises, to strengthen the court system to enforce business laws and regulations (related to NPLs in particular), and to continue progress on enterprise and financial sector privatizations.[12]

4.5 Despite high growth of GDP and exports, unemployment remains high, particularly among the youth. With the persistence of high unemployment the competitiveness program needs to be assessed with a view to developing complementary programs that would facilitate the shift of labor to the modernizing sectors and provide the youth with the assets to participate in growth.

Lessons Learned

4.6 The main lesson are:

- Tunisia's successful economic performance has been due to three attributes: ownership and broad political consensus, a well-developed human resource base, and a stable macroeconomic environment.

- Experience in privatization and the financial sector shows the need for the Bank and the development partners to stay the course and show flexibility in their support, provided there is evidence of genuine and sustained reform efforts. For example, by accepting partial reforms in some areas, and

[12] The prior authorizations of investment are numerous and inhibit startups. Inefficient operations and the lack of competition and the dockers' monopoly are amongst the issues cited in the Bank's 2000 Private Sector Assessment Update. Since then, under ECAL III, 60 percent of all prior authorization for start-ups were removed. Customs documentation has been simplified but the ports still constitute a major bottleneck, leading to high costs and delays. Goods until recently spent up to 18 days in storage in port because traders used it as a substitute for inland storage. Recent reforms are reported to have greatly reduced clearance times for goods to 4 days.

building on partial successes to deepen them in subsequent operations, the support from the Bank and other partners was ultimately effective. Patience, perseverance and flexibility paid off.

- An important lesson for other small emerging countries seeking to lay the foundations for sustainable growth and poverty reduction is the success of Tunisia in creating a competitive economy by the coordinated use of macro and structural policies and reforms.

Economic Competitiveness Adjustment Loans

Economic Competitiveness Adjustment Loan I (ECAL I L-4069)

Objectives

1. The main objective of the first Economic Competitive Adjustment Loan (ECAL I) was to improve international competitiveness of the Tunisian economy following the signing of the EUAA with the EU, with the aim of achieving a sustainable increase in the economic growth rate. The focus was to be on key areas suitable for immediate policy actions and to leave other issues for the subsequent competitiveness operations. Specific policy measures in the first program concern: (a) a sound macroeconomic and fiscal framework, including measures to replace revenues lost from the expected cut in tariffs and tariff surcharges, (b) the acceleration of the implementation of EUAA, (c) the acceleration of the privatization program in competitive sectors, (d) the improvement in the regulatory and administrative environment in which enterprises work (i.e., actions to reduce transport costs, facilitate the passage of goods through ports and customs and to improve the legislative framework), and (e) greater flexibility in the labor market, while protecting dismissed workers and containing labor costs.

2. ECAL I-III were successive policy loans with the same objective: to enhance the country's competitiveness and increase economic growth. The ECALs' objectives conformed to Tunisia's development goals and the Bank's country assistance strategy. The 1996 country assistance strategy argued for a Bank program in Tunisia over the coming few years that would support the country's effort to promote economic integration within the world economy, and particularly that of the EU, while maintaining social and environmental sustainability.

Outcome

3. The outcome of the first ECAL was *satisfactory*, as the first three of the above objectives fared well and are assigned heavier weight, while some progress was made in the last two. At the macro level, developments were to be monitored concerning GDP growth, gross domestic investment, the external accounts and real export growth. The growth targets were met. In l996 after two years of decline a growth rate of 7 percent was recorded supported by a 29 percent rise in agricultural output based on abundant rainfall. Aggregate real growth was on target in l997 and 1998 at 5.4 percent and 5.0 percent, respectively, supported by rising investment. Exports grew rapidly in 1997 leading to a rise in reserves, which also reflected Tunisia's ability to raise funds on the international market.

4. The fiscal deficit exceeded the program target although there was improvement in l997 over l996. The drop in revenues during the first year of EUAA, rigidities in the wage bill and lower than expected impact of compensating tax measures were responsible. The value added tax (VAT) was increased to compensate for lost tariff revenues, but additional expenditure cuts were also required. Other compensatory measures included increasing the prices of administered food products and making transparent public subsidies to the agencies commercializing oil and cereals. The

inflation rate was on target in l996 but rose to 4.5 percent in l997, above the programmed 3.7 percent and higher than amongst European partners. Government implemented new expenditure restraint measures.

5. The phased introduction of EUAA was accelerated roughly two and a half years prior to its ratification in the EU. Tunisian firms benefited from less costly access to intermediate goods, and a larger market for their goods. As noted above (Competitiveness Phase II) ECAL I accelerated EUAA implementation by permitting tariff reductions to be included in the l996 budget thereby supporting ratification.

6. Prior to l998 privatization had proceeded slowly. In that year there was a great leap forward. Foreign direct investment rose. Problems were encountered in adhering to the list of enterprises to be privatized due to political and strategic reasons. Government substituted other enterprises in order to meet the target of bringing to point of sale at least 51 percent of the capital of a number of enterprises. This allowed the two large cement companies to be sold under internationally transparent conditions, which caused the program to exceed target.

7. The improved regulatory framework led to reforms in maritime transport, which were aimed at cutting costs and increasing the speed of shipping. Government abolished privileges to Tunisian charterers but was slow to adopt other maritime reform legislation and to promote competition in dock labor working conditions. A technical waiver was granted as draft law was presented to the Chamber but not yet approved at the time of the release of the second tranche. The second tranche release was delayed by six months. When the tranche was released the implementation completion report noted that the deregulation of dock labor, the adoption of a new company code and the restructuring of STAM (port) were lagging. In short, there were two technical waivers and one partial waiver. These technical waivers recognized the substantial progress made in other program areas.

8. Some progress was made in introducing increased labor flexibility with the draft law submitted to the Chamber of Deputies creating a limited severance scheme for laid off workers. Measures were also taken to deduct the burden of social security contributions for non-agricultural private employers.

9. In summary, the overall ECAL I program outcome was rated satisfactory. The macroeconomic monitoring indicators were met, and stabilization maintained. The recently signed EUAA was being implemented rapidly, faster than had been anticipated. Two large cement plants were privatized in 1997 and 1998 for US$430 million, exceeding the total privatization receipts of US$400 million between 1987 and 1996. As for enhancing the enabling environment, a number of agreed actions were taken, including the submission of a draft law to the Chamber of Deputies to create a limited severance scheme to cover separation packages to workers laid-off for economic reasons. This law has since been passed, although the dismissal of workers for economic reasons remains heavily regulated. Since then, a 2004 report by the Bank, entitled, *Employment Strategy*, provided an in-depth analysis of the employment and labor market situation and made a number of recommendations for improvement. These have been discussed with Tunisian authorities.

Sustainability

10. The sustainability of key program components such as trade liberalization and privatization is highly likely and is reflected in the movement of factors of production toward the export sectors. Reforms outside the program cited by the implementation completion report were the intention of Government to reform the civil service with the objective of cutting the public sector wage bill and enabling the public sector to better support private sector competitiveness. Government has sustained macro stability and is likely to continue to do so. Overall sustainability is rated *likely*.

11. However, there are fiscal stability risks associated with the wage bill and contingent liabilities of enterprises and banks, which could adversely affect their competitiveness in Europe. It should be noted that ECAL II addressed the reform of the financial sector (see below). Structural problems also exist because of the inability of the private sector to absorb new university graduates making Government the employer of first resort.

12. External factors can also impact sustainability such as the possibility of a slowdown in Europe, which absorbs the bulk of Tunisia's exports. Uncompetitive public enterprises and private enterprises, which are only able to survive in the protected domestic market, also increase the vulnerability of the economy and thereby the sustainability of growth. However, the progress achieved in attaining and maintaining macroeconomic stability is likely to be sustained. A broad political consensus has evolved that realizes the benefits and understands the importance of economic stability. Similarly, the structural reforms that have been accomplished have been based on a consensus among the key actors in the economy and are likely to be sustained. Sustainability is rated *likely*.

Institutional Development Impact

13. The project demonstrated the capacity of Government to make efficient and sustainable use of human and financial resources in support of policies and actions to promote competition. The policies and measures to promote institutional development were commendable. Specific features are discussed below.

14. Implementing a new tax structure and reduction in consumer subsidies to replace lost revenues due to tariff disarmament ECAL I merits a substantial rating.

15. Accelerating steps to implement the EUAA ECAL I exceeded targets and warrants a high rating.

16. With respect to the privatization program progress was slow. Nevertheless, two major divestitures took place showing both resolve and flexibility on behalf of the authorities. A rating of modest seems appropriate.

17. In the maritime sector some important measures were adopted but the objective of substantially cutting costs and promoting dockworker competition was below expectations. The rating for this component is negligible. The overall rating of Institutional Development impact is *modest*.

Bank Performance

18. The Bank maintained an active dialogue with the authorities during program design and implementation. Bank flexibility was shown when it agreed to postpone financial sector reform, initially envisaged in ECAL I as a component, a change which led to cutting the loan amount by half. The conditionality was both detailed and substantive and the indicators provided an appropriate standard to judge progress.

19. Timing proved to be problem as some component timetables were tight. The Bank accommodated Tunisia's gradual and cautious implementation of reforms while encouraging fast and vigorous reforms where appropriate. In this respect large-scale privatization was successfully undertaken for the first time in Tunisia. The Bank also persuaded the authorities to make more transparent the privatization program, which was critical to maintaining public acceptance. Coordination took place with the EU, which provided parallel financing, and the Bank worked closely with the IMF on the design and monitoring of the macro framework. The performance of the Bank is rated as *satisfactory*.

Borrower Performance

20. Tunisian officials assumed full ownership of the program and were actively involved in its design. They managed the process of obtaining political consensus for the program including getting legislation through the Chamber of Deputies. The delays involved were offset by the wide acceptance the program has enjoyed. In some areas of macro management and privatization actions exceeded program targets. There was a positive response to Bank requests for improved dissemination of information on privatization. Borrower performance was *satisfactory*.

Second Economic Competitiveness Adjustment Loan (ECAL II, L-4461)

Objectives

21. The operation was designed to support a program of reforms in the financial sector, building on the intimate knowledge of that sector developed in the context of the FY94 Private Investment Credit Project, and in line with the assistance strategy outlined in 1996. Besides maintaining an adequate macro-economic setting, specific policy goals included: (a) increasing the financial soundness of the banking system through a large settlement of non-performing loans to public and semi-public enterprises, (b) improving the quality of loan collateral and foreclosure procedures, (c) privatizing banks and consolidating the sector, (d) modernizing the banking law; and upgrading prudential regulations, (e) improving the payments system, (f) promoting indirect monetary control through a reform of the securities market, and (g) enhancing the regulatory framework on non-bank financial intermediation by mutual funds, securities firms and insurance companies. The loan was in two equal tranches with parallel financing from the EU and AfDB.

Outcome

22. The overall outcome of ECAL II was *satisfactory*. At the macro level the same monitoring criteria were retained as in ECAL I. In 1999 growth of between 5 percent and 6 percent was targeted and 6.1 percent was achieved. The rise in per capita incomes created a strong middle class, who, coupled with expanded social programs, insulated the economy from adverse social and political development in the region. The challenge to competitiveness was seen as increasing due to the slowdown in European growth. The macro framework was considered satisfactory with respect to GDP growth, the current account deficit and reserves, and with inflation on target. Real exports rose by the targeted 5.1 percent but manufactured exports rose by only 5.7 percent compared with the 11.0 percent targeted in part due to slower European growth.

23. Due in part to Government granted wage increases for l999-2002, the Government's actual budget deficit was 3.5 percent at the end of l999 versus the target of 3.4 percent.

24. *Non-performing loans (NPLs)*. Conditions regarding the settlement of public and semi-public enterprise non-performing loans were substantially met. These loans were settled in a variety of ways. A few viable enterprises were offered Government guarantees. One enterprise was privatized and the debt of 24 liquidated firms was assumed by Government with 25 year payback periods to the banks at no interest.

25. However, despite a significant decrease in their volume in recent years, NPLs still represent a significant proportion of the overall portfolio of the commercial banking system, reaching 21 percent in 2002 (see annex C, table 5). The ECAL II called for substantial settlement of NPLs (TD 279 million or US$190 million by Board presentation and another TD 400 million by second tranche), which did take place.

26. *Bank privatization and the merger of development banks*. Bank privatization was not achieved under ECAL I. BTEI's other sovereign owner backed out of the merger with UIB. The Government informed the Bank that it was impossible to comply with the loan's condition. Government decided to privatize its share in UIB as a condition of ECAL III, which did take place. Two development banks BDET and BNDT were merged with STB in December 2000 leading to high NPLs. Provisioning is adequate in the banks lending to the service sector, but the real estate collateral they hold is overvalued and will be difficult to realize.

Tunisia-Financial Performance Indicators in ECAL II (%)

	1997	*1998*	*1999*	*2000*	*2001*	*2002*
NPL Net of Provisioning/ Total Loans	18.4	14.3	14.2	13.3	12	12.9
ECAL II Target		23	18	14		
Aggregate Capital Adequacy ratio actual	6.3	11.7	11.6	13.3	10.6	10.1
ECAL II target		6.7	7.5	8		

Source: Bank data.

27. *Financial sector legislation and regulatory reform*. A revised banking law was presented to the Chamber of Deputies that would increase accountability of directors, allow banks to create financial service subsidiaries, strengthen control on bank transactions, and introduce parameters for BCT (Central Bank) corrective actions for banks in distress. An amended Civil and Commercial Procedures Code to facilitate the

judicial process for recovering bank loans and credits was submitted to the Chamber of Deputies. Under ECAL III these amendments were undertaken to facilitate loan recovery and real estate foreclosures. An amendment to the public enterprise law was presented to the Chamber of Deputies to require more than 50 percent instead of 34 percent Government ownership to be defined as a public enterprise, which reduces the number of banks defined as public.

28. *Reform of Government securities market*. The Central Bank law was amended to promote market based Central Bank intervention. Non-bank intermediation increased with the volume of public stock market issues quadrupling between 1997 and 2001 in conjunction with ECAL II. ECAL II required licensing primary dealers by Board presentation and marketing new issues by second tranche.

29. *Insurance sector.* The Tunisian Lloyd Company was restructured and a decision taken to privatize it. At least 30 percent of the capital had to be floated on the Tunisian stock market.

30. *Improving the bank payments system*. A phased development of new electronic interbank payments scheme was introduced as a condition for the release of first tranche. The government adopted proper safeguards against payments system risks and dedication procedures for large value payments. The government also revised Banking Law, which strengthened the control and restrictions on bank transactions and the revised judicial process for recovering loans.

Sustainability

31. The actions taken in settling public enterprise NPLs supported by such reforms as the liquidation of non-performing debtor enterprises together with strengthened legal and regulatory requirements augur well for the long-term sustainability of the reforms. The reforms of the financial sector with respect to the legal and regulatory framework will be continued in ECAL III, which will expand from the banking to the insurance sector as well as the private investment climate. Sustainability is rated is as *likely*.

Institutional Development Impact

32. The financial sector reform under ECAL II increased the efficient use of resources in the banking sector and improved institutional stability, but only a rating of modest is warranted. More detailed aspects of this performance are discussed below.

33. The program to eliminate non-performing loans succeeded in putting the public enterprise sector on sounder basis but at a long-term heavy cost to the banks. The decline in NPLs was the result of Government taking over or guaranteeing bad debt rather than evidence of better lending. The rating is modest.

34. The privatization and merger of development banks is considered unsuccessful by the implementation completion report due to disagreements with a foreign partner over the merger of UIB and BTEI. Government disagreed (see paragraph 37 below on PPAR's view). Government could not control the outcome and in fact important longer-term

institutional progress seems likely. The rating is modest.

35. The provisions for legislation and regulatory framework reforms were met with probable lasting structural benefits. Civil Code revisions to improve loan recovery took longer than expected. A major problem is that the judicial system is very slow in implementing procedures related to loan recovery. For example, whenever the seizure of property used as collateral is possible, in principle the procedure is so cumbersome and lengthy that it is effectively not an option that is used. The rate of real estate recovery is found to be very low by international standards, reflecting the inefficiency of the judicial process. The rating is modest.

36. Finally, important structural measures were introduced concerning the securities market and insurance company solvency. Rating on balance is *modest*.

Bank Performance

37. The performance of the Bank was *satisfactory* in meeting the objectives contained in ECAL II. The operation was well designed and included appropriate regulatory reform measures. The Bank should have realized that the UIB-BTEI merger was not in the borrower's control and should have restructured the loan or ensured that BTEI's foreign owner had made a binding commitment

38. Bank supervision was rated marginally satisfactory by the implementation completion report and the PPAR concurs; the first full supervision took place a year after effectiveness. When by the end of 2000 it became clear that the UIB-BTEI merger could not be completed, thus compromising second tranche release, the Bank showed flexibility in accepting an alternative measure. The overall Bank performance rating is *satisfactory.*

Borrower Performance

39. Government performance was *satisfactory* as it implemented financial sector reforms with co-financiers based on its own program of restructuring and modernizing the financial system. Government made a best effort to resolve the UBI-BTEI problem and then proposed a reasonable alternative. Implementing agencies in general performed well in completing loan conditions.

Third Economic Competitiveness Adjustment Loan (ECAL III)

Objectives

40. ECAL III consists of a broad range of second-generation measures aimed at enhancing private sector development (see annex C, table 8 for a list of target and conditions). The loan supports actions to: (a) promote private investment climate, (b) strengthen the financial sector, in particular the insurance sub-sector, and (c) liberalize the telecommunications sector, while (d) maintaining a macroeconomic framework. It aimed at efficiency gains in the public, and private sector, and a more transparent investment climate. The State would continue its disengagement from the economy.

The soundness and transparency of the financial sector will be promoted and the telecommunication sector opened to private sector participation.

Outcome

41. At the macro level ECAL III was launched against the backdrop of adjustment to adverse conditions, which led to a 4.7 percent real GDP growth rate in 2000 versus the average of 5.2 percent for the previous five years. Agricultural value added contracted, and services growth slowed. Despite the challenge of liberalized imports from the EU and some Arab world partners, manufacturing continued to grow at a healthy pace. Unemployment fell slightly due to a sizable increase in non-agricultural job creation, and programs to retrain and finance activities of the unemployed.

42. The current account deficit widened to 4.2 percent of GDP, higher than its 1999 level. Low rainfall caused a drop in food output and high-energy prices, and the appreciation of the dollar raised import and debt service costs. A favorable indication was the rise in equipment goods and raw materials by investing firms, which will favor growth of exports. Overall, however, the Government's prudent macroeconomic management has preserved the country's macroeconomic stability in the face of these unfavorable shocks.

43. GDP growth in 2001 moderated to 4.9 percent due to the slowdown in Europe and drought conditions. The negative effect of high oil prices, on the trade balance, and the level of budgetary subsidies on petroleum prices, was offset by rising tourism receipts and a sharp increase of manufactured exports by 19 percent, with exports of mechanical and electrical equipment rising by 33 percent. A strong increase in tax receipts led to a decline in the budget deficit. The first tranche was released at the end of December 2001.

44. In 2002 the outlook was for a 4.9 percent GDP growth rate versus 5.8 percent projected before September 11, 2001. Instead, growth was only 1.7 percent due to the full effects of the slowdown in Europe, lower tourism receipts, and the drought in agriculture. Exports declined by 2.3 percent from a 12.1 percent growth in 2001. Tourist receipts fell by 13.5 percent. Fiscal policy aimed at reducing the deficit by strict expenditure controls and improvements in the tax base. The March 2003 supervision report notes that the reform program substantially accelerated after December 2002.

45. In the June 2003 supervision report the investment climate component was reported to be accelerating but would need more time as the privatization process of a large enterprise, SNDP, was just starting. The Bank team recommended improving the draft action plan for private investment with regard to incentives and direct tax privileges, as recommended by the a 2002 FIAS report. Bank comments were shared with the EC team. The Bank was satisfied with Tunisia's macroeconomic performance. The authorities prepared a study on investment promotion and adopted an action plan satisfactory to the Bank. The authorities also adopted a regulatory framework, satisfactory to the Bank governing the implementation of the "Company Law". More important, the French bank *Société Générale* bought for US$72 million the Government's 52 percent stake in *Union Internationale de Banques* (UIB), meeting the ECAL III privatization condition. One the other hand the privatization process for *Société Nationale de Distribution du Pétrole* (SNDP) started, but it was not completed before the loan closing date of December 31, 2003 given the needed environmental and social assessments. A waiver was therefore requested for this condition, which was granted and the

investment climate floating tranche was released in December 2003.

46. In the telecom sector important reforms were implemented and comprehensive timetables to accelerate and deepen liberalization were submitted to the Bank. There were concerns about the transparency of the GSM bid award process. The Bank was not comfortable with the process and allowed the associated floating tranche of ECAL III to lapse (see paragraph 3.12 above).

47. Government has completed and incorporated Bank comments on a series of studies aimed at assessing the impact of reforms under the first tranche on collateral recovery. The summary study contains the provision of detailed baseline data on non-performing loans of the banking sector including their age and retaliation of real estate collateral. While NPLs remain a problem for the financial sector, no regulatory measures to accelerate loan recovery were undertaken for the time being pending the assessment of provision of the *Code des Procedures Civiles et Commerciales*.

48. In the insurance sector the data base and control functions of the CGA (*Société Générale des Assurances*) has been significantly improved. It can now track the weaknesses of undercapitalized companies and negotiate restructuring plans. In auto insurance, premiums have been raised by 3 percent following an earlier 8 percent rise. These measures helped reduce the deficit of this branch in a manner satisfactory to the Bank. A new legal framework satisfactory to the Bank has been presented to the Chamber of Deputies that complies with international best practice and standards. The restructuring plan of *El Ittihad* has been completed and an implementation plan to set up a new fully capitalized mutual company (*Assurance Mutuelle Ittiahad*) has been established. The restructuring plans of three insurance companies has been adopted in order to meet Insurance Code solvency constraints. The floating tranche concerning strengthening of the financial system was released at the end of September 2003.

49. In conclusion, macro performance was considered satisfactory in view of prudent management in the face of external shocks; although some of Tunisia's macro indicators such as growth and the budget deficit deviated from the projected path in ECAL III in 2002. Economic growth rebounded to about 5.5 percent in 2003, and the economy is expected to meet the 2004 growth projection of 6 percent. ECAL III supported telecommunication reforms have been implemented as the sector has been opened up to private participation and prices have been reduced by some 10 percent. The Government adopted a regulatory framework, satisfactory to the Bank governing the implementation of the *Code des Procedures Civiles et Commerciales*. The privatization of one public commercial bank, *Union Internationale des Banques* (UIB) was completed. A large insurance company (*El Ittihad)* was restructured, and a new mutual fund company was created to take it over. One the other hand the privatization process for *Société Nationale de Distribution du Pétrole* (SNDP) started, but it was not completed before the loan closing date of December 31, 2003, requiring a condition waiver, which was granted in view of the substantial progress made.

50. The overall outcome is rated *satisfactory*.

Sustainability

51. The sustainability of macro performance is well in hand in view of the actions taken to date. The insurance sector reforms have established the basis for the sustainability of the sound management and financial solvability of this sector. On the other hand, the gradual privatization approach has allowed the Government to build the necessary consensus and has served the overall objective of reform well. Overall, sustainability is rated *likely*.

Institutional Development Impact

52. The institutional reform of the insurance sector represents an important basic improvement in institutions and regulatory control. Important progress was made in improving the investment climate, which will have a lasting impact. A major weakness became apparent in the award process in telecommunications, which raises the issues of transparency in the procurement process. Overall the institutional development impact is rated as *modest*.

Bank Performance

53. Close supervision was exercised during the supervision process. The role of the Bank in the telecom component is fully justified in view of the procurement policy issue at stake. Relations with other donors were improved. Both the AfDB and the EU adopted the same tranche release conditionality as the Bank in addition to their own conditionality. The dialogue with development partners was strengthened particularly in the telecom and insurance sectors. Bank performance is rated *satisfactory*.

Borrower Performance

54. Government's role in implementing the loan was largely positive. The Government issued the GSM license and competition was introduced, leading to greater access to mobile telephone, better services, and lower prices. However, the Bank did not yet receive the documentation required to demonstrate that the GSM license was tendered following a transparent process. The legal and regulatory framework for the telecommunications sector has been strengthened, implementing regulations for new telecomm code, and creating the National Telecom Agency. The insurance sector was restructured. However, the privatization of SNDP is progressing at a slower pace than expected. Borrower performance is rated *satisfactory*.

Basic Data Sheets

TUNISIA: ECONOMIC ADJUSTMENT STRUCTURAL LOAN (LOAN NO. 4069 TUN)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	195	195	100
Loan amount	75	75	100
Cofinancing			
European Union	120	120	100

Cumulative Estimated and Actual Disbursements

	FY97	*FY98*
Appraisal Estimate (US$M)	75	75
Actual (US$M)	37.5	75
Actual as a % of Estimate	50	100
Date of Final Disbursement	12/31/96	6/30/98

Project Dates

	Planned	*Actual*
Pre-appraisal	11/27/95	11/27/95
Appraisal	2/27/96	2/27/96
Negotiations	5/2/96	5/2/96
Letter of development policy	6/12/96	6/12/96
Board presentation	7/25/96	7/25/96
Signing	8/2/96	8/2/96
Effectiveness	12/6/96	2/2/97
Disbursement of first tranche	8/31/96	12/31/96
Disbursement of second tranche	6/30/97	6/30/98
Closing date	12/31/97	6/30/98

Staff Input

	Actual	
	Weeks	*US$ (Thousand)*
Preparation to Appraisal	152.5	578.4
Appraisal	20.7	70.8
Negotiation through Board Approval	6.0	16.0
Supervision	74.3	248.5
Completion	6.0	29.0
Total	**259.5**	**942.7**

Source: World Bank internal documents.

ECAL 1 Mission Data

Stage of Project	No. of Persons and Specialty			Performance Rating	
Month/Year	*No. of Persons*	*Days in Field*	*Specialty*	*Implementation Progress*	*Development Objective*
Pre-appraisal					
11/95	11	110	(3) Economists (1) Privatization Specialist (2) Financial Sector Specialists (2) Maritime Transport Specialists (1) Labor Market Specialist (2) Legal Reform Specialist	--	--
Appraisal					
02/96	8	56	(2) Economists (2) Privatization Specialists (2) Financial Sector Specialists (1) Telecom Specialist (1) Maritime Transport Specialist	--	--
Supervision					
05/97	2	22	(2) Economists	S	S
11/97	4	20	(2) Economists (1) Financial Sector Specialist (1) Maritime Transport Specialist	S	S
12/97	2	8	(1) Maritime Transport Specialist (1) Privatization Specialist	S	S
05/98	1	5	(1) Economist	S	S

Source: World Bank internal documents.

Basic Data Sheet

TUNISIA: SECOND ECONOMIC ADJUSTMENT STRUCTURAL LOAN (LOAN NO. 4461 TUN)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	399	399	100
Loan amount	159	159	100
Cofinancing			
European Union	100	100	100
African Development Bank	140	140	100

Cumulative Estimated and Actual Disbursements

	FY99	*FY01*
Appraisal Estimate (US$M)	159	159
Actual (US$M)	159	159
Actual as a % of Estimate	100	100
Date of Final Disbursement	04/20/99	6/3/01

Project Dates

	Planned	*Actual*
Appraisal	11/19/98	11/19/98
Board presentation	4/20/99	4/20/99
Signing	8/2/96	8/2/96
Effectiveness	8/10/99	6/15/99
Disbursement of first tranche	6/15/99	6/15/99
Disbursement of second tranche	9/6/00	3/6/01
Closing date	6/30/01	6/30/01

Staff Input

	Actual	
	Weeks	*US$ (Thousand)*
Identification/Preparation	NA	NA
Appraisal/Negotiation	NA	357.7
Supervision	NA	115.0
Completion	NA	8.0
Total	NA	**480.7**

Source: World Bank internal documents.

ECAL II Mission Data

Stage of Project Cycle	No. of Persons and Specialty		Performance Rating	
Month/Year	*Count*	*Specialty*	*Implementation Progress*	*Development Objective*
<u>Identification/Preparation</u>				
03/98	2	(1) Financial Specialist (1) Economist	--	--
<u>Appraisal/Negotiation</u>				
06/98	6	(3) Financial Specialists (3) Consultants	--	--
11/98	7	(2) Financial Specialist (2) Economists (2) Operations Analysts (1) Consultant	--	--
02/99	7	(3) Financial Specialists (1) Economist, (1) PSD Specialist (1) Legal Counselor (1) Disbursement Officer	--	--
<u>Supervision</u>				
06/00	2	(1) Financial Specialist (1) Economist	S	S
10/00	5	(5) Financial Specialists	S	S
ICR*				

*Note: ICR mission planned for 9/01 was cancelled due to travel restrictions following the terrorist attacks of September 11, 2001, in the United States.

Source: World Bank internal documents.

Basic Data Sheets

TUNISIA: THIRD ECONOMIC ADJUSTMENT STRUCTURAL LOAN (LOAN NO. 7094 TUN)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	518.4	478.5	92%
Loan amount	283	252.5	89%
Cofinancing			
European Union	72	72	100%
African Development Bank	194	194	100%

Cumulative Estimated and Actual Disbursements

	FY02	*FY04*
Appraisal Estimate (US$M)	132.5	283
Actual (US$M)	132.5	252.5
Actual as a % of Estimate	100%	89%
Date of Final Disbursement	06/30/2003	12/31/2003

Project Dates

	Planned	*Actual*
Appraisal	04/18/200	04/18/2001
Board presentation	12/20/2001	12/20/2001
Signing	12/20/2001	12/20/2001
Effectiveness	12/27/2001	12/27/2001
Disbursement of first tranche	12/31/2001	12/27/2001
Disbursement of second tranche	06/30/2003	09/30/2003
Closing date	06/30/2003	12/31/2003

Staff Input

	Actual	
	Weeks	*US$ (Thousand)*
Identification/Preparation	-	675[1]
Appraisal/Negotiation	-	-
Supervision	-	273
ICR	-	25
Total	-	**973**[2]

[1] This covers the combined expenses from identification of Board approval.
[2] This is Bank budget direct cost. Supervision amount does not included CTF expenses totaling about $32,000.

Source: World Bank internal documents.

ECAL III Mission Data

Stage of Project Cycle	No. of Persons and Specialty		Performance Rating	
Month/Year	***Count***	***Specialty***	***Implementation Progress***	***Development Objective***
Identification/Preparation				
10/15/2000	10	(1) PSD Specialist/TTL (1) Financial Specialist	S	S
Appraisal/Negotiation				
4/23/2001		(1) PSD Specialist/TTL	S	S
Supervision				
03/14/2002	3	(1) PSD Specialist/TTL (1) Insurance (1) Financial Specialist	S	S
07/26/2002	2	(1) PSD Specialist/TTL (1) Insurance	S	S
12/27/2003	2	(1) PSD Specialist/TTL (1) Sector Manager / Mission Leader	S	S
05/15/2003	3	(1) PSD Specialist/TTL (1) Team Leader	S	S
10/09/2003	1	(1) PSD Specialist	S	S
ICR				
03/16/2004	1	PSD/ Financial Specialist		

Source: World Bank internal documents.

Statistical Tables

Annex Table 1: Tunisia-Privatization and Restructuring by Sector (1987 to August 2003)

Sector	*Volume*		*No. of Enterprises*	
	in Million TD	*in %*	*No.*	*in %*
Agriculture, Fisheries, and Agro-industry	**72.0**	**3.2**	**18.0**	**10.7**
Industry	**952.0**	**40.6**	**56.0**	**33.3**
Construction Materials	825.0	35.1	18.0	10.7
Mechanical, Electrical and Chemical Industries	108.0	4.6	30.0	17.9
Textiles	19.0	0.8	8.0	4.8
Services	**1318.0**	**56.2**	**94.0**	**56.0**
Tourism and Handicrafts	277.0	11.8	37.0	22.0
Commerce	137.0	5.8	21.0	12.5
Transport	69.0	3.0	16.0	9.5
Others	835.0	35.6	20.0	11.9
Total	**2346.0**	**100.0**	**168.0**	**100.0**

Source: Directorate of Privatization, Government of Tunisia.

Annex Table 2: Privatization and Restructuring by Sector (October 1998 to August 2003)

Sector	*Receipts in Million TD*	*% of Total*
Agriculture, fishing & food	**24**	**1**
Industries	**855**	**45**
Construction materials	798	42
Chemical & mechanical industries	51	3
Textiles	6	0
Services	**205**	**11**
Tourism & Handicrafts	143	8
Transport	0	0
Trade	62	3
Others	**806**	**43**
Total	**1891**	**100**

Source: Ministry of Economic Development, Tunisia.

Annex Table 3: Tunisia-Foreign Investment in Privatization (million TD) (1987 to August 31, 2003)

Sector	*Receipts from foreign investors*	*% of Total*
Agriculture, fishing & food	**0**	**0**
Industries	**782**	**44.6**
Construction materials	771	43.9
Chemical & mechanical industries	6	0.3
Textiles	5	0.3
Services	**974**	**55.5**
Tourism & Handicrafts	93	5.3
Transport	17	1.0
Trade	76	4.3
Others	788	44.9
Total	**1755**	**100**

Source: Ministry of Economic Development, Tunisia.

Annex Table 4: Sectoral Distribution of Non-Performing Loans (million TD)

	2000	*2001*	*2002*
Agriculture			
Deposit Banks	298 (7%)	302 (7%)	335 (7%)
Private	44 (1%)	62 (2%)	21 (1%)
Public	254 (6%)	241 (5%)	264 (6%)
Industry			
Deposit Banks	1587 (37%)	1705 (42%)	1913 (42%)
Private	646 (15%)	942 (23%)	1112 (24%)
Public	941 (22%)	258 (19%)	802 (18%)
Services			
Deposit Banks	2359 (56%)	2056 (51%)	2356 (51%)
Private	623 (16%)	821 (21%)	997 (22%)
Public	1685 (40%)	1235 (30%)	1358 (29%)
Total			
Deposit Banks	4244 (100%)	4063 (100%)	4604 (100%)
Private	1363 (32%)	1529 (45%)	2150 (47%)
Public	2580 (68%)	2234 (55%)	2424 (53%)

Source: Tunisian Government.

Annex Table 5: Tunisia: Banking System Indicators

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*
Cover Ratio Average Risk (%)				*(percentage)*				
Commercial Banks	4.6	5.1	6.3	11.7	11.6	13.3	10.6	9.8
Private	10.5	9.4	6.8	8.9	10.3	11.5	10.4	10
Public	2.2	3.4	5.9	14.6	12.8	15	11	9.4
Development Banks	32.6	30.8	33.3	36.3	39.1	74.6	63.9	54.6
				(percentage of total credits)				
Non-Performing Credits (% of total credits)	34.8	31.5	29.9	26.4	25.9	23.6	21	21.4
Commercial Banks	30.8	25.1	23	19.5	18.8	21.6	19.2	20.9
Private	18.2	17	19.4	19.4	18	15.3	16.1	18.1
Public	36.8	29.3	25.8	19.6	19.5	26.8	22.8	24.3
Development Banks	56.7	64.2	67	64.3	65.8	54.6	50.3	30.5
				(percentage of total credits net of provisions)				
Non-Performing Credits After Provisions and Reserves	26.1	20.4	18.4	14.3	14.2	13.3	12	12.9
Commercial Banks	23.2	15.2	12.4	8.9	8.8	12.3	11.1	12.9
Private	9.6	7.3	9.6	9.1	8.3	7.6	9.1	10.8
Public	29.8	19.3	14.6	8.8	9.2	16.3	13.5	15.5
Development Banks	44.6	52.4	54.6	50.3	52.2	34.2	30.7	11.8
				(in percentage of non-performing loans)				
Provisions and Reserves	33.6	44	47	53.7	52.7	50.3	48.7	45.6
Commercial Banks	32	46.7	50.4	59.7	58.5	49.2	47.4	43.9
Private	52.2	61.9	55.3	58.3	58.8	54.7	47.7	44.9
Public	27.3	42.1	47.5	60.7	58.3	46.6	47.1	42.9
Development Banks	38.5	38.6	40.6	43.7	43.3	56.7	56.3	69.5
Return on Equity								
Commercial Banks	11.4	12.3	11.8	12.8	12.8	13.7	14	8
Development Banks	4.1	4.2	4.1	4.7	6.1	4.8	3.8	n.a.

Source: Tunisian Government.

Annex Table 6: Tunisia-Economic Indicators

Indicator	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*
Real Goods Import Growth (%)			-2.5	8.7	5.4	5.8	6.5	13.6	-2.4	3.8
Real Effective Exchange Rate				-0.1	0.1	1.0	-0.6	-2.5	-3.5	
Exch. Rate per US$ (IMF)				1.1	1.1	1.2	1.4	1.4		
GDP Deflator				4.0	3.0	3.1	3.3	2.7	2.6	2.1
CPI (IMF)				3.3	3.1	2.7	3.0	1.9	2.8	2.5
Budget Balance				-4.6	-3.6	-3.9	-3.8	-3.5	-3.5	-3.1
Gross Domestic Fixed Investment (% of GDP, CAS)	27.0	24.0	23.0	25.0	25.0	26.0	27.0	27.0	27.0	
Government	4.0	4.0	5.0	5.0	6.0	7.0	7.0	7.0	7.0	
Private	23.0	20.0	18.0	20.0	21.0	22.0	22.0	22.0	22.0	
Foreign Direct Investment (US$ mill. INIT)			299.0	492.0	485.0	357.0	731.0	420.0	945.0	

Source: World Bank internal data.

Annex Table 7: ECAL I-II-Macroeconomic Monitoring Indicators, Outcomes, and Projections

	1994	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004 (proj.)*
GDP growth (%)	3.3	2.6	7.1	5.5	5	6.2	4.7	4.9	1.7	5.5	5.7
Real Exports growth (%)	14.9	1.3	-2.4	6.8	7.0	5.1	6.6	12.1	-2.3	4.0	6.0
Real Manuf. Exports growth (%)	23.2	5.5	4.4	8.2	8.4	5.7	4.6				
ECAL I projections											
GDP			7.1	5.5	4.9						
Real Exports			4.7	7.3	7.2						
Manuf. Real Exports			4.4	8.2	8.4						
ECAL II projections											
GDP growth (%).					5.1	5.5	5				
Real Exports growth (%)					3.2	5	6				
Manuf. Real Exports growth (%)					13.1	11	11.1				
ECAL III projections											
GDP growth (%)								5.2	4.9	5.7	6
Real Exports growth (%)								9.3	5.4	6.8	7.1
Manuf. Real Exports growth (%)								15.5	3.5	7.0	7.2

Source: World Bank internal data.

Annex Table 8: Tunisia ECALs I, II and III-Principal Objectives and Outcomes

ECAL I	*Targets and Conditionalties*	*Outcomes*
Objectives Improve macro balances competitiveness and accelerate growth to 5-6% per annum.	Adopt medium term macro framework including reserves, external debt, export, growth, and fiscal deficit.	GDP growth between 5 and 7% 1996-1998. Inflations 2.7 to 3.3%.
Fiscal Ensure sustainable fiscal framework.	Fiscal measure to compensate loss revenues due to tariff cuts.	Increase in value added taxes and repay arrears of cereals and edible oil offices.
Trade Greater integration in world economy.	Submit draft EUAA law to Chamber.	Law passed June 1996, progressive removal of tariffs achieved as well as WTO negotiation to eliminate QRs.
Disengagement of State Increase role of private sector.	Bring to point of sale at least 51% of capital of enterprises corresponding to 50% of assets for agreed public enterprises.	Met criteria by including privatization of two large cement plants; exceeded targets.
Deregulation Improve competitiveness of maritime transport.	Submit law eliminating charter privileges. Submit law to eliminate monopoly.	Law passed. Law not passed.
Trade facilitation Ensure rapid and cheap transit of cargo.	Decree introducing unique document for customs.	Facilitation Committee produced single trade document envisaged by the Association Agreement with the EU and in accordance with the EU code.
Harmonize custom regulation with EU.	Draft law to Council of Ministers.	Decree signed.
Legal Legal framework to support competitiveness.	Draft law to Chamber.	New company law discussed by Ministers.
Social Decrease cost of labor and improve protection.	Draft law submitted to Chamber of Deputies to create a severance scheme for laid off workers.	Draft law adopted.

ECAL II	*Targets and Conditionalties*	*Outcomes*
Macro		
Growth of at least 6% per annum.	Satisfactory medium term framework including targets for external debt, fiscal deficit, current account balance and inflation.	ECALII growth target exceeded, real exports target of 5.1% met, debt to GDP targeted at 50.1% but reached 55.4% in 1999. Current account deficit at 2.1% in 1999 versus target of 3.9%. Fiscal deficit slightly above 3.4% target.
Banking Sector		
Settlement of arrears to public enterprise.	Settle NPL's to 24 enterprises.	Settlement was achieved.
Upgrade prudential regulations on capital adequacy.	Revise capital adequacy rations from 5% to 8%.	The capital adequacy ratio rose from 7% in 1997 to 13.3% in 2000 and declined to 9.6 in 2002.
Privatization and bank mergers.	UIB BTEI merger proposed.	UIB merger declined by outside owners. Government later privatized.
PE reform.	Liquidate 24 enterprises.	Condition satisfied.
Government securities market.	Promote market based Central Bank intervention.	Central Bank law amended to meet objective.
ECAL III		
Macro		
Stable macro framework Strengthen debt management and fiscal sustainability.	Meet performance indicators (growth, exports, inflation, gross fixed investment, budget deficit, current account deficit and foreign debt) Computerized debt database for domestic and foreign debt.	Conditions met. Growth declined in 2002, following the drought and slowdown in Europe, but rebounded in 2003. Satisfactory action plan for public debt was put in place.
Trade facilitation	Develop an electronic data interface between all agencies involved in international trade procedures to expedite trade document flows.	Automation has decreased the average time taken to clear goods once unloaded from anywhere between 8 and 18 days to between 2 and 5 days, and customs clearance time has been reduced from 2-3 days to 15 minutes.
Private Investment		
Improve relations between fiscal authorities and private enterprises.	Finalize study and adopt action plan Submit code of fiscal right to Chamber.	Study finalized and action plan implemented.
Simplify procedures for start up and operation of private enterprise; simplify customs procedures.	Reduce to a maximum of 30 days VAT reimbursement.	This was mainly met by reimbursing 75% of the VAT within 30 days for firms subject to the industrial modernization program. Ongoing changes will take place in the context of the Investment Code reforms.

ECAL III *(cont.)*	*Targets and Measures*	*Outcomes*
Financial Sector		
Strengthen governance of public banks.	Adopt at STB and BNA dual-board management structure.	Adopted.
Measure to clean up portfolios of credit institutions.	Submit to Chamber draft amendment relating to loan recoveries to the code of Civil and Commercial procedures.	Draft submitted.
	Carry out study to evaluate effects of new legislative environment.	Study completed incorporating Bank comments. It concluded that NPLs are a problem for financial sector but no new measures are proposed until the Code has been assessed.
Strengthen insurance sector.	Submit to Chamber a draft law amending the insurance code.	Law submitted.
Strengthen legal framework and regulatory supervision.	Agree on time bound action plan to strengthen DGA.	Action plan implemented. Supervision authorized by law and qualified staff recruited.
Reducing automobile sector deficit.	Increase premium by 3% with MT plan to eliminate deficit.	Auto insurance premiums have been raised by 3% following an earlier 8% rise, which helped to eliminate the deficit of this sector in a manner satisfactory to the Bank.
Restructure insurance sector.	Modify tax treatment and social charges. Present restructuring scenarios.	New law adopted. New mutual company established and 3 companies restructured.
Information and communications.	Improve the legal and regulatory framework.	The legal and regulatory framework for the sector has been strengthened (i.e., implementation regulations for new telecommunications code adopted, and creation of the National Telecom Agency).
Electronic data interchange.	Prepare terms and conditions for provider of electronic certification	The implementation of the electronic data interchange (TTN) was supported by the Bank and the EU and is already being used by 80 enterprises. A new law concerning exchanges and electronic commerce was adopted.

ECAL III *(cont.)*	*Targets and Measures*	*Outcomes*
Liberalize the telecommunications sector.	Launch international bidding for 2^{nd} GSM license and introduce effective competition.	The Telecommunications liberalization have been achieved, the GSM license (wireless telecom) has been issued, and outcomes include: competition has been introduced in the wireless component of the telecommunications sector leading to greater access to mobile telephone, better services and lower prices. However, the telecom tranche of ECAL III was not disbursed because the Bank did not receive the documentation required to demonstrate that the GSM license was tendered following a transparent and competitive process.

List of Organizations and Individuals Met

Ministry of Development & International Cooperation
Kamel Ben Rejeb, Direcor General
Monir Boumessouer, Director General, Infrastructure
Fouad ElShrafi, Director
Lutfi Frad, Director
Mohamed Naceur Braham, Counsellor of Public Services, Director of Agriculture and Agro- Industries
Foued Charfi, Director General, Productive Sectors
Borgi Kacem, Director General of Regional Development
Abel Hamid Triki, Director
Moncef Youzbachi

Ministry of Finance
Belhadji Jameleddine, Director General

National Statistical Institute
Khalifa Ben Faqih, Director General
Abdel majd El-Wislati

Ministry of Transport
Salem Miladi, Director General

Ministry of Industry and Energy
Hamdi Guezguez, Principal Engineer
Ridha Ben Mosbah, Dir-Gen., De mise à niveaù
Mohamed El Kamel, Project Manager, ISIUP

Tunisia Leasing
Fethi Mestri, Director General

National Agricultural Bank
Berraies Mohamed, Directeur

Exports Promotion Agency (FAMEX)
Slim Chaker, Director for Coordination

Tunisia Central Bank
Habib El Montacer, Managing Director
Badreddine Barkia, Director General, Supervision
Samir Brahimi, Director General, Services & Audit

Private Sector
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Ahmed Benghazi, Associe-Gérant, Axis
Ahmed Smaoui
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Development Specialist, MNSIF)
Domenico Fanizza (Deputy Division Chief IMF)