Tunisia's Request for Country of Operations Status

Technical Assessment*

21 October 2011

*** This document is provided as background reference material exclusively for participants to the EBRD SEMED Partnership Assembly on 28 November 2011. It was produced by EBRD Management for discussion with the Bank's Board of Directors at an earlier date, and may contain information that is out of date.**

Index

1. Introduction and Overview

Tunisia has requested to become a recipient country of the Bank. As set out in the Report of the Board of Directors to the Board of Governors of 28 July 2011 (BDS11-187) and consistent with the respective resolutions and amendments to the Agreement Establishing the Bank (AEB), it is expected that the Bank would follow a three-phase process in becoming active in Tunisia:

- In the first phase, the Board of Directors would consider the use of cooperation funds;
- in the second phase, once the amendment of Article 18 AEB has been accepted by members, the Board of Governors would consider the use of Special Fund resources for special operations;
- in the third phase, once the amendment of Article 1 has been accepted by members, the Board of Governors would consider granting recipient country status to Tunisia and therefore allowing the use of ordinary capital resources for ordinary operations.

This Technical Assessment has been prepared as a basis for the Board of Directors to make an informed decision at the first stage of the process. It will be further updated ahead of the second stage and replaced by a "regular" Country Strategy for Tunisia in the third stage. Additional updates either orally or in writing, for instance on progress towards implementing the political aspects of the Bank's mandate, will be provided to the Board of Directors regularly. These would allow the Board to calibrate the Bank's activities in accordance with events.

The Technical Assessment builds on assessment missions to Tunisia during which Bank staff consulted with the authorities, benefited from the views of numerous other parties and conducted an initial scoping of demand for the Bank's services. The Deauville Partnership process has offered the opportunity to build a strong basis for cooperation with other IFIs. The Technical Assessment thus serves not only to deepen the Bank's understanding of the situation in Tunisia, but also to identify an initial set of priorities for action that could be financed with cooperation funds. While not a Country Strategy in the strict sense (since that would require recipient country status), it should therefore be seen to discharge some of the practical purposes of a Country Strategy.

The paper has four main sections. Section 2 provides an update of political developments and the current status of Tunisia's progress towards pluralism and multi-party democracy. It is meant to inform the Bank's judgement on whether Tunisia is on a trajectory that will allow it to meet the political aspects of Article 1 within the not-too-distant future. The assessment is based on the Bank's established methodology for country strategies, and in particular, presents an analysis "criteria by criteria" as envisaged in the 1991 policy on Implementing the Political Aspects of the Bank's Mandate (BDS91-16). It notes that the interim authorities have undertaken important commitments to democratise political life in Tunisia and reform the system: beginning to dismantle the repressive system in place before the revolution, adhering to a clear timetable for constitutional reform, paving the way for credible elections to the National Constituent Assembly.[1]

Section 3 sets out an assessment of Tunisia's progress in economic transition. Given that the Bank has had little prior knowledge of Tunisia, and absent the background usually contained in the Bank's Transition Reports, the section also presents some of the history of reforms in the country and is supplemented by considerable sectoral detail in Annex 1. Tunisia has benefited considerably from years of structural and macroeconomic reforms. However, privileges for the well-connected stood in the way of a fair distribution of opportunities, and there was a growing divide between coastal and inland regions and between educational patterns and labour demand. The economic policy challenge is to achieve growth while overcoming social exclusion. As the government's *Jasmine Plan* sets out, the private sector should play a key role in this process, on its own – and without special privileges – as well as through appropriately designed public-private partnerships.

Section 4 describes progress made in ensuring that the Bank's potential engagement in Tunisia is closely coordinated with other IFIs. The work done so far, including under the aegis of the Deauville Partnership, should provide comfort that the Bank will focus its activities on those areas in which it has skills and capabilities that are complementary to other IFIs. Steps have also been taken for the Bank to join, and in some cases lead, joint initiatives among the IFIs in Tunisia and elsewhere in the new region, once it has the mandate to do so.

Finally, section 5 presents the results of a scoping mission that assessed opportunities for the Bank to promote Tunisia's transition through operations. It identifies project areas that address transition gaps and where the Bank's specific business model, on its own or jointly with other IFIs, would add value. While the Bank will not be in a position to finance projects during the first stage of its engagement, this review helps to inform the selection of possible technical assistance and similar activities, which are also outlined in this section. Altogether, there would appear to be considerable demand that meets the criteria for a Bank engagement, and the section provides for a range of possible initial operations by the Bank.

[1] A methodological note on how to apply the Bank's approach to political assessments in the potential new region of operations has been circulated to the Board (Political Criteria and Methodology for Carrying Out Political Assessments of Countries in SEMed (SGS11-272 (Add 1))).

2. Political Assessment

2.1 Introduction

The events of December 2010 and January 2011 in Tunisia, in which large-scale protests resulted in the ouster of then-President Zine El Abadine Ben Ali, have put the country on a new course towards development of a multiparty democracy that respects human rights. Tunisia was the birthplace of the 'Arab Spring', where a single street vendor, Mohamed Bouazizi, triggered a national democratic uprising when he set himself on fire to protest police abuse and the lack of economic opportunity. The campaign by Tunisian civic activists which brought an end to authoritarian rule sparked protests across the Arab world and established Tunisia as a standard bearer for the rest of the region in the transition to democracy. The process of dismantling the old system and building a new one is at a very early stage in Tunisia, though many of the signs are pointing in a positive direction.

2.2 History

Tunisia was a French protectorate from 1881 and gained its independence in 1956. For more than 30 years the country was ruled by President Habib Bourguiba, a social moderate and secular nationalist. President Bourguiba was ousted in a bloodless coup in 1987 by then-Prime Minister Ben Ali. President Ben Ali continued some of Bourguiba's reforms, particularly with respect to economic modernisation and promotion of women's rights, but like his predecessor he kept a tight rein on politics.

The Tunisian political system under President Ben Ali was highly repressive, authoritarian and personalised. The media operated under heavy restrictions and was dominated by state-owned broadcast and print outlets; criticism of the President was not tolerated on the public airwaves and various legal and extra-legal instruments were used to silence critics in the handful of private media outlets. Political opponents, independent journalists and Islamists were harassed and imprisoned. Although the state religion is Islam, the main Islamist party, Ennahda, was banned and its supporters faced persecution and arbitrary arrest. Non-governmental organisations were legally prohibited to engage in any political activities and independent human rights groups were denied registration. There was no effective separation of powers amongst the executive, legislative and judicial branches and checks and balances in the system were weak to non-existent. The judiciary was not independent of the executive branch, which controlled the appointment and assignment of judges and interfered routinely in legal rulings.

During his 24 years in power, President Ben Ali was re-elected to office five times, winning his fifth five-year term in 2009 with nearly 90 per cent of the vote. The campaign environment during these elections was restricted, with tight controls imposed on media coverage and on candidate registration and harassment of the opposition and independent journalists. During his period in power, President Ben Ali created a 'party of power', the Constitutional Democratic Rally (RCD), that dominated both houses of parliament and loyally supported his policies.

Parliamentary elections were similarly marred by a highly restrictive campaign environment, absence of meaningful competition and allegations of widespread fraud.

2.3 Recent political reforms

When President Ben Ali was forced from power on 14 January 2011, Tunisia embarked on a course of political reform that is still unfolding. The early days after the revolution were marked by turbulence and instability, as the interim leaders struggled to maintain order and begin a transformation process that would satisfy the persistent demands of the ‘street’. Some reforms were undertaken by the first post-revolutionary government, led by interim President Fouad Mebazaa and Prime Minister Mohamed Ghannouchi, the last Prime Minister to serve under President Ben Ali. Political prisoners were granted an amnesty. The RCD was dissolved and its funds liquidated. The Ministry of Communications, a propaganda arm of the government, was dissolved. However, Prime Minister Ghannouchi’s government was accused of protecting elements of the old regime and failing to purge the ranks of some of the most noxious ministries quickly enough. With protests mounting and turning violent, Ghannouchi stepped down on 27 February and Béji Caïd Essebsi, an elder statesman from the Bourguiba era, was appointed Prime Minister.

The Essebsi government has launched a number of important political reforms that have created the framework for transforming the Tunisian system of governance. The government sees its main task to maintain public order and the delivery of basic services until new institutions, and new legitimate leaders, are put in place. It has continued the process of dismantling the old system by investigating human rights abuses and corruption by former ruling elites and tearing down – albeit not as quickly as human rights groups would like – the former regime’s security apparatus. The Interior Ministry has dissolved the State Security Service and the political police. Several former party officials and close associates of the former President have been arrested. A new electoral law issued by the interim government permits far greater competition and openness and invests authority for overseeing the election process in the High Independent Authority for Elections. Dozens of political parties have been created since the revolution and the ban on Ennahda has been lifted. Tunisia has moved towards adherence of international human rights treaties, and on 24 June joined the International Criminal Court.

Most of the responsibility for preparing to build a new system of political governance is invested in the High Commission for Revolutionary Goals, Political Reform and Democratic Transition, headed by Yadh Ben Achour and made up of representatives from the political establishment, civil society and the legal profession. The Ben Achour Commission is focused mainly on steering the country towards elections and defining the functions of the National Constituent Assembly (NCA), members of which will be elected on 23 October. The main task of the NCA, which will become the first and only legitimate sovereign political authority in Tunisia until parliamentary and presidential elections can be held, is to draft a new democratic Constitution. The task of putting in place other democratic institutions will be left to the government appointed by the NCA and the next parliament and president.

Soon after the elections on 23 October, the NCA is expected to appoint a new executive which could be either (i) the current president and provisional government, (ii) a new caretaker government outside the NCA or (iii) a new "political" government reflecting the balance of political forces within the NCA. That government would be expected to remain in place until a new Constitution is drafted and new parliamentary and presidential elections are held. The task of drafting the Constitution is expected to last up to one year.

2.4 Status of political transition

As in the case of Egypt, the political transition in Tunisia is complicated by the need to first dismantle the old system and then design and build a new one. The process will take time and is still at an early stage. The focus thus far has been on preparing the country for the first set of free and fair elections in its history. The direction of change, starting with the revolution itself, is unmistakeably positive, but there have been setbacks, delays and disappointments along the way.

Political accountability

Elections. Elections to the National Constituent Assembly were originally scheduled to take place in June but have been pushed back to 23 October to allow more time to prepare the process and for new political parties to establish themselves and launch a campaign. The High Independent Authority for Elections has taken several steps to guarantee a free and fair election with broad participation of all Tunisians of voting age, whether inside or outside the country: the Ministry of Interior, which has a history of manipulation and falsification, has been excluded from the process; domestic observers from political parties, the Tunisian League of Human Rights, NGOs and the media will be accredited to monitor elections; international observers from the EU, the Carter Center (USA), the UN and international NGOs will also be accredited to monitor – but not oversee or regulate – elections. Preparations have been slower than hoped for, and communication with the electorate about the process has been inefficient. Over 100 political parties have registered to take part in elections. The proportional electoral system is designed to make it impossible for any one party or bloc to gain more than 30 per cent of the seats in the NCA, so single party dominance is effectively ruled out. Expectations are for a reasonably free and fair election on 23 October. Voters' fear of violence at polling stations is a concern, which could keep turnout lower than desired. A turnout of 60 per cent is considered by the High Independent Authority on Elections to be satisfactory result, but the hope is to reach something more like 80 per cent.

Representative government and an accountable executive. At the current stage of transition, Tunisia does not have a representative government and an accountable, legitimate executive. Political authority rests with the interim government, which was appointed after the revolution as a caretaker until elections could be held. Within one month of the revolution in mid-January 2011, the two chambers of parliament passed a law allowing the acting President, Fouad Mebazaa, to govern by decree. Parliament was then suspended and dissolved. The interim government of Prime Minister Essebsi runs day to day affairs, and is held accountable mainly by the active civil society and invigorated political party system that has emerged since the revolution.

Separation between the state and political parties. Dozens of new independent political parties have been created that are actively participating in the campaign for seats in the National Constituent Assembly on a level playing field. The former ruling party, the RCD, has been disbanded.

The rule of law and corruption

Constitutional rule and means of redress. Although Tunisia has a Constitution that defines the political system and guarantees the rights of its citizens, it is in the process of electing a Constituent Assembly whose main task is to re-write the Constitution and, possibly, re-define the political system. The Tunisian authorities have been in contact with the European Commission for Democracy Through Law (Venice Commission) to make use of their expertise in the preparation of the new Constitution.

Independence of the judiciary, equal protection under the law and fair criminal procedure. Judicial reform has been debated and civic activists have been pressing demands for more attention to this issue, but progress has been slow. The main challenges, as recognised by the Ben Achour Commission, are rooting out corrupt judges and establishing independence of the judiciary (particularly with regard to the assignment and promotion of judges). Cases pending against officials of the former regime are unlikely to be handled in a transparent and credible manner that will meet the expectations of the electorate without reform to the judiciary.

Separation between business and politics. Corruption has been a significant problem for some time. According to the 2010 Transparency International Corruption Perceptions Index, Tunisia is ranked 59 out of 178 countries. Under President Ben Ali, family members are believed to have owned or controlled many of the country's largest companies and to have held their assets overseas. Shares in some of these companies were reportedly acquired through force and political pressure. The interim authorities are investigating corruption and have taken steps to expropriate shares of companies controlled by President Ben Ali's family members and associates. Ben Ali and his wife, who fled to Saudi Arabia, have been charged with several criminal counts of embezzlement and misuse of state funds. They were tried and convicted in absentia and sentenced to 35 years in prison and US$ 66 million in fines.

Civic and human rights

Freedom of speech, media, association and assembly. Restrictions on basic freedoms, which were axiomatic before the revolution, were substantially lifted following the ouster of President Ben Ali. Censorship in the media has been abolished. The national press has been reporting freely and often critically on political and other developments in the country. A new Press Code was adopted by the interim authorities in August 2011, which strengthens the rights of journalists and eases access to information, though some continue to raise concerns of pressure and harassment when reporting is deemed too critical. Public demonstrations are frequent and address a wide range of issues ranging from social conditions and quality of life, to economic policy, religious and moral concerns, wages and work issues. Security forces are often required to maintain crowd control, but do so through non-lethal means and generally respecting people's right to protest peacefully. There have been incidents of assault against protesters and journalists, and human rights campaigners have complained that they are singled out for harsh treatment by the security forces and have been victims of arbitrary arrest and mistreatment.

Freedom of conscience and religion. Under the existing Constitution, freedom of religion is guaranteed, however with some restrictions. Political parties based on religion were prohibited and the freedom of worship of Baha'is was restricted in practice. Islam is the state religion, and the existing Constitution stipulates that the President must be a Muslim. Since the revolution, the ban on religious parties has been lifted, and the most popular Islamist party, Ennahda, operates freely.

Gender equality. Under the former regime, Tunisia was recognised as a country with relatively progressive social policies. Women in Tunisia enjoyed greater social freedoms, legal rights and economic opportunities than in other countries in the Middle East and North Africa region. Tunisia ratified the Optional Protocol to the UN Convention on Elimination of All Forms of Discrimination Against Women in 2008. The law guarantees women equal rights in education marriage, divorce and protection against 'honour crimes'. Women played an important role in the demonstrations that brought about political change through peaceful protest against the regime. The interim authorities continue to uphold the rights of women and promote gender equality.

2.5 Assessment

The interim authorities have undertaken important commitments to democratise political life in Tunisia and reform the system: beginning to dismantle the repressive system in place before the revolution, adhering to a clear timetable for constitutional reform, paving the way for credible elections to the National Constituent Assembly. Moreover, Tunisia has a community of mobilised civic activists who are demanding greater voice and freedom from the bottom up, a sizeable and politically active middle class, an interim government that has the political will to move in a cautious but decisive way towards multiparty democracy and pluralism and strong support from the international community. These commitments and conditions are consistent with those normally expected for countries of operations under the Bank's Article 1 mandate.

In recognition of the progress already made to develop democratic institutions, and the commitments undertaken to make further progress in this direction, Tunisia has been invited into the G-8's Deauville Partnership. This important reference point supports the conclusion that Tunisia is engaged in a credible transition towards a free, democratic and tolerant society. However, there is more to be done to solidify the progress made since the revolution and ensure Tunisia's development as a sustainable democracy, most importantly the effective transfer of power to a legitimate sovereign body that reflects the will of the electorate following the elections of 23 October, the drafting of a new democratic Constitution and creation of other important institutions of democratic governance and, in time, the holding of free and fair democratic parliamentary and presidential elections.

3. Transition Assessment

This section analyses the state of economic reforms and private sector development in the Tunisian economy. Following some historical background it provides an overview of the current state of economic and sectoral reforms, building on Tunisia's own priorities as described in the *Jasmin Plan*[2] which was presented in the context of the Deauville Partnership. It outlines the key transition challenges Tunisia faces in its transition to a well-functioning market economy. Annex 1 provides a more detailed sector-level assessment.

3.1 From socialist planning to reforms 1956-2010

Before the events of the Arab Spring, Tunisia was considered a success story. Decent progress had been made in structural reforms, establishing macroeconomic stability and economic growth. Yet, the Arab Spring was sparked in Tunis, dramatically underlining that growth without perceived fairness, respect for individual freedoms and social inclusion is not sustainable. In 2010 large segments of the workforce remained unemployed: 13% overall, about 17% for women, as much as 30% of the young (aged 20-24), and 44% for university graduates. Regional disparities were equally striking, with unemployment especially high in the interior of the country. Behind the appearances of a rules-based institutional framework, governance and transparency problems allowed cronyism and privileged access to markets and finance. This section gives an overview of structural and macro economic reforms from independence until the revolution in early 2011.

- *After gaining independence in 1956, Tunisia embarked on socialist planning and protectionist economic policies like most of the other North African countries, albeit with some liberal elements.* Tunisia focused more than others on an industrial strategy based on the infant industry argument and protected certain manufacturing sectors, such as textiles and leather, until they had sufficiently developed. Led mainly by the state sector but supported by private sector investment in a gradually improving business environment, Tunisia managed an export–led growth from labour-intensive sectors as well as from energy production.
- *Lack of adjustment to the decline in oil production from the early 1980s and a drop in world oil prices led to unsustainable fiscal and external imbalances by 1984/85.* As foreseen, Tunisia's oil production began to decline from the early 1980s while world oil prices fell. Initially fiscal policies failed to adjust to shrinking oil revenues, resulting in large twin fiscal and external current account deficits and a rapid rise in public and external debt. At first the authorities resorted to administrative measures to limit the current account deficit (import restrictions), before embarking on a serious adjustment effort.
- *Stabilisation and structural reforms to diversify the economy 1986-2004*. By the mid-1980s, the Tunisian economy needed to go through not only a painful macro economic adjustment but also had to start a major structural shift towards

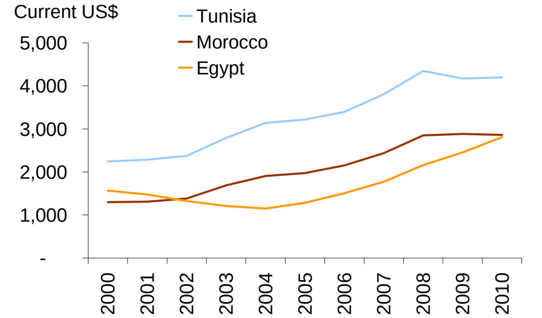
[2] République Tunisienne - Stratégie de Développement Economique et Social 2012-2016.

a more diversified economy. A multi-annual macroeconomic and structural adjustment programme was launched in 1986, supported by the IMF and other IFIs. Beyond macroeconomic stabilization and prudent fiscal policies in the two decades that followed, an important component of the programme was structural reforms to create better institutional frameworks and a more business friendly environment. Reforms were carried out in a number of areas: *(i)* financial sector: moving away from direct credit controls and finally liberalising deposit and lending rates in 1994; starting a treasury bills market and establishing an interbank foreign exchange market; and improving the regulatory and banking supervision regimes; *(ii)* trade liberalisation: Tunisia acceded to GATT in 1990, became a founding WTO member in 1995, and concluded a bilateral free-trade agreement with the EC in the same year; and *(iii)* selective privatisation, focusing mostly on non-strategic sectors with, however, limited success. Only 45 companies were privatised in the first decade and state-owned enterprises maintained their dominance in most sectors.

- *Privatisation and fiscal reforms gained momentum in the period 2005-10.* Privatisation proceeded in telecommunications, banking, insurance, manufacturing and petroleum distribution, often with foreign participation. Nevertheless, the government still retained control in a number of sectors, most notably finance, electricity and gas distribution, hydrocarbons and water. Prudent fiscal policies continued with only moderate fiscal deficits, and a domestic price adjustment mechanism for petroleum products was introduced in early 2009. Financial intermediation accelerated and private sector credit to GDP reached more than 65% by 2010. Inflation remained contained at around 3-4% a year, without recourse to widespread price controls and subsidies. Prudent macroeconomic policies paved the way for reducing public debt and external debt to 40% and 49% of GDP by 2010, respectively, with a comfortable level of international reserves covering more than 6 months of imports.

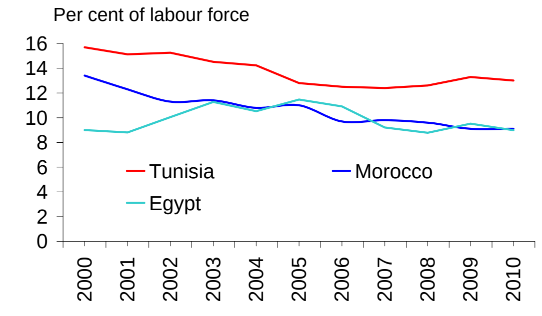
The results appeared favourable: a solid growth record (5% on average annually over two decades) within a stable macroeconomic environment, translating into the highest GDP per capita among the three SEMED countries (Chart 1). Moreover, Tunisia managed a noteworthy structural transformation and diversification in the 1980s and 90s. It successfully broke into light manufacturing, which helped to diversify its production base away from oil and created medium- and low skilled jobs. These policies, coupled with targeted social programmes put Tunisia on track to reach the Millennium Development Goals (MDGs), according to the African Development Bank and the World Bank.

Chart 1: GDP per capita



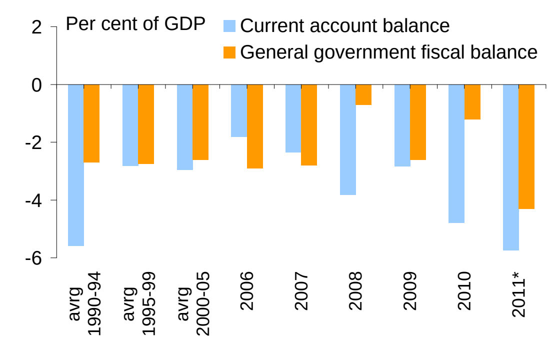
Source: IFS, 2011

Chart 2: Unemployment rate



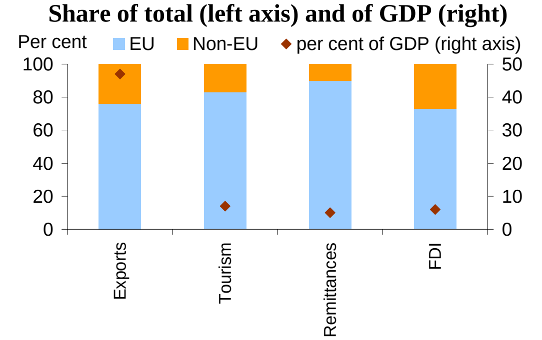
Source: IFS, 2011

Chart 3: Current account and fiscal balance



Source: IMF Regional and World Economic Outlook
* estimates

Chart 4: Exposure to the eurozone
Share of total (left axis) and of GDP (right)



Source: IFS, 2008

However, problems persisted under the surface:

- Growth had been inadequate to absorb new entrants to the labour market, given the country's very rapid population growth. Unemployment remained stubbornly high, particularly among the young and the educated as well as women. Moreover, employment creation was concentrated geographically, with large numbers of unskilled long-term unemployed in the interior of the country. Progress in school enrolment and literacy did not ultimately translate into ensuring that the young acquired marketable skills. Skills mismatches remained widespread.

- Restrictions on certain business activities impeded market entry and access to finance. In fact, Tunisia's development proceeded on a dual track: an export-oriented 'off-shore' economy under a liberal regime that managed to attract foreign direct investment (given generous incentives such as tax holidays, duty-free imports and free repatriation of profits); alongside a backward 'on-shore' economy without tax incentives or market contestability and with significant state interference and red tape. This dual economy and the associated regional disparities are reflected in growth and income, as well as in unemployment figures.

- The privatisation agenda remained incomplete particularly in the banking sector, where three large banks remained under majority ownership by the state (controlling about 33% of total bank assets with weak balance sheets); the utilities sectors are dominated by state-owned enterprises.

- While credit to the private sector increased steadily, a significant part constituted directed lending or connected lending to a limited number of borrowers; SMEs, in turn, had far less access to finance.
- Tunisia appears to be an example of the gap that can exist between *de jure* institutional frameworks and their actual implementation and effectiveness. The country achieved a stellar rise in the World Bank's *Doing Business* rankings from 139th in 2006 to 55th in 2010. But as the World Bank itself points out, surveys suggest discretionary application of rules and regulations, including through rigged procurements and the use of public banks for directed credit. Moreover, taxation on business remained high.

3.2 The global financial crisis and the Jasmine Revolution

Tunisia's economy weathered the impact of the global financial crisis in 2008/9 well. Being a small and increasingly open economy, the main transmission channels of the crisis impact were trade and remittances. The government introduced targeted fiscal measures to mitigate the impact of falling external demand, accelerated public investment and provided direct support to exporting firms that had been particularly hard hit. Monetary policy was appropriately flexible, initially easing liquidity conditions with interest rate cuts and lowering reserve requirements, and subsequently absorbing liquidity as conditions improved by raising reserve requirements. As a result, real GDP growth decelerated only slightly to 3 % in 2010, with some widening of the external current account deficit.

However, during the popular uprising of the Jasmine Revolution and following the conflict in Libya, economic activity was seriously affected. Strikes and protests caused major disruptions to industrial production and services. The conflict in Libya prompted the return of workers from that country with a loss of remittance income; led to an influx of refugees; and further weakened investor sentiment. Overall, GDP contracted by 3% y-o-y in the first half of 2011. Tourism receipts more than halved between January and July 2011, but export growth remained strong. Capital inflows declined by 26% in the first half of 2011, of which FDI by 17% and portfolio inflows by a dramatic 75%. International reserves declined to the equivalent of 4 months of imports by end-September 2011, despite significant international financial support, mainly from IFIs and the EU. Monetary policy has been geared toward supporting economic recovery, with the central bank cutting the refinance rate to 3.5% at the beginning of September 2011 in the context of weak demand conditions, and reducing reserve requirements. Inflation remains under control. After an increase to 4.2% in 2010 reflecting in part the reduction in oil and food price subsidies, inflation declined to 3.1% by August 2011.

The short-term outlook is challenging in the context of lingering political uncertainties, including the prospect of a series of elections and caretaker government(s) for the next 12 months. On present trends in tourism and FDI, GDP is projected to stagnate in 2011, which, according to some estimates, may prompt a further jump in unemployment, which is already estimated to be close to 15%. Growth may pick up in 2012 as the political outlook becomes clearer and FDI and tourism rebound. Fiscal policy will be slightly expansionary, with the fiscal deficit projected to reach 4½ % of GDP in 2011 and 2012. The government announced in April that a ceiling on subsidies set by the previous administration will be breached. Extra spending will be directed to the considerably poorer interior regions, and there will be tax incentives for investment in those regions. According to the IMF, implementing the fiscal stimulus package will support recovery and job creation.

There are significant downside risks to the short-term outlook. First, there is a risk that growth remains insufficient and that a continued rise in unemployment fuels further social tensions. Bank balance sheets and capital positions would further weaken, setting off a vicious circle of weak growth, credit constraints and rising unemployment. Second, Tunisia is exposed to the ongoing euro zone crisis, with more than 75% of its exports, tourism, remittance income and FDI dependent on the EU. Third, there are risks of continued tensions in Libya; however, stabilisation in that country could impact Tunisia positively.

The authorities' *Jasmine Plan* under the Deauville Partnership outlines Tunisia's key challenges and priorities around a set of 10 strategic targets:

1. Establishing trust through transparency, social responsibility and citizen participation;
2. Ensuring that development is all-inclusive and equitably shared amongst the different strata of society;
3. Promoting a knowledge-based economy in which science and technology will play a significantly enhanced role;
4. Creating favourable conditions for the promotion of productivity and entrepreneurship;
5. Fostering integration with the world economy;
6. Investing in human capital through education and training, and fostering professional competency in all fields;
7. Promoting social justice and equal opportunity programs;
8. Ensuring an adequate, balanced and viable financing of the economy;
9. Rehabilitate the public service and civil action; and
10. Optimize the utilisation of resources and the preservation of the environment.

These strategic targets fall under three main broad themes: (1) good governance, (2) incentives for entrepreneurship; and (3) inclusive growth. The latter is a particularly important priority; the government is embarking on a number of short term social emergency measures, including job-support programs and enhanced financial support for lagging regions.

The *Jasmine Plan* is quite explicit about the role of the private sector in creating job opportunities and growth and includes a commitment by the government to divest some of its assets and to overhaul its regulatory framework pertaining to SMEs, PPPs and private equity. With regard to the latter, the transition government is launching an innovative generational investment vehicle (the "Aiyal Fund"), aiming at attracting private investment into large ticket items such as infrastructure, renewable energies, technology and agribusiness.

Overall, the strategic objectives and themes are consistent with tackling the main transition gaps identified below.

3.3 Transition gaps

The sector review in Annex 1 documents that, despite decades of reform, there are still very sizeable transition gaps across most sectors of the economy, with particularly large challenges in the energy, municipal and transport infrastructure sectors and the financial sector. Structural policies and reform priorities outlined below have been discussed with both the government and private sector participants and aligned with the authorities' detailed *Jasmine Plan*.

- **The energy sector has large transition gaps across-the-board.** In contrast to its neighbours, Tunisia has limited own energy resources and became a net energy importer in 2001. The upstream and downstream oil, gas and power sectors remain dominated by state-owned companies in need of restructuring. Although there have been efforts to encourage private sector generation, it still only accounts for around a fifth of total generation. The power sector operates as a single buyer/wholesale model with no market based incentives for network and investment. Further unbundling, tariff reforms and regulatory independence are the key reform challenges.
- **Infrastructure – both municipalities and the transport sector - also suffers from a number of large gaps.** Separation of regulatory and operational responsibility of municipalities has not taken place, negatively impacting the efficiency of water and waste water services as well as urban transport management. Given the ineffective tariff system, in particular for wastewater, with service fees only covering half of operating costs, the sector remains dependent on subsidies. Developing transparent PPP solutions to attract private sector participation will be important for structural policy as well as fiscal sustainability reasons. For the transport sector disentangling infrastructure from operations is an important first reform goal, so as to attract private sector participation and introduce competition.
- **The financial sector has a number of structural deficiencies, particularly in MSME lending, private equity and local capital market development.** High NPLs indicate weak bank balance sheets in particular in the state owned banks that have been prone to directed lending to connected businesses and overexposure to a few sectors. This has partially crowded out lending to SMEs, which suffer from a lack of access to finance and are faced with low institutional capacity and skills to lend on a cash-flow basis. Information on borrowers is limited. The Tunis Stock Exchange has low market capitalisation and is dominated by financial institutions. The government bond market is underdeveloped (Box Chart 8 on the EBRD government bond index).

There are several themes that cut across sectors:

- **Labour market rigidities and skills mismatches.** Firing costs, including high severance payments as well as difficult out-of court settlement procedures have contributed to a high structural unemployment rate. Additionally the university system produces graduates that are not well equipped to meet the demands of the labour market.
- **High tax burden on businesses.** Tunisia compares unfavourably with other SEMED countries and comparable emerging markets in terms of taxes levied on businesses. Taxes on labour and profit are above regional average, with a total combined tax bill of up to 62.7 percent.[3]
- **Regional disparities.** Segmentation of economic development is starkest in the manufacturing sector with a highly competitive off-shore sector and a red-tape intensive on-shore sector dominated by well-connected businesses. But this is also evident in virtually all human capital and labour market indicators with limited job opportunities in the interior regions of the country.
- **Regulatory frameworks.** Despite earlier reforms, a level playing field has not been established in many sectors, pointing to weak de facto regulatory frameworks. Independent regulatory agencies are yet to be set up in natural resources and power.

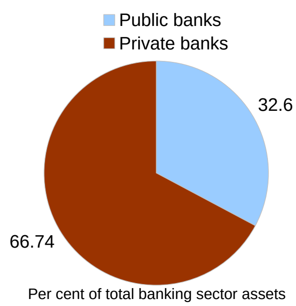
[3] World Bank 2011 *Doing Business* survey.

Box 1: Financial Sector Vulnerabilities

The Tunisian banking system has major structural weaknesses and local money and capital markets are underdeveloped:

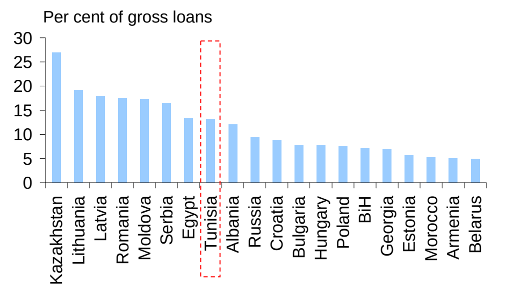
- **High share of state-owned banks.** State-owned banks make up a significant part of the banking system. Three of the top four banks are majority state-owned, controlling 33% percent of banking sector assets and 37% of deposits (Chart 5). Their balance sheets are substantially worse than those of the private banks.
- **Weaknesses in bank corporate governance.** Key problems include underdeveloped board practices; poor transparency; weak risk management particularly, but not exclusively, in state-owned banks.
- **Non-performing loans are high at around 13.2% despite a recent declining trend** (Chart 6). NPLs are mainly driven by directed lending to connected parties and high concentration of exposure to specific sectors. NPLs believed to be much higher in state-owned banks.
- **Local financial markets are underdeveloped.** Tunisia scores in the lower range of market development according to the EBRD's government bond market index, with virtually no secondary market liquidity and limited overall market development.

Chart 5: State owned banks vs private sector owned banks



Source: Central Bank of Tunisia, 2009.

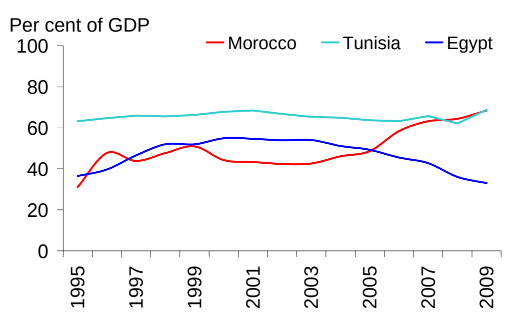
Chart 6: Non-performing loans (NPL)



Source: WDI

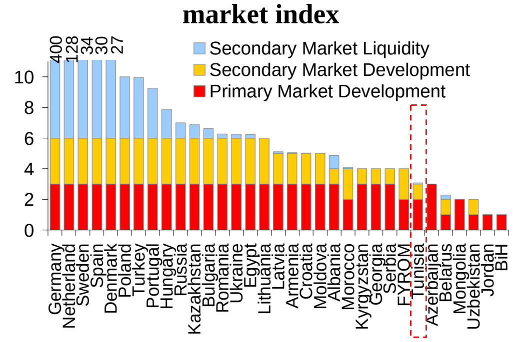
Note: Data is 2010, except for Egypt, Poland and Tunisia, where it refers to 2009

Chart 7: Domestic credit to the private sector



Source: World Bank WDI

Chart 8: EBRD Government bond market index



EBRD calculations

3.4 Assessment and risks

Tunisia has benefited considerably from years of carefully sequenced structural and macroeconomic reforms. These delivered a stable macroeconomic policy environment and solid growth rates of around 5% over the last two decades as well as comfortable levels of international reserves. This has allowed Tunisia to react to the global financial crises with a small stimulus package and keep growth rates above 3% in 2009-10.

However, the long track record of structural reforms did not create the robust institutions that are needed to ensure rules-based regulation, a level playing field, market contestability and universal access to finance. Governance problems and private sector development that was built in part on privileges impeded unleashing the private sector's full potential to deliver growth, and with benefits that are more evenly shared within the society. Moreover, in the past decade a significant portion of new entrants to the labour market have been university graduates whose skills are not suitable for the current production structure. Unemployment remained high and the sentiment of social exclusion strong. These persistent social tensions may help explain why the popular unrest of the Arab Spring erupted in Tunisia, one of the most developed countries in the region.

The economic policy challenge is as clear as it may be daunting: to achieve growth that is sufficiently high to absorb the continued strong inflow of labour market entrants, and provide training and education that produces skills demanded by the market. Regarding growth, there is a need to continue shifting from a low value-added and low-cost production structure to a higher value-added, knowledge-intensive economy over the medium term. As the *Jasmine Plan* sets out, the private sector should play a key role in this process, on its own – and without special privileges – as well as in the form of appropriately designed public-private partnerships. A new PPP draft law aims, among others, at attracting private sector investments into municipal and transport infrastructure with hoped job generation. Regarding training, the public sector will need to lead reforms both in the education system and the labour market, but the private sector can also help with instruments such as on-the-job training.

The Tunisian financial sector faces large transition gaps and is fraught with major structural weaknesses. These prevent it from playing an adequate role in support of growth - and are not commensurate with Tunisia's relatively advanced level of development. More than in some other countries in the region, financial sector reform and restructuring is therefore an immediate priority.

Overall, Tunisia has made important strides in economic development and reform over the past decades and was able to engineer a major structural transformation in the face of dwindling energy production from the early 1980s. Thanks to earlier reforms many of the institutions and market frameworks are in place *de jure*. Making them work effectively will eliminate cronyism, lack of opportunity, and privileged access to jobs and finance. Only then will the private sector, supported by a reformed state, be able to deliver stronger and more inclusive growth.

Tunisia: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 *Projection*
Output and expenditure	*(Percentage change in real terms)*					
GDP	5.7	6.3	4.5	3.1	3.1	0.0
Private consumption	4.9	5.2	4.8	3.9	4.5	…
Public consumption	5.7	2.8	4.0	4.5	4.0	…
Gross fixed capital formation	7.9	4.1	5.3	3.8	4.3	…
Exports of goods and services (volume)	4.0	8.1	4.4	-6.6	…	…
Imports of goods and services (volume)	7.6	9.5	5.0	-4.9	…	…
Labour Market	*(In per cent of labour force)*					
Unemployment rate (end-year)	12.5	12.4	12.6	13.3	13.0	14.7
Prices	*(Percentage change)*					
Consumer prices (annual average)	4.2	3.4	4.9	3.5	4.4	3.5
Consumer prices (end-year)	3.3	5.1	4.0	4.0	4.1	3.5
Fiscal Indicators	*(In per cent of GDP)*					
Fiscal balance	-2.9	-2.8	-0.7	-2.6	-1.2	-4.3
General government revenues*	26.5	27.4	29.6	29.0	29.5	30.9
General government expenditure	29.4	30.2	30.7	32.0	30.8	35.6
General government debt (gross)	48.8	45.9	43.3	42.8	40.4	41.7
Monetary and financial sectors	*(Percentage change)*					
Broad money (M2, end-year)	11.6	12.4	14.8	12.5	11.4	…
	(In per cent of GDP)					
Credit to the private sector (end-year)	63.2	65.8	62.2	68.8	…	…
	(in per cent of total loans)					
Non-performing loans ratio	19.3	17.9	15.5	13.2	12.1	…
Interest and exchange rates	*(In per cent per annum, end-year)*					
Local currency deposit rate	3.3	3.3	3.3	3.0	3.2	…
	(TND per US dollar)					
Money market rate	5.1	5.2	5.2	4.3	4.4	…
Exchange rate (end-year)	1.3	1.2	1.3	1.3	1.4	…
Exchange rate (annual average)	1.3	1.3	1.2	1.4	1.4	…
External sector						
	(in per cent of GDP)					
Current account	-1.8	-2.4	-3.8	-2.8	-4.8	-5.7
Foreign direct investment, net		4.0	5.7	3.3	3.2	1.1
Gross reserves, excluding gold (end-year)	19.8	20.3	20.1	24.4	21.5	15.7
External debt stock	52.8	49.3	48.8	48.2	48.8	49.3
	(In months of imports of goods and services)					
Gross reserves, excluding gold (end-year)	4.4	4.0	3.6	5.6	4.1	…
Memorandum items	*(Denominations as indicated)*					
Population (end-year, million)	10.2	10.3	10.5	10.6	10.7	
GDP (in billions of US dollars)	34.38	38.92	44.88	43.52	44.28	48.93
GDP per capita (in US dollars)	3394.2	3806.6	4345.9	4170.9	4199.3	4592.6
Share of industry in GDP (in per cent)**	10.2	9.4	8.7	9.1	8.0	…
Share of agriculture in GDP (in per cent)	28.6	30.1	31.9	29.6	31.9	…
Net FDI (In million of US dollars)	3394.4	1696.4	2594.6	1729.8	1505.7	…

* Excluding grants

**Excludes refining

4. Cooperation with other International Financial Institutions

4.1 An unprecedented coordination effort under the aegis of the G8

Several international financial institutions (IFIs) and major regional and bilateral organisations are currently active in Tunisia. As emphasised by EBRD Governors in Astana, it will be important to avoid duplication and competition and to ensure that any potential activity of the EBRD brings specific value-added based on the mandate and competencies of the EBRD. Field missions from Banking, OCE and the Political Counsellors offered numerous opportunities to meet our sister institutions in Tunis.

This natural coordination process has been strengthened under the aegis of the Deauville Partnership, announced in May by G8 leaders. A follow-up Ministerial meeting in Marseille on September 10 formalised the Partnership and involved actively the World Bank Group, the AfDB, the EIB, the IsDB, and the Arab regional Funds (Arab Fund for Social and Economic Development; Arab Monetary Fund; and the OPEC Fund), in addition to the EBRD.

The MDBs and regional financial institutions signed a Joint Statement in support of the Deauville Partnership, committing to strengthened cooperation in the four partner countries – including Tunisia. For this purpose, they created a “Coordination Platform” dedicated to (i) facilitating information sharing and mutual understanding, (ii) coordinating monitoring and reporting on the implementation of the Deauville Partnership, and (iii) identifying opportunities for collaboration on financing, technical assistance, and policy and analytical work. The group will be led by one of the participating IFIs on a rotational basis (starting with the AfDB).

The World Bank also coordinated a MDB Action Plan, whereas the AfDB put forward a Private Sector Development Initiative, which is still being discussed by MDBs and would consist of various joint initiatives on which the interested MDBs would work together. The EBRD is a full participant in these endeavours, subject to confirmation by shareholders of its engagement in the region.

The EBRD is also a member of the EU-Tunisia high-level “task force” aimed at building commitment while ensuring coordination, and joined the first meeting of the task force in Tunis together with other IFIs and private sector representatives.

In addition to these broad-based efforts, the EBRD signed Memoranda of Understanding with the AfDB and IsDB, respectively. A MoU with the EIB is, of course, already under implementation and will be adjusted to take account of specificities in the new region. The MoUs with AfDB and IsDB provide a general framework of cooperation in common countries of operation. The types of cooperation envisaged include: information exchange, secondments, joint training, coordinated technical assistance and co-financing. The MoU with AfDB also includes an offer from AfDB to make available office space pending the establishment of EBRD offices. Overall the MoUs confirm the complementarity of EBRD and the other institutions and the shared intention to use their skills and experience to advance their respective mandates.

4.2 IFI and major bilateral financing activities in Tunisia

IFI annual business volume reached a high of €1.6 billion in 2010 for a total portfolio in the country estimated at €12.5 billion. World Bank, AfDB, EIB and AFESD traditionally account for the bulk of that financing. The EU is also active through the Neighbourhood Investment Facility, which provided €23 million in grants for 3 projects cofinanced by KfW, AFD, and (for 2 of them) EIB. The volume of IFI financing in Tunisia as a proportion of GDP is in line with the regional average (2.2 %).

After the Revolution, IFI activities resumed rapidly as the administration felt empowered to take substantial policy decisions. Post-Revolution loans include:

- policy-based support for Tunisia underpinning government reforms of access to information, freedom of association, transparency in public procurement and application of regulations, with total financing of US$1.3 billion from AfDB, AFD, EU and the World Bank;
- a $550 million regional facility approved by AfDB, IBRD and IFC for access to finance by SMEs, along with first sub-loans to Tunisia of $50 million each from AfDB and IBRD;
- three new loans signed by EIB totalling € 307 million; and
- a $100 million rural water supply project expected to be signed by AfDB before the end of the year.

In the *Jasmin Plan* presented in Marseille within the framework of the Deauville Partnership, Tunisia estimated its financing needs from IFIs at € 7 billion over the next 3 years, which exceeds past levels considerably. IFIs have announced a special effort for Tunisia. The IBRD is expecting $ 1.5 billion to be approved over the coming three years, the IFC approximately $ 1 billion and the EIB € 1.9 billion.

Summary of the activities of IFIs in Tunisia

	Portfolio	ABV	Forecasts	Main sectors of activity	Private sector operations
World Bank (IBRD)	$ 970 m (excluding DPLs)	$ 1 bn over the last 3 years, including $ 180 bn in 2010. In 2011, the IBRD provided a $ 500 m DPL	The envelope over the next three years is estimated at about $1.5 bn ($500 m annually)	Budget support; employment; health; education; agriculture	N/A
IFC	$256 m in 6 companies	In 2011, the IFC signed a $ 7.8 m project in the health sector	$300 - $400 m per annum in the next 3 years	Trade finance, MSME credit lines, investment climate	Focus on PPPs, equity investments and IT
AfDB	UA 1.5 bn (approx. $ 2.4 bn)	$ 480 m in 2010. For 2011, a $ 500 m budget support operation and three other projects for $ 370 m	The envelope for 2012 includes operations estimated at about USD 500m	Transport, power, lines of credit and budget support	Lines of credit and hydrocarbon sector
EIB	€ 4 bn	€ 500 m in 2010 (over 3 projects)	€ 500-800 m for 2011 € 1.9 bn over the period 2011 - 2013	Private-sector development; environmental protection; support to large-scale infrastructure	21% on average over the last 3 years
IsDB	$ 1.1 bn (excluding trade finance)	$ 282.5 M in 2010 (electricity transmission network)	$900 m over the period 2011-2013, with focus on SMEs, agriculture and infra-structure	Energy, transportation, education, MSME, trade, agriculture, water and health	14 % on average
Arab Fund for Economic and Social Development	$2.3 bn	$ 133 m in 2010 (power plant). In 2011, AFESD has provided two loans amounting to $ 195 m	Currently preparing a loan of about $150 m for rural development projects.	Power, industry and mining sectors	No recent project

	Portfolio	ABV	Forecasts	Main sectors of activity	Private sector operations
OPEC Fund (OFID)	$ 126 m	No operation in 2010		Energy, transportation, education	None in Tunisia
Arab Monetary Fund (AMF)	No loan to Tunisia so far	N/A	Expects to lend $ 500 m to Tunisia and Egypt	Provide financial assistance to correct balance of payments disequilibria and implement structural reforms aimed at modernising financial systems	N/A
KfW/DEG	€ 1.4 bn	€ 48 m in 2010		Strong focus on the sustainable use and efficient management of water resources	No recent project
AFD	€ 1.7 bn	€ 135 m on average with a peak at € 213 m in 2010 – sovereign and non sovereign; (excluding Proparco)	€ 425 m in the next 3 years (sovereign), including 185 m in 2011 (excluding Proparco)	SMEs, energy efficiency, urban transport, water & sanitation; environment; financial sector; education	Proparco operations are irregular. ABV in 2010 amounted to € 8 m.

4.3 Scope for cooperation on projects

IFI private sector financing has been very limited in Tunisia. At the same time, the government's *Jasmin Plan* emphasises "the critical, but newly defined, role that the government will play in significantly promoting the contribution of the private sector in carrying out new investments". Supporting that focus on the private sector will be both an opportunity and a challenge for the IFIs, including EBRD.

Cooperation will build on each institution's specific competencies and business model. The EBRD's business model was described in detail in "Fighting the crisis, promoting recovery and deepening transition" (BDS09-54) providing the basis for the formulation of the medium term operational priorities of the Bank endorsed by Governors in May 2009. These include institutional, mandate and operational attributes such as, *inter alia*, its transition focus, respect for additionality, capacity to evaluate, structure, mitigate and take debt and equity risks, experience in supporting local (less experienced) and smaller businesses, ability to support different ownership models, and ability to intervene directly at company level to promote high quality standards in areas such as governance.

In preparing this technical assessment, the Bank has consulted closely, both on an institutional level and on the ground, with all IFIs active in the region. Based on the response, there would appear to be a range of opportunities for cooperation, some of which are set out in Section 5.

Regionally, in the context of the Deauville Partnership Action Plan, the EBRD has been flagged as a potential partner for the AfDB-World Bank SME Facility; the Arab Financing Facility for Infrastructure (AFFI); the Arab World Initiative for food security (driven by the World Bank); and the World Bank-led MENA Concentrated Solar Power Program. Under the AfDB-led Private Sector Initiative, the EBRD has been asked to take the lead in exploring the scope for joint initiatives on “Local currency and capital markets” and is expected to participate in exploring others, including joint guarantee facilities, liquidity support for banks, PPPs and work on the investment climate.

In terms of policy dialogue, cooperation should be particularly helpful in overcoming major regulatory hurdles, in particular for PPPs, commercialisation of utilities, and local currency financing. Finally, cooperation with other MDBs will entail shared analytical work. The EBRD is already working with the World Bank on producing jointly LiTS and BEEPS studies for the new region.

5. Outline of potential operational areas

5.1 Operational themes and technical cooperation framework

The operational directions for the Bank's potential activities in Tunisia reflect the following factors:

- the overall directions set in the context of the Deauville Partnership including the **Economic and Social Programme** prepared by the Tunisian authorities in September 2011 and set out in the "*Jasmine Plan*";
- the transition challenges and operational themes which emerged from the Bank's operational assessment trip to Tunisia in September 2011;
- the activities of other IFIs active in Tunisia; and
- the specific set of competencies, comparative advantage and transition mandate of the Bank.

Transition challenges are summarised in this section and described in more detail in Annex 1. Based on the work to date, the following operational themes have been identified to guide the Bank's activities in Tunisia:

- **restructuring and strengthening the financial sector** to support private sector development;
- **financing private enterprises, with a focus on SMEs**, to boost the creation of high quality private sector jobs and develop a resilient and diverse economy;
- **supporting energy efficiency and the development of a sustainable energy sector,** to improve energy security, sustainability and enhance economic competitiveness; and
- **facilitating non-sovereign financing for infrastructure development** to provide wider access to better quality urban services and the efficient provision of public services.

In the build-up phase, there will be a particular focus on private sector / SME support and on the financial sector. Furthermore, in each case the "horizontal" focus will be on project structures and instruments that draw on the Bank's specific attributes and strengths.

These operational themes support the implementation of Tunisia's medium term policy programme and particularly of its priority areas for collaboration under the Deauville Partnership. The interim government has already reformed the regulatory frameworks for microfinance and private equity in view of their immediate impact on job creation and the promotion of small businesses, particularly in rural areas. Other regulatory reforms are underway in relation to Public Private Partnerships ('PPP'), and support for SMEs. The Bank's agenda also supports key elements of the interim government's medium-term strategy of promoting a knowledge-based economy; fostering integration into the world economy; ensuring an adequate, balanced and viable financing of the economy; and optimizing the utilisation of resources and the preservation of the environment.

Nonetheless key infrastructure projects will require extensive policy dialogue to agree on significant structural changes before they can be implemented and the Bank will in many cases need to develop local currency financing capacity to match the revenue base of infrastructure assets. Some of these developments will likely have to await the appointment of a new government with a democratic mandate.

As noted in Section 4, the Bank is committed to participating in joint initiatives with other IFIs active in its potential new region of operations. These include local currency and capital market development and the possible design of joint guarantee schemes, on both of which the EBRD is expected to take a leading role, as well as regional cooperation on SME investment vehicles, liquidity facilities for banks, PPP development, capacity building programmes, work on the business climate and possibly further initiatives. These are not specifically taken up in the following but should be seen to complement the Bank's plans in Tunisia.

The Bank's operations in Tunisia, at both the initial and later stages, will seek to address issues of gender equality and women's entrepreneurship, within its mandate and in keeping with the Bank's Gender Action Plan. As noted previously, women's rights are comparatively well-established in Tunisia and the authorities remain committed to this agenda. Nevertheless, the Bank could assess ways to further enhance their participation in the labour force. This might include technical assistance to encourage MSMEs in the informal sector to become officially registered, as well as tailored projects that would accompany future investments – e.g., with intermediary banks on lending to women-owned businesses, with corporate clients on improving their human resources policies, and in municipal projects ensuring benefits are equally shared between men and women.

Finally, the themes and potential activities described in this section have been formulated on the basis of the knowledge available to date in a situation where the Bank does not yet have any operational experience in the country and no local presence. Accordingly, the directions and priorities set in this section constitute an initial basis for the start of operational activities in Tunisia and will be enriched as the Bank's knowledge and experience builds up.

Annex 2 presents a tabular summary of challenges, investment priorities and related TC.

Technical cooperation framework

The operational themes guide the initial definition of Technical Cooperation (TC) assignments which could be launched as soon as the Board authorises the use of cooperation funds in Tunisia. Based on its operational experience, the Bank has developed a range of TC mechanisms which generally fall into the following broad categories:

- **Regional or sector studies**: overarching reviews of particular areas or sectors, intended to inform the Bank and its interlocutors and to facilitate the identification of specific opportunities. This might include for example a market survey of energy efficiency investment opportunities.

- **Capacity building and environment enabling**: targeted assistance to create an environment more conducive to transition or to facilitate particular reforms. This might include for example reform of securities law or support for PPP development. This category can also be viewed as covering TAM/BAS activities which are essentially stand-alone.
- **Project preparation and implementation**: assistance to support a particular project, during both preparation and implementation. An example of the former might be a feasibility study for a wastewater treatment plant investment and of the latter, technical assistance to a small bank following an equity investment by the Bank.

These categories can be thought of as following a natural sequence in the order in which they are presented above: the first step for the Bank is to understand the general area in which it is operating, to identify opportunities and to share its experience with its interlocutors. The next step is to focus on specific sub-sectors where a need is identified and the Bank's involvement is appropriate and lay the groundwork for successful interventions. Often, particularly in the infrastructure sector, significant policy dialogue is required, long in advance of any project commitments, in order to create an environment in which projects can proceed. Finally TC is deployed to ensure the success of specific projects or enhance their transition impact.

In practice of course there is considerable overlap so that one assignment may fall into more than one category. Similarly in some cases certain steps in the sequence will be unnecessary or can be pursued concurrently. This EBRD TC "toolkit" provides a framework within which the TC assignments outlined below have been identified and prepared. The initial TC activities identified for each operational theme are presented in the sequence described above with the volume and nature of TC assignments varying for each operational theme. It should be understood that TC that belongs in the first two categories may not result in investment projects during the initial stages of the Bank’s engagement, but is no less urgent given the significant lead times involved if the Bank is to respond appropriately to Tunisia's medium-term challenges in the coming years.

5.2 Restructuring and strengthening the financial sector

Key transition challenges

Banking and insurance sectors

The Tunisian banking system comprises 21 banks of which 11 are publicly traded on the Tunis Stock Exchange. Three of the top four banks, representing 33% of total banking assets, are majority state-owned. The largest five banks account for 54% of total banks’ assets.

Banking penetration is in line with peers with 1,348 branches, i.e. 13 branches per 100,000 inhabitants, compared with 4.5 in Egypt, 14 in Morocco and 15 in Romania (but 44 in France).

In 2009, the ratio of non-performing loans for the banking sector stood at 13.2% (below 22% in Egypt and above 5.5% in Morocco). The high level of NPLs was the result of an NPL crisis in the early 2000s, as well as some continued weaknesses in credit screening.

Many banks, particularly the state-owned ones, suffer from an inadequate level of capitalisation, weak corporate governance, and a relatively low level of management expertise. In addition, state-owned banks are a particular source of concern as they seem to have engaged in directed lending, often to the benefit of the former ruling family.

Solvency and liquidity are becoming important issues for the system. Many banks have tier 1 levels not far above 10%. Loan-to-deposit ratios average 129%, well above the countries of operation of the EBRD, which range between 80-90 per cent, but close to the Eurozone's 120 per cent). Banks may face a liquidity problem, which results in part from a low deposits/GDP ratio. A significant fraction of the low income population does not have a bank account.

Bank lending to SMEs is estimated at around 15% of total lending which is above Egypt's 6%, but below the OECD average of 26.8%. Generally in the corporate sector, access to bank loans is heavily dependent on the presentation of personal guarantees or collateral, even when the cash flow analysis is satisfactory. Tunisian SMEs therefore typically rely on self financing and informal financing. Two public banks, the *Banque de Financement des Petites et Moyennes Entreprises (BFPME)* and the *Banque Tunisienne de Solidarité (BTS)*, provide targeted finance for SMEs.

A new microfinance law, approved in mid September 2011, does not yet reflect best practice. The sector is split between around 300 "associations", which BTS tries to fund and steer, and just one commercially operating institution, *Enda Inter-Arabe*, servicing more than 168,000 borrowers.

The institutional framework that supports lending needs to be strengthened. For example, the credit registry suffers from information gaps with regards to the smallest loans, while a unified collateral registry does not exist and contract enforcement remains costly and lengthy.

In the non-bank financial sector, insurance suffers from a lack of specialisation (no separation of life and non-life activities). The regulated price for car insurance also makes most P&C activities unprofitable. The state-run pension fund, which covers government and some vulnerable sector workers, has poor investment returns. Private pension funds and asset management are still weak, while leasing is well developed (but exclusively through bank subsidiaries).

Against this background, key transition challenges in the financial sector are to:

- broaden access to finance for SMEs;

- raise standards in, restructure and privatise state-owned banks;
- improve the quality of loan underwriting and servicing;
- strengthen the institutional environment to support lending; and
- strengthen the insurance and pension sectors.

Equity funds

Except for AfricInvest-TunInvest, the private equity industry is under-developed and nascent in Tunisia. The sector is in the hands of few regional or pan-African players (5 fund managers investing in Tunisia with a generalist strategy) with limited competition. IFIs represent the bulk of capital raised with Gulf investors having recently shown interest. Investment strategies are mainly focused on growth/ expansion capital. There is almost no track record for fund managers as hardly any exits have been made to date. Only one player targets SMEs, while others are focused on medium-sized investments.

Potential investment areas

Banking and insurance sectors

Reflecting these transition challenges, potential activities in the banking sector in Tunisia include:

- support to SMEs, which would also help local banks better cover rural areas. This could be achieved by providing a donor-funded first-loss cover or pool-based risk sharing, accompanied by “downscaling” programmes;
- specifically in the microfinance segment, support for Enda Inter-Arabe;
- building on proposed TC activity (see below), the Bank may engage with BFPME to develop a sustainable commercially run SME finance institution;
- support for capital restructuring and institution building of selected banks, particularly state-owned banks, via subordinated debt and possibly equity or pre-privatisation investments. One possible candidate would be Banque de Tunisie, the ninth largest bank, a listed bank with Credit Mutuel-CIC as a minority strategic partner;
- EBRD’s willingness to share risk with local banks, under Medium-Sized Co-Financing Facilities (MCFF) would support the provision of financing to mid-size companies, while removing the need for syndication among local banks.
- while the raising of local currency on the local market by EBRD may not yet be possible, hedging opportunities seem to exist locally and could be leveraged to allow EBRD to provide local currency solutions to its partner banks; and
- support the transition of the insurance sector through TC and equity investments.

Equity funds

There is a significant need for capacity building of the private equity industry (represented mainly by the industry association ATIC, small PE players and venture capital associations). The Tunisian authorities have also developed an ambitious strategy to develop a fund of funds approach to bolster capital investment in support of government objectives, particularly job creation in the short term and technology development. Together with the IFC and other IFIs the Bank has initiated a dialogue with the authorities on the Generational Fund (the Ajyal Fund) to share its experience with similar instruments. Finally, the Bank will explore ways of engaging with locally-based and regional generalist funds that are raising capital.

Technical cooperation priorities

Banking and insurance sectors

The Bank's initial TC activities in the financial sector could include both sub-sector reform projects and technical assistance targeted at specific entities, as follows:

- Technical assistance to support the balance sheet restructuring of up to four banks to identify and reduce their level of non-performing loans. This may be through direct analysis conducted with the banks, or via assistance to the Government to set up the appropriate framework for a special purpose distressed asset fund.
- Support for BFPME to redefine its business model, which currently does not properly segregate its commercial and TC activities.
- Technical assistance to assist Enda Inter-Arabe in its conversion into a joint-stock company, consistent with the requirements of the new microfinance law, which will allow it to further expand its activities.
- A project to review and propose revisions to the insurance regulatory framework.

Equity funds

Potential areas for TC to the equity funds sector will focus on targeted activities to strengthen the industry environment and support specific projects or investees.

- Capacity building to support the local private equity and venture capital association ("ATIC") and local first time fund managers backed by the Bank.
- Technical assistance to enhance the performance of portfolio companies in private equity funds where the Bank is an investor.

5.3 Financing private enterprise

Transition challenges

The Tunisian industrial and commercial sector is largely privately owned with the State retaining minority stakes in some cases, including as a result of confiscation from those close to the former regime. It is highly export oriented with more than one third of output exported and some companies exporting their entire output. In terms of sectors, mechanical, metallurgical and electrical industries, including automotive components, together with textiles, clothing and leather are the largest; with construction materials, ceramics and glass close behind; and chemicals also significant.

In recent years Tunisian industry has moved steadily up the value chain, for example into automotive components and as research and development subcontractors for Western companies. Key challenges for the Tunisian economy are to continue this trend, whilst generating employment at an increasing rate for a highly educated workforce.

Sectors where there are particular opportunities to maximise value are textiles, where there is scope to replace imported cloth with lower cost local products, and tourism, where there is a need to diversify away from low cost package holidays. Another challenge is to unwind the distorting impact in certain sectors, for example property development, of those close to the family of the former President.

The agribusiness sector is characterised by heavy state involvement in regulating prices, imposing production quotas on strategic products and, sometimes, influencing investment decisions. Prices of key products such as flour, edible oil and sugar are controlled by the state, and much of the sales take place through state-owned entities. The sector remains fragmented, dominated by small or state-owned entities practising outdated and inefficient practices. The storage, processing, logistics and distribution sectors are particularly underdeveloped, limiting the sector's ability to capture more value and build domestic brands. There is only a small presence of modern retail chains.

Primary agricultural production and food manufacturing account for approximately 8 per cent and 3 per cent of Tunisia’s GDP, respectively. Main agricultural commodities are wheat, milk, tomatoes and olives, accounting for about 46 per cent of agricultural production and revenue. Government policies target cereal production (mainly wheat and barley) to promote self-sufficiency, as Tunisia has the highest wheat per capita consumption in North Africa and is a net wheat importer.

The Tunisian banking sector generally serves the needs of larger companies adequately but there are gaps in specific areas and funding for SMEs is much less prevalent. The textile sector is an example where banks are reluctant to lend because it is perceived as low value added. The banks also lack expertise in cashflow based lending so companies that do not have significant assets to pledge (such as those in the service sector or R&D) find it difficult to get financing, as do companies in disadvantaged regions away from the more prosperous coast. Finally, the banks do not have expertise in balance sheet restructuring which some private sector companies require.

The state is heavily involved in rural financing through the *Banque Nationale Agricole* (BNA) and the *Banque Tunisienne de Solidarité* (BTS) which specialise in rural credit and microfinance, respectively. Approximately 20 per cent of financing needs are covered by bank instruments, while the other main sources of finance are government subsidies and company retained earnings.

Potential investment areas

Supporting private enterprise is critical to generate employment and promote a more resilient, diverse market economy which also generates employment for Tunisia's rapidly growing skilled workforce. The Bank is positioned to support this in a number of areas with particular expertise in supporting SMEs and the agribusiness sector. Specific opportunities include:

- acquisition and restructuring financing to support consolidation or reorganisation resulting in larger, more efficient and competitive entities; expansion financing to support businesses (for example in textiles or agribusiness) extending up or down the value chain;
- companies, particularly in the service sector, with a limited asset base but good cashflow generation;
- complex transactions where the Bank can play a role in organising financial restructuring;
- investments in the agribusiness storage, processing, logistics and distribution sector; and
- SME financing facilities, potentially including risk-sharing arrangements with local banks to promote credit provision in underserved sectors.

Technical co-operation

The expected TC activities in Tunisia in this sector are focussed on direct support for individual companies and projects:

- As with Egypt and Morocco the main TC tools which the Bank will deploy initially are the TAM and BAS programmes. Most companies in Tunisia are eligible for the TAM programme in terms of size. BAS would be specifically beneficial to micro companies and small start ups.
- TAM's focus would be on companies currently in need of reorganisation, and those that are planning to expand their business to add value. There is potential for SMEs to grow through M&A or integration of businesses to include processing, warehousing, and distribution. Particular sectors are tourism (with a focus on more sophisticated tourism), textiles (supporting higher value added), construction materials (particularly in respect of energy efficiency), mechanical and electrical components; agribusiness and R&D related companies.

- BAS would be beneficial to SMEs outside of Tunis, particularly in the underdeveloped regions, by providing them with access to advisory services and developing local consultants operating outside of Tunis as well as promoting the use of consultants for strategy and organisational support. The SME support infrastructure around Tunis is relatively well developed: BAS could work with existing SMEs in parallel with the 'Bureau de Mise à Niveau de l'Industrie' and with entrepreneurs together with UNIDO and the Carthage Business Angels through joint programmes to access rural enterprises and support start ups.
- While the Bank does not normally use TC to support larger private companies, TC could be used in this way in Tunisia in exceptional circumstances such as pre-privatisation or for companies in financial difficulty. For example TC may be deployed to support companies which suffered from discriminatory treatment under the old regime but which are fundamentally sound and could implement a turnaround plan supported by Bank finance.
- There could also be a role for the Bank in co-operation with microfinance institutions to provide technical assistance to help young people start their own businesses.
- A study to assess the advantages of investment in certain agribusiness segments and to develop private sector investment in these areas, in particular the currently underdeveloped midstream and downstream sectors. This would be done in cooperation with the government Agency for Promotion of Agricultural Investment.
- The Bank may also seek TC support for the deployment of its programmes to finance smaller companies directly such as the Local Enterprise facility (LEF).

5.4 Supporting energy efficiency and a sustainable energy sector

Transition challenges

Energy consumption in Tunisia is rising steadily as a result of economic and social developments. The cost of supplying energy is currently high and the way it is generated has a negative impact on both the environment and the climate. The country's heavy dependence on fossil fuels, most of which has to be imported, is proving increasingly detrimental to the national budget and economy. Driven by both growth of internal energy demand and by diminishing local oil reserves, Tunisia has become a net importer of energy, with energy expenditure accounting for 13% of GDP and energy subsidies for 4% of GDP in 2009.

The Government has introduced support schemes to promote the implementation of sustainable energy measures. These measures fall into two groups: direct financial incentives and tax incentives. Capital subsidies, grants and rebates (one-off payments by the government or utility) have been available to support specific technical measures.

In spite of the absence of regulatory incentives to save energy Tunisia has set up the ANME (Agence Nationale pour la Maitrise de l'Energie) which has been a key driver of energy efficiency and renewable energy programmes. This includes the implementation of specific incentives schemes, financing mechanisms and support to ESCO development. Specific energy efficiency programmes were launched from 2005 with significant results being achieved particularly in the industrial sector, which accounts for a third of energy consumption. These activities, combined with a shift of economic activity to higher value added industries, have resulted in a decrease in energy intensity of over 25% between 1990 and 2010.

The Tunisian power sector is dominated by the state-owned Société Tunisienne d'Electricité et du Gaz (STEG) which is responsible for natural gas distribution and almost all electricity activities. The only private entity is Carthage Power, an Independent Power Producer (IPP) of 470 MW located near Tunis. The Government is involved in all aspects of the energy sector. In addition to controlling STEG, it sets tariffs for gas, which represents 98% of the fuel consumed, and retail prices for electricity.

Total installed capacity in Tunisia is 3.4 GW, consisting of mostly conventional generation (gas fired) with only 120 MW wind capacity. With consistent investments in new capacity, Tunisia has remained self-sufficient in terms of power supply despite demand increasing by 5% a year since 1990. The quality of supply and electrification levels are good by regional standards, with electricity reaching almost 99% of the population.

Although there is good potential for solar and wind energy large scale renewable electricity generation remains a challenge and is not a priority for STEG. At a smaller scale, the ANME has developed and implemented a strong solar heating approach for residential hot water with an effective financing mechanism whereby the financing / subsidies are part of the electricity bills. Beyond its national energy programme, Tunisia is also considering solar energy projects oriented to the export of green energy to Europe, both in the context of the Desertec project and of a bilateral solar energy supply to Italy.

The power sector is heavily subsidised through both direct subsidies for fuel and financing and the extensive use of sovereign guarantees and concessional loans. While recognising the need for sector reforms to improve its governance, transparency and overall efficiency, the interim government is limiting reforms to avoid unrest which could result from any tariff increases.

The natural resources sector in Tunisia is controlled by a number of state agencies. Tunisia, once self sufficient in fuels, has failed to keep pace with the increasing demand of its developing economy, leading to increasing imports. Tunisia faces a particular challenge in developing its own resources, both to reduce the environmental footprint and foreign exchange costs of imports and to foster development in the impoverished regions where most future onshore potential lies. While offshore development is well served by the majors, developing remote onshore potential means fostering mid-cap involvement which typically has difficulty raising long term funding for production and needs equity participation for exploration.

Potential investment areas

Opportunities for energy efficiency are likely to arise from the Bank's operations in Agribusiness, Manufacturing and Services, Power and Energy, Municipal Services, Transport and through specialised credit lines with banks. Opportunities would be scoped in the context of a market study TC described below.

The Tunisian power sector requires substantial reform as an essential component of a sustainable energy strategy. There will be opportunities for the Bank to bring its specific expertise to bear in this area by promoting liberalisation, unbundling and commercialisation, potentially linked to large projects requiring co-financing. These activities would need to be closely coordinated with other IFIs active in this sector, and would be focused on the specific expertise the Bank can bring to bear in a joint approach.

The Bank could also promote the development of renewable energy, which has been negatively affected by subsidies to conventional energy, and explore possible investments in the distribution sector to reduce both residential demand and summer demand peaks. Investment in the distribution sector would also help improve sector governance.

The Bank may also have a role in supporting the development of oil and gas projects that are predominantly located in disadvantaged regions as well as supporting mid-cap foreign investors. In the natural resources sector, the Bank would make its engagement conditional on energy efficiency and highest EHSA standards. Tunisia is planning a number of domestic oil and gas handling and processing projects related to energy security, energy efficiency and the environment where the Bank's engagement to ensure these standards would be appropriate. There are also typically substantial energy efficiency savings to be gained in the transmission system itself.

Technical co-operation

The initial TC objective would be to develop a comprehensive roadmap for the sustainable energy sector, supported by targeted interventions at project or sub-sector level. These activities would comprise:

- A market study TC to determine the potential for energy efficiency measures in industry, small business, infrastructure and the built environment, as well as the role that can be played by renewable energy. It would include an assessment of the prevailing regulatory framework and the effectiveness of existing policy initiatives and funding programmes, taking particularly into account the activities undertaken by other IFIs and bilateral agencies. The market study will build upon the activities and results achieved by the ANME, seeking to identify key areas to deepen the energy efficiency impact of government measures. The results of the study will guide the identification of priority areas of activity, including follow-up work on policy dialogue and structuring commercial financing arrangements such as Sustainable Energy Finance Facilities through commercial banks or direct energy efficiency financing from the Bank.

- A resource audit facility could be put in place to offer energy audits and water use audits to private sector clients, principally in the Natural Resources, Agribusiness and Manufacturing and Services sectors.
- The role of renewable energy is important for Tunisia and could benefit from a separate TC funded study to assess the demand pattern for solar power and the optimal approach to support renewable energy, both for its contribution to the energy mix and to create opportunities for local manufacturing.
- A technical and financial assessment of STEG distribution entities. This would, develop principles for regulation to pave the way for an independent regulator focused on the supervision and monitoring of service quality and benchmarking among distribution departments while identifying key investments to increase efficiency and improve quality of supply.
- In the oil and gas sector, the Bank could implement a technical and financial assessment of the relevant state agencies to identify the prospects for investments in refining, distribution and storage. Related to that could be an extension of ongoing work on remediation and coastal protection.

5.5 Facilitating non-sovereign financing for infrastructure development

Key transition challenges

The dominant role of the state and high degree of centralised decision making, which are features of the infrastructure sector across the region, also characteristic of Tunisia, with both the transport and municipal infrastructure sectors fully reliant on state or state-supported financing.

The national railway company is vertically integrated and receives substantial direct state support in terms of capital investment and operating subsidies. The road network is also centrally managed and depends on state budgetary funds. The port sector is semi independent in terms of operational management and there are terminal concessions tendered to the private sector in most of the seven ports. The four domestic shipping companies serve only 10% of the passenger and cargo traffic, with the balance serviced by foreign companies. The sector is in need of fleet renewal but its access to long-term debt financing is restricted. The Government has made one attempt at infrastructure development in the aviation sector via a PPP structure to develop a new airport.

The situation is similar for municipal services, which are mostly run on a centralised basis, including water, wastewater, urban transport and landfill management. Municipalities are only responsible for a few areas of municipal infrastructure such as solid waste collection, traffic management and street lighting.

Decentralisation and increased decision-making at the local level are themes which have emerged following the revolution. The pace and scope of these reforms will only be determined after the elections but they determine the extent to which sub-sovereign financing could be envisaged in the future. This is a major transition challenge, one which the Bank has addressed in a large number of its countries of operations.

Other IFIs are active in the infrastructure sectors in Tunisia but typically only sovereign or sovereign backed facilities with foreign currency lending on a concessionary basis are available. No IFI is financing full risk PPPs while only Agence Française de Développement (AFD) is offering sub-sovereign lending. Local commercial banks have limited appetite for infrastructure projects.

Against this background, key transition challenges in the infrastructure sectors are:

- implementing the Government's reform agenda for state enterprises including introducing competition, corporatisation, reductions in operating subsidies and privatisation to help finance further capital expenditure alongside;
- introducing an appropriate legal and regulatory framework to allow for the expansion of PPP projects while supporting improvements in port/airport concession arrangements to introduce wider participation of the private sector;
- encouraging development of sustainable private sector operations in infrastructure more generally;
- developing decentralised financing solutions; sub-sovereign structures will encourage improved cost recovery and commercial discipline;
- investment in mass transit systems and bus operations development to provide affordable urban transport solutions, accompanied by the reorganisation of the traffic management system, institutional development, decentralisation and commercialisation of urban transport.
- establishing modern integrated waste management facilities, wastewater collection and treatment facilities, water clean-up and desalination, including through PPPs.

Potential investment areas

The Bank would operate in close coordination with other IFIs active in this sector, with a focus on non-sovereign financing solutions and on its areas of strength, including commercialisation, regulatory reform and private involvement. In the transport sector there are investment opportunities across sub-sectors (railways, roads, ports, shipping, aviation), in which the Bank might engage conditional on sector reform. Furthermore, there appears to be scope for the Bank to support private sector operators such as logistic companies, private freight forwarders, port concessionaires etc.

Similarly in the municipal sector, the focus would be on supporting financially reform minded municipalities and viable public sector entities committed to restructuring and commercialisation, and on funding the development of private sector participation, including through PPPs. Occasionally, there may be demand for sovereign loans in parallel with other IFIs where there are financing gaps in larger projects, in each case linked to specific transition goals.

Technical Cooperation

Taking account of these challenges, TC activities for the infrastructure sector have been identified following the structure typically adopted by the Bank in this area of analysing the overall environment and implementing projects targeted at specific reforms or projects:

- An assessment of the legal and regulatory frameworks for the transport sub-sectors (ports, railways, roads, aviation and motorways) to identify reform requirements. The transport sector requires large scale and far reaching reforms in each sub-sector and this TC would support engagement with the authorities to complement the on-going efforts of other MDBs and the development of future co-financing opportunities based on EBRD’s specific competencies.
- Technical assistance to develop a transport reform strategy, focusing on support for the liberalisation of service provision and encouraging private sector participation, including identification of priority PPP projects.
- A thorough analysis of the current framework for financing municipal projects and the reforms necessary to make sub-sovereign financing approaches bankable. This could include a creditworthiness assessment of the Tunis Municipality. Building on this the assignment could also formulate a road map to reform municipal and regional finance, supporting the Government in its decentralisation approach and drawing on the Bank's experience in this area.
- Project preparation for specific projects, such as rolling stock renewal or air navigation upgrading on a non-sovereign basis, or feasibility studies for waste collection system improvements in Tunis or urban transport projects.

Annex 1: Assessment of transition challenges

A 1. Corporate Sectors

A 1.1 Agribusiness

Transition gap: Medium

Key challenges: (i) support the liberalisation of the agricultural sector to promote greater productivity and efficiency and decrease state dependence; (ii) improve access to finance by increasing collateralisation options; and (iii) further develop the local supply chains in agro-production.

Primary agricultural production and food manufacturing account for approximately 8 per cent and 3 per cent of Tunisia's GDP, respectively. The main agricultural commodities are wheat, milk, tomatoes and olives. These four products account for about 46 per cent of agricultural production and revenue. Government policies target cereal production (mainly wheat and barley) to promote self-sufficiency, as Tunisia has the highest wheat per capita consumption in North Africa and is a net wheat importer. MFN applied tariffs are high with an average of 40.9 per cent. Input subsidies and price setting systems are in place, for grain production in particular. According to the Tunisian government, the sector suffers from limited irrigation systems, serious threats of erosion as well as small land holdings. The fragmentation of agricultural land is an important problem, due to the fact that most land plots are inherited. Thus, only 17.5 per cent of ownership transfers occur by means of sale.

Rural financing remains limited. The state is heavily involved in the sector through the *Banque Nationale Agricole* (BNA) and the *Banque Tunisienne de Solidarité* (BTS) which specialise in rural credit and microfinance, respectively. Approximately 20 per cent of financing needs are covered by bank instruments, while the other main sources of finance are government subsidies and company retained earnings. The share of arrears is very high and the government tried to promote agricultural credit through subsidies, fixed interest rates and debt forgiveness. Private sector financing is limited due to high agricultural income volatility as well as the lack of land titles and collateralisation options. More sophisticated risk management tools such as weather indexed insurance products are not well developed.

The infrastructure along the value chain is underdeveloped; although it is improving (for example an increasing number of cold storage rooms are becoming available to farmers). The agribusiness value chain lacks quality control and traceability. The application of international standards is underdeveloped, limiting export opportunities. Furthermore, the level of specialisation of suppliers to retailers is low and there is a lack of modern and efficient supplier networks. International retailers such as Carrefour and Casino are present in both the supermarket and hypermarket segments. However, approximately 80 per cent of the grocery retail market in Tunisia is still dominated by small corner shops. Modern retail stores are mainly located in urbanised areas along the coast, in particular the greater Tunis area, while hypermarkets are present in Tunis only.

A 1.2 Manufacturing and Services

Transition gap: Small

Key challenges: (i) strengthening the judiciary and enhancing the transparency requirements for enterprises to improve access to finance, especially by the high-risk segment; and (ii) completing the privatisation process, enhancing competition and easing barriers to entry by lowering MNF tariff levels for non-agricultural goods.

The size of the manufacturing sector in the economy is relatively small and accounted for 16 per cent of GDP in 2010. The sector is dominated by mechanical and electrical industries, textiles and food processing. By contrast, services account for around 45 per cent of GDP. Since the late 1980s, the Tunisian authorities have implemented a series of structural reforms to transform the country into a market-based economy through trade liberalisation and privatisation. Since the launch of privatisation programme in 1989, around 160 state-owned enterprises were partially or fully privatised. In the manufacturing sector, large enterprises in the construction materials, automotive and chemical sectors have been sold to foreign strategic investors. The government is yet to complete the privatisation of steel and tyre manufacturing companies, which were launched in 2010. Under the national strategy for Tunisia to become a “Euro-Med Hub for Innovation” for the period 2007-2016, an offshore regime for export-oriented and foreign-owned companies has been established. This has attracted FDI by international companies in sectors such as automotive, electrical engineering and aeronautics both through privatisation and green-field investments, contributing to an overall increase in competitiveness and further diversification of the manufacturing sector.

Prices are liberalised and energy intensity compares favourably to the EBRD countries of operations. Tunisia joined GATT in 1990 and is a founder member of WTO. It signed an association agreement with the EU in 1995 thereby tariffs and non-tariff barriers were gradually abolished to establish a free trade area by 2008. Tunisia also has a number of other bilateral free trade agreements. Nonetheless, the average MNF tariff for non-agricultural goods at 18.6 per cent is the highest in MENA and the EBRD region. Tunisia’s R&D expenditures as a percentage of GDP are high, similar to the levels of Russia, Hungary and Estonia.

The quality of market institutions compares to that of CEB countries. Competition policy is based on the Competition Act adopted in 1991 that was subsequently amended five times (the last time in 2005). Overall, the provisions of the law are in line with international standards, according to a peer review on competition policy by UNCTAD in 2006. Enforcement is based on a two-tier structure. The Competition Board, an independent authority with advisory and adjudicatory roles, advises the Government on draft legislation and all competition issues and provides judgement on applications related to anti-competitive practices. The Directorate-General for Competition of the Ministry of Trade is responsible for implementing the competition policy. The Board issues around 20 decisions per year and 40 advisory opinions. The remaining challenges are to provide greater emphasis on penalties and establish an internal information, documentation and training system.

In terms of overall business environment Tunisia ranks favourably compared to other MENA countries and the EBRD region. It ranks 55^{th} out of 183 countries in the World Bank Doing Business Survey 2011. It scores particularly highly in starting (48^{th}) and closing (37^{th}) a business. However, similar to Egypt and Morocco, there are weaknesses in contract enforcement and investor protection. The legal process for foreclosure is considered to be long and difficult. Corruption is relatively less of an issue compared to other MENA countries. According to the Corruption Perception Index by Transparency International, Tunisia is ranked 59th out of 178 economies, at par with Latvia and Slovakia and above Morocco and Egypt (85^{th} and 98^{th}, respectively). Tunisia's positive investment climate is also highlighted by the World Economic Forum's Global Competitiveness Index 2010-2011 where it ranked 32^{nd} out of 139 countries, higher than other MENA countries and the Bank's countries of operation. It ranked particularly well on the quality of human capital base.

A 1.3 Real Estate

Transition gap: Medium

Key challenges: (i) further streamlining property-related bureaucracy, such as reducing the costs of obtaining construction permits; (ii) improving access to land and property related information; (iii) further developing the affordable residential segment; and (iv) improving the quality of the office and warehouse segments.

Before the revolution, there was a significant activity in the higher-end residential, retail and hotel sub-segments, to a large extent driven by developers from the Gulf region and financed by banking consortia. However, many of the large-scale developments have been either on hold or cancelled since then. The hotel segment is relatively well developed but the tourism sector could still benefit from further development of higher value added services. Foreign entry into the sector was restricted before the revolution but a number of major international retailers (e.g. Carrefour and Zara) managed to establish their presence in the country. There seems to be a gap in the low and middle level sub-segments of the residential segment, despite significant government support for investments into affordable housing. Overall, there is a lack of international quality commercial space and the sector would benefit from an increased level of sophistication (so far, the focus has been mainly on basic products). Although there are a number of relatively modern offices, especially in the industrial zones and techno-parks, most of the office stock does not meet international standards and many offices are located in converted residential properties.

Tunisia has a relatively big local construction industry, comprising a large number of small companies that may benefit from further upgrading of skills, e.g. related to the implementation of energy efficiency technologies. Energy efficiency standards are taken into account for new developments but penetration is still low.

Access to land was subject to restrictions before the revolution and the price of land is still very high. The process of obtaining construction permits is very costly (Tunisia is ranked 106th out of 183 countries in the 2011 World Bank Doing Business survey as it takes almost 860 per cent of income per capita to obtain a permit). Foreign ownership is not restricted, except for agricultural land. Lease contract terms are not restricted. Land information is available, although accessibility could be further improved. Transparency in the sector is still relatively low.

A 1.4 Telecommunication

Transition gap: Medium

Key challenges: (i) completing the privatisation of the fixed-line incumbent and re-privatising the recently frozen stakes in network operators; (ii) continuing to develop the telecommunications infrastructure (broadband internet); (iii) ensuring the independence and strengthening capacity of the telecommunications regulator; and (iv) improving the protection of intellectual property rights.

The incumbent, Tunisie Telecom (TT), maintains a dominant position in the fixed-line segment, although a second fixed-line license has been awarded to Orange. Although the government privatised a 35 per cent stake in 2006, TT remains majority state controlled and an IPO has recently been cancelled. In the mobile segment, there is competition between three main players, TT, Tunisiana (controlled by Qatar Telecom) and Orange. Some of the assets in the telecom sector, including stakes in the operators Tunisiana and Orange Telecom, have been recently frozen by the interim government due to the owners' links to the previous regime. It remains to be seen how and when these assets will be put up for sale again. There is competition between a number of private and public internet service providers (ISPs), one of them controlled by TT. Fixed broadband internet penetration has been increasing rapidly, reaching close to 5 per cent in 2010, i.e. a level below the average for the transition region of close to 10 per cent, but significantly higher than in Egypt and Morocco.

Tunisia scores very well in terms of international competitiveness and preparedness for the development of the knowledge economy, as measured e.g. by the World Economic Forum's Network Readiness Index 2010-2011 – Tunisia is ranked 32nd, better than any of the EBRD countries of operations. Tunisia scored particularly well in terms of the readiness component, including the quality of math and science education and the government's prioritisation of ICT. The government has been developing a number of technology parks which attracted a number of global leading companies, such as ST Microelectronis, Microsoft, Ericsson and Alcatel. Tunisia has a well developed off-shoring industry with a large number of IT companies providing services for a wide range of industries in the EU.

The telecommunications sector is regulated by the *Instance Nationale des Télécommunications* (NTI) and the Ministry of Communication and Technologies. Regulatory responsibilities are distributed between theses two bodies, thus raising concerns about sufficient independence of the regulatory process. The NTI's capacity to regulate also needs to be improved further.. Intellectual property protection needs to be further supported as indicated by the relatively high software piracy rate (over 70 per cent).

A 2. Energy

A 2.1 Natural Resources

Transition gap: Large

Key challenges: (i) promoting greater competition in the upstream and downstream oil and gas sectors through liberalisation and further restructuring of state-owned companies; (ii) strengthening the legal and regulatory framework, including setting up an independent regulator; and (iii) increasing the transparency of revenue flows from extractive activities.

Unlike its neighbours, Tunisia has limited own energy resources. Until the late 1980s, Tunisia had an energy surplus and this sector was a major driver of the economy. However, in 2001, Tunisia became a net energy importer. Given the limited resources and the forecasted increase in industrialisation and in consumers' demand, energy imports – which represent around a quarter of total energy needs – are expected to increase substantially. Tunisia has also relatively modest metallic (mainly phosphates, barium, fluorine, zinc, lead and iron) and non-metallic mineral resources, such as marble, gypsum and bentonite. The government has shown a strong interest in their development by opening up for exploration around 80 per cent of Tunisia's territory.

The Ministry of Industry and Energy oversees the oil & gas and mining sectors through several state-owned companies. The *Entreprise Tunisienne d'Activités Pétrolières* (ETAP), entirely state-owned, manages oil and gas exploration and production activities on behalf of the state and dominates the upstream oil & gas sector. Nonetheless, international oil companies (IOC) play a significant role in the upstream oil & gas sector via 50:50 production sharing agreements (PSAs) with ETAP. These PSAs follow the contractual terms set out in a Hydrocarbon Code adopted in February 2000. At the end of 2009, around 40 companies held an interest in at least one exploration block in Tunisia.

Tunisia has very limited refining capacity, with only one state-owned refinery, the *Société Tunisienne des Industries du Raffinage* (STIR), which provides around 34,000 bbl/d and supplies almost 50 per cent of the refined products consumed in the country. The *Société de Transport des Hydrocarbures par Pipelines* (Sotrapil) is in charge of the transport of refined petroleum and is partially state-owned. Distribution of petroleum products is also dominated by the state through the *Société Nationale de Distribution des Pétroles* (SNDP) and its brand AGIL, which accounts for around 50 per centof the market.

The downstream natural gas sector is dominated by the *Société Tunisienne de l'Électricité et du Gaz* (STEG) which owns and operates most of the natural gas transport pipeline network, has a monopoly over imports and exports of natural gas and fully controls gas distribution. STEG uses natural gas for power generation and is the country's major gas customer, with about ¾ of all the gas consumed in the country.

Despite the release in 2003 of a Mining Code, which sets a clear legislative framework for prospecting, research and exploitation of mineral resources, investments have been rather limited over the past decade. In 2009, a significant number of new exploration permits have been allocated, with large investment commitments, which could to some extent revitalise the sector. However, there is limited revenue transparency in extractive industries. Tunisia is not an EITI candidate country.

Going forward, a significant challenge for the sector will be to elaborate a strategy to further liberalise the sector and create a more competitive environment both upstream and downstream. Moreover, the legal and regulatory framework should be strengthened, in particular with the creation of an independent energy regulator.

A 2.2 Power

Transition gap: Large

Key challenges: (i) establish an independent regulator; (ii) pursue market liberalisation reforms, unbundling, and privatisation; and (iii) create a wholesale market to attract new capacity in order to meet growing energy demand.

The power sector in Tunisia is dominated by the state with the natural monopoly elements, namely transmission and distribution, under the control of a single company, the *Société Tunisienne de l'Électricité et du Gaz* (STEG). The only non public player is Cartage Power, an independent power producer of 470 MW, located near Tunis. Although there have been efforts since 1996 to encourage private sector participation in power generation, it still only accounts for around a fifth of total generation. The total installed capacity in Tunisia is 3.4 GW, consisting mostly of conventional gas fired generation with only 120 MW of wind capacity. Domestic electricity production reached 15.7 TWh in 2010. Despite demand having increased on average by 5 per cent a year since 1990, Tunisia remained self-sufficient in terms of power supply. The degree of electrification is high by regional standards, with electricity reaching almost 99 per cent of the population.

The country operates a single buyer wholesale model where all power is controlled by the state-owned company. Although such a system provides stability and could provide price signals for new entrants, the existence of long term power purchase agreements does not stimulate competition. This system is further compounded by the fact that STEG enjoys monopoly rights over the country's electricity imports and exports through its connections to Morocco and Algeria. Access to interconnection should be opened to third parties with effective capacity allocation rules before the market is connected to Europe through the anticipated link to Italy. Account unbundling has taken place within STEG but further steps are needed in the form of legal, management and ownership separation if the country wants to increase the confidence of new market participants.

Within government, the Ministry of Industry and Technology is responsible for formulating and implementing the energy policy in Tunisia. Currently there is no dedicated energy regulator, which is a significant weakness in the sector, and tariffs include relatively small energy subsidies. Official statistics indicate that losses are reasonable at the distribution level but considerable demand growth continues to place strain on network development. There is a clear need to develop market based incentive systems for both network and generation investment.

A 2.3 Sustainable Energy

Transition gap: Large

Key challenges: (i) develop a transparent financial support system that will allow the country to meet its targets for renewable generation; (ii) implement systems that guarantee access to the network within reasonable timeframes; (iii) continue to support facilities that promote energy efficiency.

The government of Tunisia established the National Energy Management Agency (ANME) to implement its renewable energy policy. The vast majority of electricity generation in Tunisia comes from fossil fuels. Although the objective set out in the Government's Economic Development Plan 2005-11 was to achieve a 4 per cent share of primary energy consumption from renewable sources (excluding biomass), current installed capacity is less that half this figure. In spite of relatively limited progress against this target, the ANME aspires to reach an overall objective of 6.5 per cent of primary energy consumption to come from renewable sources by 2030, with a significant proportion of this to come from wind. There is a national plan for the exploitation of renewable energy with a focus on using photovoltaic power to help develop electricity supply in rural areas. In 2009 the government established the Tunisian Solar Plan covering 40 project that should be implemented by 2016 and is part of the ELMED project that will allow for interconnection with Italy.

Energy efficiency has been similarly prioritised by the government with a national fund to support energy finance programmes and projects through subsidies, soft loans and credit guarantees. This is against a background of having relatively low energy intensity when compared to its neighbours. CHP generation and the use of gas are actively promoted as ways of both supporting energy efficiency and lower carbon fuel sources.

Non-discriminatory connection policies have been established along with a favourable Wheeling policy. Renewable generation benefits from fixed price contracts and CHP receive a price indexed to the price of gas. However, neither technology benefits from priority dispatch.

A 3. Infrastructure

General overview of the transport sector: Tunisia's transport system comprises about 22,000 km of roads (including 400 km of highways), a railway network of 2,165 km, 7 commercial ports currently handling 30 million tonnes of freight volumes and 1.3 million passengers a year, and 16 airports (of which 8 are international airports) offering a total capacity of 18.8 million passengers. Transport activities make up 6 per cent of the country's GDP and provide for 120,000 jobs (around 4 per cent of the labour force). The sector accounts for 15 per cent of the country's total investment.

A 3.1 Transport

Railways

Transition gap: Large

Key challenges: (i) promoting further restructuring by disentangling infrastructure from operations; (ii) separating the policy making and regulatory functions and further strengthening the regulatory framework; (iii) granting third party access to the network and enhancing competition in the market; and (iv) increasing private sector participation in operations and wagon provision/leasing.

The incumbent, the Tunisian Railways National Company (SNCFT), is fully owned by the state. The company is organised with five sub-divisions but there is no institutional separation between infrastructure and operations, although accounting is separated within the same company. The separation between freight and passenger operations is equally weak (i.e. only accounting separation). There is almost no third party access to the railway sector although there is one case of private sector participation in the passengers business, i.e. a private operator service for tourist. All locomotives are provided and operated by the incumbent and there is little provision of wagons by the private sector. There is no leasing capacity in the country. There is no independent regulator and sector regulation is under the direct responsibility of the Ministry of Transport. There is separation between regulation and operations.

There are a number of railway-related laws and regulations, developed with the support of numerous international organisations, and the quality of these laws seems fairly good. There is a concession contract between the government and the SNCFT and there is a arms' length relationship between them.

Passenger tariffs are determined by the government while freight tariffs are flexible. Passenger tariffs have been frozen for more than a decade for social reasons and compensation from the government has been limited. Therefore SNCFT suffered financial losses. Restructuring efforts have been made in a past decade. There has been extensive labour restructuring. The total staff number was reduced form 9,000 in 2000 to 4,800 in 2008. There has also been a lines' rationalisation programme and some uncompetitive lines have been closed.

Roads

Transition gap: Large

Key reform challenges: (i) achieving full separation of regulation from operations; (ii) divesting road maintenance companies and introducing competition in the sector; (iii) improving road sector financing; and (iv) implementing PPPs.

Compared to its neighbouring countries, Tunisia's territory is less vast and its population is concentrated in the Northern part of the country. Therefore, the main road corridors are relatively short and the total motorway network is only 400 km long. Tunisian roads have been improved substantially with the financial support from international organisations and most roads are currently paved (i.e. more than 60 per cent of state and regional roads).

The administration of the national road network is carried out by the General Roads Directorate (*Direction Générale des Ponts et Chaussées* - DGPC) in the Ministry of Equipment and Housing. DGPC is in charge of the design, planning, and implementation of the strategy and national policy for roads infrastructure, as well as for their operations and maintenance. The Road Operation and Maintenance directorate develops the general operational and maintenance framework and allocates the maintenance budget and monitors maintenance activities. But there is no or limited competition in maintenance activities and transparency/accountability are lacking.

There are a number of tolled motorways, constructed and maintained by a 95 per cent state-owned company, the *Concessionaire*, that de facto resembles a public motorway agency rather than commercial concessionaire, although there is clear independence from the Ministry and transparency of accounting. No private concessions have been developed, despite the fact that the concession law was adopted in 1986.

There is limited information regarding road sector financing. Fuel prices are significantly higher than neighbouring countries, but slightly less than the African average. This indicates that road user charges (in terms of collection) are moderately high. An adequate budget allocation for road maintenance and the low efficiency of the contractual structure (e.g. open tender) seem major remaining challenges for the sector.

Ports and Shipping

Overall transition gap: Medium

Key challenges: (i) improving the efficiency of port operations; (ii) implementing a port landlord model and promoting private concessions in port operations; (iii) privatising the largest shipping company; (iv) facilitating the renewal of existing fleet capacities and expanding private ownership in the domestics shipping sector; and (v) achieving compliance with international maritime standards, particularly with regard to safety and environmental regulations.

The Tunisian port infrastructure is spread over a 1,300 km long coastline and includes seven ports that are open to international trade, of which 3 are moderately large in size. Ports are managed by the Office of the Merchant Navy and Ports (OMMP), a state establishment with operational and financial autonomy. Prices and safety regulation is under the government responsibility and there is moderate separation with the operating function.

The Code of Maritime Commercial Ports introduced a concession system for the public domain and port equipment for the duration of 30 to 50 years. There have been some tenders for terminal construction and operations and other ancillary services. However, these concessions are still at an early stage of development and limited operations are provided by the private sector for the time being. There is a plan to develop a large scale BOT for a new port.

The shipping industry is dominated by foreign companies. The market share of domestic shipping companies is only about 10 per cent, of which the largest is state-owned. There are three domestic private shipping companies but each of them has only one ship. Contractual arrangements and fee structures are largely commercial. Awareness in safety and transparency standards (including ISO certifications) is relatively high but most of the domestic shipping companies have yet to obtain international certification.

Aviation

Transition gap: Medium

Key reform challenges: (i) increasing private sector participation in airlines and airports operations; (ii) improving the operational efficiency of state owned companies; and (iii) strengthening the effectiveness and transparency of regulations.

There are about 30 airports in Tunisia, of which 9 are international. Most airports are publicly owned and managed. The largest airport is the Tunis–Carthage International Airport. Ground handling is provided by TunisAir Handling, a 100 per cent subsidiary of TunisAir.

The Tunisian Civil Aviation and Airports Authority (OACA) is a governmental body with moderate autonomy that manages 7 out of the 9 Tunisian international airports. OACA signed a concession contract with a private company for the operation of the International Airport of Enfidha Hammamet in 2007 and the International Airport of Monastir Habib Bourguiba (AIMHB) in 2008. Profitability and fees structure are unclear, but it seems that government intervention is significant.

Air navigation services are provided by the Tunis Area Control Centre (ACC), a semi-autonomous body providing radio communications with aircrafts and supervising safety issues in the air and at airports. The safety record is moderately good. The last notable accident was a crash of Egypt Air in 2002, which caused 14 casualties. The aviation industry is regulated by the Ministry of Transport, and its arm - Tunisian Civil Aviation and Airport Authorities are in charge of the regulation on airports and air navigation. Tunisia is an ICAO member.

There are a number of airlines in Tunisia, of which the largest is TunisAir - the flag carrier airline of Tunisia (also an IATA member). It was formed in 1948, with the participation of Air France. The Tunisian government is the majority owner of the company. TunisAir counts 53 destinations and has alliances with the Arab Air Carriers Organization as well as Air France. The airline has a number of modern aircrafts (the majority of its fleet are either Boeing or Airbus carriers), and is commercially successful. There is no visible state subsidy.

A 3.2 Municipal and Environmental Infrastructure

General Overview of the municipal infrastructure sector The municipal sector in Tunisia is characterised by limited fiscal and administrative decentralisation. Water and sanitation coverage in Tunisia is relatively high compared to other countries in the SEMED region. As of 2008, reportedly 94 per cent of urban households and 38 per cent of rural households were connected to water services. Wastewater connections are lower, with 75 per cent of urban households and only 4 per cent of the rural population connected to sanitation services in 2008 according to a report produced by Global Credit Rating Co in cooperation with the AfDB.

Urban Transport services are comprehensive and based on publicly owned transport companies. However, the sector's sustainability is at risk as financial performance is deteriorating due to the mismatch between fare revenues and transfers, and high operating costs for regional service providers. Well regulated landfills for solid waste operate throughout the country and cover about 70 per cent of the population. While landfills are under the supervision of the central government, waste collection is under municipal supervision, where local administrative capacity and private sector involvement have had a mixed track record to date.

Water and Wastewater

Transition gap: Large

Key challenges: (i) streamlining the institutional structure of the sector, including ownership decentralisation and rationalisation between water and wastewater services; (ii) developing incentive-based contractual arrangements; (iii) effective tariff reform, in particular for wastewater services; (iv) improving cost control and collection procedures; and (v) promoting private sector participation and PPP solutions for water supply.

The Tunisian water and wastewater sector is predominantly owned and controlled by the central government. The national water distribution company, SONEDE, is responsible for the water supply systems in urban areas and large rural centres. It operates in 40 districts across the country and is organised as an autonomous public entity under the Ministry of Agriculture and Water Resources.

Wastewater collection and treatment is mainly provided by the *Office National de l'Assainissement* (ONAS). ONAS plans and implements sanitation projects, and provides sanitation to about 75 per cent of the population. The rest is covered by the private sector (around 15-20 per cent) and municipal authorities. ONAS is set up as an autonomous public entity under the Ministry of Environment and Sustainable Development, covers a territory comprising 24 districts and has 94 operational centres.

The national water distribution company, SONEDE, has a fairly robust operational and financial performance. It does not receive operational subsidies as revenues from bills' collection tend to cover operating and maintenance costs and also a minor part of capital expenditures. However, deteriorating bills' collection and relatively high staff costs are areas to be improved going forward. ONAS, the national sanitation company, is financially more constrained. The revenues collected through service fees only cover about half of the operating costs and hence the company is dependent on substantial operating subsidies. SONEDE collects sanitation fees from customers on behalf of ONAS, which prevents ONAS from initiating its own actions to increase collection rates. ONAS also appears to have a high number of staff and staff related costs.

Capital expenditures are generally financed through grants provided by the government or international donors or through international borrowing from IFIs in the form of sovereign loans. Although some small-scale loans have been provided by domestic commercial banks, companies have not benefited from direct commercial financing for large-scale investment projects.

There has been very limited private sector participation in water supply in Tunisia to date. However, a spinning-off programme in the wastewater sector has led to a significant proportion of about 20 per cent of sanitation facilities/treatment plants operated by the private sector. By the end of last year, the operation of almost 3,000 km of the network, 29 wastewater treatment plants and 155 pumping stations had been transferred to the private sector. Water and wastewater tariff methodologies are fairly well developed and include special arrangements for poor households. However, tariffs cover only operating costs for water supply, and sanitation tariffs are low and cover only 50 per cent of operating expenditures. The degree of cross-subsidisation between consumer groups is unclear.

There is no independent water regulator in Tunisia and utilities are directly regulated by the line ministries.

Solid Waste Management

Transition gap: Large

Key Challenges: (i) strengthening municipal capacity to plan, organise and outsource waste collection: (ii) promoting further private sector participation in waste collection and land-fill operations through outsourcing or BOTs; (iii) enhancing incentive based contractual arrangements between collection companies and municipalities; and (iv) improving tariff policies to achieve full cost recovery tariffs and predictable revenue streams for both waste collection and land-fill operations.

In Tunisia, municipalities are responsible for solid waste collection while landfill and waste treatment is under the government's responsibility. Solid waste collection is predominantly operated by municipalities (i.e. yet to be corporatised) and the costs are directly born by the municipal budget. There are a few examples of outsourcing of waste collection to the private sector. There is a large number of dump sites, mainly operated by private companies. At the national level, policy and planning rests with the Ministry of Environment and Sustainability, whereas sector coordination, including the country's landfills, is under the supervision of the National Agency for Waste Management (ANGed).

Tunisia has a network of controlled (sanitary) landfills throughout the country, reaching a coverage rate of about 70% at present. An effort to rehabilitate and close nearly 400 uncontrolled dumps of various sizes is underway. Among these 400 dumps, about half have been nearly fully rehabilitated, while another 200 dumps still await rehabilitation and closure. Thus environmental regulation and its implementation seem to have been improved in recent years.

Supporting the municipalities in terms of planning and management of waste collection is a challenge in many areas, both in terms of administration, human resources, cost control, budget evaluation and organisation of awareness activities. Nine pilot municipalities are currently implementing a Municipal Plan for Waste Management (PCGD) as a step to improve the organisation of waste collection at the municipal level.

Private sector involvement in waste collection remains moderate and experience so far seems mixed. Some municipalities, which have outsourced the collection activities to well structured and equipped companies, appear to be satisfied with the quality of services, while other municipalities have experienced poor compliance and quality of service provided by the private sector.

Both operational costs and investment are predominantly provided by budgetary transfers, as neither tipping fees nor collection fees are enough to recover the costs. This is particularly the case for household waste. There is no waste collection tariff paid by households, and general municipal tax rates and collection remain low.

Urban Transport

Transition gap: Large

Key challenges: (i) decentralisation of the regulatory and operational responsibilities to municipalities; (ii) improving urban transport planning and pricing to address congestion and encourage sustainable commercial solutions; (iii) improving cost control within public transport companies and increasing ticket prices and collection to secure adequate fare-box ratio; (iv) increasing private sector participation in the provision of urban transport services and infrastructure; and (v) promoting commercial financing of urban transport providers operating within well defined and implemented contractual arrangements.

Tunisia urban transport services are predominantly provided by buses and over-ground metro services. These services are provided by a centralised single public company responsible for managing urban transport**.** The only exceptions are a limited number of bus operations for suburban and inter-urban transport, but their market share is negligible. There is a shared regulatory responsibility between the State and regional authorities. Each of the country's 24 regional governments has a regional transport authority (AROTTs) in charge of the organisation and coordination of urban and regional transport. The state has a central role in terms of regulation and planning, including tariff setting and funding arrangements.

The quality of urban transport services appears to be better than that of neighbouring countries in the region, but the financial performance of transport companies is weak. The Ministry of Transport is responsible for developing and adopting urban transport pricing policies. The State compensates the shortfall in ticket revenues due to concessionary fares. However the compensation from the State combined with ticket sales does not cover the operating expenses of several public transportation companies. The financing of investment in the sector comes primarily through grants or IFI loans to the State.

The role of the private sector is limited to bus operations for suburban and inter-urban transport and limited bus routes in the capital city. In Tunis, four private companies have entered into concession agreements with the Ministry of Transport to operate 36 routes covering 15 per cent of the network with less than 10 per cent of the passengers.

According to sector regulations, the State may sub-contract public transport operations to the private sector on the basis of concession contracts with competitively selected operators. The State Strategy for the sector as of 2008 stated as an objective to strengthen private sector participation in the public transportation services by giving more lines in major cities such as Tunis, Sousse and Sfax to the private sector. The state sector strategy also recognised the need to (i) ensure full compensation for the shortfall in the passenger transport from reduced fares, and (ii) search for new mechanisms to achieve financial balance of businesses. Implementation of these policies is still lagging behind and is a key challenge going forward.

A 4. Financial Institutions

A 4.1 Banking and Finance to MSMEs

Banking

Transition gap: Medium

Key Challenges: (i) restructuring and privatising state-owned banks; (ii) further consolidating the banking sector; (iii) increasing banking penetration; (iv) further develop banks' screening and monitoring skills and improving accounting standards; and (v) improving corporate governance.

The Tunisian banking system comprises 21 banks, of which 11 are publicly traded on the Tunis Stock Exchange, 2 merchant banks and 8 offshore banks. In October 2009, Zitouna Bank became the country's first bank to offer sharia-compliant products, alongside its classic retail products. Three out of the top four banks, representing 33 per cent of total banking assets, are majority state-owned. The top 3 banks account for 36 per cent of total banks' assets and the top 5 for 54 per cent. The Tunisian banking sector is fragmented with 21 banks for 10 million inhabitants. Before the Revolution, Tunisia planned to merge *Banque Nationale Agricole* and *Société Tunisienne de Banque*. This project has been put on hold and plans are unclear in the current political context. One of the key issues is how to address the question of frozen assets, which include important stakes in three private banks.

The following table summarises market shares and ownership of the top ten Tunisian banks as of end 2009:

Bank name	Asset share	Ownership
Banque Internationale Arabe de Tunisie	13.31%	Maghreb Financiere Holding; Maghreb Finance Holding; Meninx Holding; SAS SIBP; Intesa Sanpaolo; GAM holding (CH) via its funds (0.16per cent)
Banque Nationale Agricole	11.59%	Entreprises Publiques et Para Publiques; Government of Tunisia; GAM Holding via its funds (CH) (0.4per cent); Rabobank Nederland- Rabobank Group (NL) (0.27per cent); Arab Tunisian Bank
Société Tunisienne de Banque	11.44%	Govt. Of Tunisia; Entreprise Tunisienne d'activités pétrolières; Caisse Nationale de Sécurité Sociale (CNSS) (BF); National Bank of Kuwait S.A.K. (KW); Office du Commerce de la Tunisie; Lybian Foreign Bank (LY); Société Tunisienne de l'électricité et du gaz; Kuwait Investment Authority (KW); Arab Investment Company SAA (SA); Private shareholders
Banque de l'Habitat	10.23%	56.7% public-owned (Govt. Of Tunisia); Entreprise Tunisienne d'activites petrolieres; Horchani Group; Blakeney Management via its funds (GB) (5.63per cent); Investec PLC via its funds (GB) (1.22per cent); other shareholders.
Amen Bank	7.80%	Other shareholders; Compagnie méditerranéenne s'assurances et de réassurances; Société de participation de gestion et d'investissement; Meninx Holding; Parc engins Industriels et agricoles (Parenin); GAM Holding AG via its funds (CH) (0.43per cent)
Arab Tunisian Bank	7.44%	Arab Bank Plc (JO); Ben Sedrine Mohamed; Loukil Mongi
Attijari Bank	6.83%	Andalumaghreb S.A. (ES); Attijariwafa Bank (MA) (54.56per cent); Banco Santander SA (ES) (10.97per cent); Industries chimiques du fluor SA; Societe Ennakl SA
Banque de Tunisie	5.04%	Belhassen Trabelsi and corporation and investment; Groupe El Fekih Abdellatif; Crédit Industriel et Commercial- CIC (FR)
Union Internationale de Banques	4.69%	Société Générale (FR); Groupe Ben Slimane Atef; Societe Tunisienne de l'air- Tunisair
Union Bancaire pour le Commerce et l'Industrie	2.53%	BNP Paribas (FR) (50per cent); BNP Paribas BDDI Participations (FR)

Note: except for Union Internationale de Banques, market shares are calculated using individual banks' asset figures from banks' websites as nominators and total banking system's assets figures from the Central Bank as denominator.

Tunisian banks have a loans/deposits ratio of 129 per cent (far above existing countries of operation of the EBRD, which range between 80-90 per cent, but close to eurozone 120 per cent). They may face a liquidity problem, which results in part from a low deposits/GDP ratio (53 per cent, close to 54 per cent in the Slovak Republic, far below 82 per cent in Morocco and the eurozone’s 102 per cent average). A significant fraction of the low income population does not have a bank account. A study by the microfinance institution Enda Inter-Arabe showed that out of a sample of 1,902 clients from various regions only 53 per cent had a current account (of which 56 per cent at the Post Office). This does not seem to result from lack of branches. The Tunisian banking networks count 1,348 branches, i.e. 13 per 100,000 inhabitants (compared with 4.5 in Egypt, 14 in Morocco, 15 in Romania or 44 in France). The ratio of credit/GDP stands at 68 per cent, 44 per cent of which is short term and 56 per cent medium and long-term. Most lending and funding is in local currency. Lending decisions are made on the basis of the presence of collateral (preferably land or real estate) as well as on trust, which makes access to credit difficult for entrepreneurs lacking such collateral or relationships.

According to the Central Bank, in 2009, the NPL ratio stood at 13.2 per cent, below 22 per cent in Egypt and above 5.5 per cent in Morocco, and average provisioning stood at 58 per cent. This 13.2 per cent represents an 11 percentage point decline compared with 2003, and would result from tighter risk assessments by both the regulator and banks, as well as more effective actions on the NPL portfolio. However, according to a recent S&P's report, banks' balance sheets, particularly that of state-owned banks, are in poor conditions, with some banks well below an adequate level of capitalisation. Banks also suffer from weak corporate governance and a relatively poor level of management expertise. Directed lending, previously often to the benefit of the former ruling family, is widespread and many banks are overly exposed to specific sectors. In particular, the banking system has a strong exposure to tourism, which accounts for 20 per cent of all bad loans.

Finance for Micro, Small and Medium-sized enterprises

Transition gap: Large

Key Challenges: (i) broaden access to finance through available financial instruments for MSMEs (ii) strengthening the institutional environment to support bank lending to MSMEs (iii) improving the financial skills and culture of SME entrepreneurs.

MSMEs constitute one of the main pillars of the Tunisian economy. They account for 97 per cent of active enterprises in Tunisia and their contribution to GDP reached 74.5 per cent in 2009[4]. Compared to other MENA countries, Tunisian MSMEs are more export-oriented and mainly concentrated in the textile industry. MSMEs started to emerge in the 70's, when the Tunisian economy was opened to the private sector.

Access to finance remains an important significant challenge for MSMEs. MSMEs use self financing and informal financing as the main sources of funding. Two public banks, the *Banque de Financement des Petites et Moyennes Entreprises (PME)* and the *Banque Tunisienne de Solidarité*, provide targeted finance for SMEs. They both finance mainly young entrepreneurs. The *Banque de Financement des PME* focuses on value added projects and especially those related to the knowledge economy, high potential export activities, activities related to the development of sustainable energy and agriculture-related activities.

According to the World Bank[5], bank lending to SMEs is estimated at around 15 per cent of total lending, which is above Egypt's 6 per cent but below the OECD average of 26.8 per cent. This level of lending amounts to about 10 per cent of GDP. MSMEs' access to bank loans depends on the presentation of personal guarantees or collateral, even when the cash flow analysis is satisfactory. Tunisian MSMEs are generally unable to fulfil these requirements. A Tunisian guarantee company called SOTUGAR was created in June 2003 to promote bank finance to MSMEs. It provides guarantees for loans and equity investments in SMEs.

Alternative official sources of finance are being developed. Tunisia was one of the first Arab countries to establish a microcredit law in 1999. The microfinance sector is dominated by two players: Enda Inter-Arabe and *Banque Tunisienne de Solidarité*. Enda Inter-Arabe is an NGO created in 1990 and which started providing micro-credit in 1995. It is the largest microfinance institution with a gross loan portfolio of over USD 56.3 million loans and more than 160,000 borrowers. *Banque Tunisienne de*

[4] See www.epsilonfin.com «*Les PME en Tunisie*»
[5] *The Status of Bank Lending to SMEs in the Middle and North Africa Region* , World Bank Washington DC, June 2010"

Solidarité, which is state-owned, was created in 1997 in order to provide access to microfinance, in particular in the regions. Its role is to fund 288 associations which provide microfinance. The African Development Bank is currently pursuing a study on the restructuring of BTS. A new microfinance law is under preparation.

Microfinance institutions are not supervised by the Central Bank but by the Ministry of Finance. However, the new law has created an independent authority for the supervision of microfinance institutions.

The institutional framework that supports lending to MSMEs needs improving. A cadastre is in place in the country and property titles have been fully documented in Tunisia.[6] A public credit registry is also in place and information is available to financial institutions and the public. However, gaps remain in terms of updating and clarity of the information available as well as with regards to the accounting for the smallest loans. A unified collateral registry does not exist and contract enforcement remains a costly and lengthy procedure.

SME entrepreneurs' awareness about the range of financial instruments available to them needs to be increased, as their perception is that that the financial market is reserved to large enterprises. Most entrepreneurs do not have a good understanding of financial products offered by banks and other lending organisations and they are also inexperienced in developing business plans.

A 4.2 Insurance and Other Financial Services

Transition gap: Medium

Key Challenges: (i) increase insurance penetration (ii) develop the mortgage market (iii) develop the private pension system; and (iv) provide long-term funding to leasing companies.

Insurance[7]

In December 2009, the Tunisian insurance sector counted 18 companies, including 2 public companies (STAR and COTUNACE, with an aggregate 21.12 per cent market share) and 4 mutual companies (AMI, CTAMA, MAE and MGA, with an aggregate 19.64 per cent market share). The market is quite concentrated with the top 3 companies accounting for 41.03 per cent of insurance premia and the top 5 for 57.03 per cent. In 2009, insurance premia stood at TDN 1.026 billion (1.75 per cent of GDP, below 1 per cent in Egypt but above 2.85 per cent in Morocco). Life insurance accounts for 13.12 per cent of total insurance premia.

The table below ranks Tunisian insurance companies in terms of market share measured as a percentage of total insurance premia:

[6] Source: *Report on the implementation of the Euro-Mediterranean Charter for Enterprise,* OECD, ETF, EUROMED, and European Commission

[7] This section relies on data from the 2009 Annual Report of the *Federation Tunisienne des Sociétés d'Assurance*, which is the last available.

Company	2007 Amount	2007 in %	2008 Amount	2008 in %	Percentage change 07/08	2009 Amount	2009 in %	Percentage change 08/09
1. STAR	212 268 166	24.2	201 175 934	20,91	-5,23	209 613 168	20,43	4,19
2. COMAR	106 457 095	12,14	115 293 762	11,99	8,30	119 637 503	11,66	3,77
3. AMI	73 433 135	8,37	82 384 828	8,56	12,19	91 769 034	8,94	11,39
4. ASTREE	70 463 431	8,03	78 597 551	8,17	11,54	83 714 473	8,16	6,51
5. MAGHREBIA	79 810 173	9,10	94 463 827	9,82	18,36	80 416 958	7,84	-14,87
6. CARTE	67 984 618	7,75	78 103 175	8,12	14,88	78 610 545	7,66	0,65
7. GAT	64 522 142	7,36	71 027 794	7,38	10,08	78 071 587	7,61	9,92
8. MAE	53 269 116	6,07	54 599 460	5,68	2,50	60 038 778	5,85	9,96
9. ASS. BIAT	33 158 293	3,78	49 073 448	5,10	48,00	50 642 154	4,93	3,20
10. LLOYD	30 694 643	3,50	40 748 459	4,24	32,75	42 622 442	4,15	4,60
11. SALIM	23 788 763	2,71	27 576 236	2,87	15,92	33 219 797	3,24	20,47
12. MGA	14 185 675	1,62	18 108 302	1,88	27,65	24 157 333	2,35	33,40
13. CTAMA	22 563 270	2,57	23 835 424	2,48	5,64	23 994 197	2,34	0,67
14. MAGHREBIA VIE	-	-	-	-	-	21 789 195	2,12	-
15. HAYETT	13 653 607	1,56	13 803 004	1,43	1,09	17 001 481	0,60	1,35
16. COTUNACE	4 980 076	0,57	6 345 801	0,66	27,42	6 177 056	0,66	-2,66
17. AMINA	4 528 313	0,52	5 125 193	0,66	13,18	2 754 064	0,27	-46,26
18. ASSURCREDIT	1 353 555	0,15	1 658 360	0,17	22,52	1 993 618	0,19	20,22
TOTAL	877 114 071	100	961 920 558	100	9,67	1 026 223 383	100	6,68

Source: 2009 annual report of the Federation Tunisienne des Societes d'Assurance

Mortgage finance

Mortgages as a percentage of GDP stood at about 6 per cent at the end of 2009 (at similar levels with Montenegro, Romania and Turkey but far below 17.4% in Croatia or 18.6% in Poland). Loans generally represent 80 per cent of the total value of a home. Although mortgages are available from financial institutions, they remain unaffordable for many. Opaque land and property rights, as well as the informal employment status of most potential homeowners, remain key barriers to accessing mortgage finance. Nonetheless, 80 per cent of Tunisians own their home.The main provider of mortgages is *Banque de l'Habitat*, which is 56.7 per cent public-owned and accounts for 55 per cent of total mortgage loans.

Leasing

The leasing industry is more active in Tunisia compared to its neighbours, with a total of 39 leasing companies operating in the country. Leasing penetration, measured as leasing volume/GDP, stood at 2 per cent in 2010[8] (against 0.3 per cent in Egypt and 4.9 per cent in Morocco). Leasing's contribution to the financing of the economy was 12.6 per cent in 2009, up from 10.3 per cent in 2008. The outstanding balance of leasing is coming from borrowed resources. Of these borrowed resources, 43.4 per cent comes from banks and 40.8 per cent from bonds. Leasing accounted for 31.9 per cent of total issues on the bond market in 2009 (and 42.4 per cent in 2008). The share of non-performing leases stood at 8.8 per cent as of end 2009, down from 11.5 per cent in 2008 and 17.6 per cent in 2007, with 79.4 per cent provisioned.

Pension Funds

The Tunisian pension system is a pay-as-you-go system. It is composed of two regimes, one for the private sector (CNSS) and one for the public sector (CNRPS). The former is comprised of seven sub-categories according to professions, with the private non-agricultural employees' category making up the biggest group. In contrast

[8] *Leasing in the Middle East and Northern Africa (MENA) region: A preliminary Assessment* by Bilal Al-Sugheyer and Murat Sultanov, October 2010

to Algeria and Morocco, which employ similar systems, Tunisia does not plan to centralise the system.

Tunisia is exposed to a huge ageing risk and reforms in recent years (increased contributions and contributors, through reforms aimed at the self-employed and low-wage segments) have tried to address this problem. As a result, the country had one of the highest coverage ratios in North Africa (around 37per cent of the labour force) as of early 2009. However, the dependency ratio is still increasing.

The administration of contribution and benefits is managed by the National Social Security Fund (NSSF), which is supervised by the Ministry of Social Affairs and Solidarity.

A 4.3 Private equity[9]

Transition gap: Large

Key Challenges: (i) increase the number of independent fund managers; (ii) enhance capacity building and strengthen locally-based fund managers; (iii) introduce a wider range of private equity products, such as mezzanine funds, venture capital funds, sector focused funds, infrastructure, ITC, etc; and (iv) attract foreign capital and enlarge the investor base.

Tunisia is host to 18 funds, which have raised USD 610 million cumulatively (excluding large international funds); this represents 1.38 per cent of GDP as of 2010. Of these funds, 11 have some capital allocated to seed investments (totalling USD 45 million), 9 to venture (totalling USD 44 million), 8 to growth (totalling USD 536 million), 4 to buyout (totalling USD 11 million) and 1 to turnaround (totalling USD 2 Million). However, this capital is available for the Mediterranean region as a whole and not just for Tunisia. Since cap per country is up to 30 per cent, not more than 30 per cent of these amounts are available for investments in Tunisia. Only 6 per cent of the funds have been invested, all in the Mediterranean region. However, these funds include *Sociétés d'Investissement en Capital à Risque* (SICAR), established by local banks and/or due to tax incentives provided by the government in order to support investments in specific sectors or regions; SICAR mainly provide portage equity and debt financing, allowing local banks to increase their exposures. Only 5 fund managers invest in Tunisia via more than 13 funds, with AfricInvest-Tuninvest being the market leader (with 5 funds focused exclusively on Tunisia, and 5 funds focused on Maghreb and Africa under management). To date, the level of exits in Tunisia has been low (at 11 per cent of total investment projects, close to 9 per cent in Morocco but below 21 per cent in Egypt).

Although Tunisia does not receive as many investments as Egypt or Morocco, amounts invested are non negligible given the relatively small size of the country. In terms of investment values, Tunisia is at the high end of the investment spectrum, i.e. witnessing relatively high value projects compared to other peer countries (higher value projects usually tend to be in the public works/real estate and transport and logistics segment). However, like Morocco and Algeria, Tunisia's entrepreneurship

---

9 All figures exclude large international funds.

potential is much larger than what is currently being achieved. Further developing its venture capital sector may help Tunisia tap that potential. However, venture capital firms may need to take a pan-regional approach, rather than a single country one, to investing.

Large and profitable companies, which did not consider private equity as a means of finance pre-crisis (since they were able to tap other sources), could now be much more eager to turn to this sector, not only for cash, but also for strategic and governance expertise. In particular, significant investment opportunities might open up in sectors which had previously been exclusively controlled by families with ties to the past regime.

Recent developments have been mainly driven by AfricInvest-Tuninvest, Sages Capital and the creation of funds dedicated to venture capital. AfricInvest -Tuninvest Group, founded in 1994, belongs to the leading firms in this segment in North and Sub-Saharan Africa. It has made 90 investments in several sectors with 40 exits generating attractive returns above IRR.

A 4.4 Capital markets[10]

Transition gap: Large

Key Challenges: (i) further develop the Tunis Stock Exchange; and (ii) increase liquidity.

As of end 2010, a total of 56 companies were listed on the Tunis Stock Exchange. Stock market capitalisation stood at TD 13.2 billion (EUR 13.62 billion) at the end of 2009[11] (or 20.85 per cent of GDP[12]), below most EBRD countries of operations, which range from 40 per cent to 127 per cent, and below 40 per cent in Egypt and 72 per cent in Morocco. As of end 2010, the top 10 market capitalisations represented 57 per cent of total market capitalisation and financial institutions accounted for 70 per cent of market capitalisation. Five IPOs were launched on the Tunisian Stock Exchange in 2010. The capital market share in total financing to the private sector was 12.1 per cent in 2009 (up from 8.1 per cent in 2008).

A segment for small and medium sized companies, the alternative market, was created in 2007. The Stock Exchange tries to promote it, through communication actions. In 2010 for example, the stock exchange participated in the seminar on funding modalities and fiscal incentives for SMEs funding themselves through the Stock Exchange organised by the Ministry of Industry and Technology and the Ministry of Finance, with the support of the *Union Tunisienne de l'Industrie, du Commerce et de l'Artisanat* and the *Agence Française de Développement*. However, only two companies are currently listed on this segment.

Public debt issues amounted to TD 1,039 million (EUR million 1,072 equivalent) in 2009, of which 76 per cent medium-long term and 24 per cent short term. The

[10] This section mainly relies on data from the 2009 Annual Report of the Central Bank of Tunisia, which is the latest available. Therefore, most figures are as of end 2009, to ensure consistency. 2010 data mainly come from the 2010 Annual Report of the Tunis Stock Exchange.
[11] TDN 13.2 billion as of July 2011, with a PER of 14.56 and a dividend yield of 2.84per cent
[12] 24.1% as of end 2010, with a market capitalisation of TDN 15.3 billion

outstanding balance of Treasury Bonds as of end 2009 was EUR equivalent 8,582 million (10.5 per cent of GDP), with an average duration of domestic public debt of four years and fifteen days. In 2009, corporate issues amounted to TD 976 million (EUR million 1,359 equivalent), of which 30 per cent in capital increases and 70 per cent of debenture loans. Leasing companies issued bonds for a duration of 5 years, with one issue for a 7 year duration (of which 2 years of franchise), while bonds issued by banks were for longer periods of up to 20 years.

Institutional investors are the main subscribers, accounting for 99.5 per cent of subscriptions in 2009. The share of foreign investors stood at 22 per cent[13]. Despite long maturities, there is no liquidity in the secondary market. Government bonds are mostly purchased by banks and SICAVs (investment funds) managed by banks that hold them to maturity. International investors (although allowed) do not actively participate in the market.

As of end 2009, there were 106 mutual funds (OPCVM) investing in securities, 13 of which dealt with venture capital. OPCVM' investments are predominantly in long and medium term securities, which account for about 72 per cent of their portfolio. The share of state bonds in the portfolio of bond OPCVMs fell from 68.5 per cent in 2008 to 62.7 per cent in 2009, leading to greater investment in private bonds, up from 26.6 per cent in 2008 to 32.8 per cent in 2009. 40.6 per cent of the portfolio of mixed OPCVMs was in the form of stocks (vs 31.6 per cent in 2008) and 53.9 per cent in the form of debt securities.

In 2009, the legal infrastructure was strengthened by the creation of a guarantee fund for clients on the stock and financial product market, meant to protect investors against non commercial risks by compensating them if a stockbroker would go into forfeiture. The institutional and legal environment was further improved by the promulgation in August 2009 of the code governing the provision of financial services to non residents, in an attempt to help Tunisia's capital market to become a major international investment site.

In order to support the development the capital market and its role in the funding of the Tunisian economy, the Tunisian State has restored fiscal incentives for companies that undertake an IPO: their corporate tax rate is 20 per cent instead of 30-35, depending on sectors, with the exclusion of companies offering less than 30 per cent of their capital or in the telecommunications and transport sectors.

Monetary policy has been focusing on real exchange rate stability so the interest rate differential historically has not covered the devaluation risk. Money markets are non-existent as the central bank manages interbank rates within a very tight range.

[13] 20.15% as of end 2010

Annex 2: Summary of challenges, opportunities and priorities

Operational priority	Transition challenges	Potential investments	Indicative TC priorities
Restructuring and strengthening the **financial sector**	• Dominance of state-owned banks. • Limited access to financing for SMEs. • Poor institutional framework and regulatory framework. • Limited development of non-banking sector such as insurance and pension funds. • Limited development of private equity industry, constraining the availability of equity capital.	• Support to SMEs, through first loss facility and/or finance for institutions targeted at SME lending. • Restructuring and recapitalisation of banks, particularly state-owned. • Support, including through equity investments, to the development of the insurance sector. • Local currency loans to domestic banks. • Investment in new funds and co-investment alongside them.	• Technical assistance for restructuring of four pilot banks. • Technical assistance for existing SME-focused institutions. • Capacity building for domestic private equity investment, complemented by targeted assistance for portfolio companies. • Study to review and propose reforms to the insurance regulatory framework.
Financing **private enterprise**	• Limited availability of finance for SMEs, • Limited exploitation of value chain. • Fragmented, wasteful and inefficient agribusiness sector, with weak storage, distribution, processing and logistics infrastructure. • Extensive state involvement in and regulation of agribusiness sector.	• Direct financing to support restructuring or sector consolidation. • SME facilities to provide credit in underserved sectors. • Investments to develop midstream agribusiness infrastructure.	• Deployment of TAM/BAS programmes. • Study on investment opportunities and benefits in agribusiness storage, processing, distribution and logistics. • Targeted technical assistance for specific companies.
Supporting **energy efficiency** and a **sustainable energy** sector	• Import dependency and low level of indigenous renewable energy development. • Poor energy efficiency throughout the economy. • State-controlled vertically integrated energy sector. • High level of energy subsidies. • Limited availability of capital for small scale exploration and production activities.	• Energy efficiency investments in power sector, industrial and agricultural companies. • Independent and small-scale renewable energy projects. • Public projects that support private sector development and drive sector reform. • Upstream investments linked to implementation of best practices and sector reform.	• Study to estimate the market size for energy efficiency and small scale renewable energy • Energy audit framework, especially in industry • Technical and financial assessment of state-owned entities operating the medium/low voltage network. • Review of existing resources sector identifying weaknesses and gaps.

Operational priority	Transition challenges	Potential investments	Indicative TC priorities
Facilitating non-sovereign financing for **infrastructure** development	• Dominant role of state and centralised financing and decision-making with municipal services not provided on an autonomous or commercial basis. • Limited level of private sector participation in infrastructure and undeveloped PPP framework • Inadequate regulatory framework for commercialisation of infrastructure or municipal service provision	• Investments in municipal services moving towards corporatisation, commercialisation and tariff reform • Support for PPPs and other forms of private sector investments in infrastructure. • Co-financing major public investments linked to sector reforms.	• Regulatory and legal framework assessments of transport sub-sectors leading to a reform strategy. • Analysis and reform roadmap for municipal services, focused on decentralisation and private participation. • Project preparation such as feasibility studies for specific projects.