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APPRAISAL STAGE

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I. Country Context

1. Tunisia's political transition gained new momentum in early 2014, with the resolution of a political deadlock, the adoption of a new Constitution and the appointment of a new government. The national dialogue platform, brokered by key civil society organizations, played a crucial role in gathering all major political parties. This resulted in the adoption of a consensual roadmap leading to general elections, planned for the end of 2014. Additionally, local elections (municipal and regional) are expected to be organized in 2015. The strategic direction that the new government embarked upon focuses on restoring and maintaining security, while laying the ground for a stronger economic recovery, as key to successfully complete the democratic transition.

2. **Today, Tunisian policymakers are rethinking the relationship between central and local governments (LGs), and have taken concrete steps towards a more decentralized system**. Since the January 2011 Revolution, Tunisia has signaled its intent to bring cities into the heart of the local development process, making them proactive players in planning, implementing and delivering municipal infrastructure and services. There is widespread recognition that LGs, with their elected municipal councils and mayors, must be more than "passive spectators" in urban development. Moreover, there is a general consensus that, if they are to play a greater role, LGs need to become more transparent and accountable to local citizens.

3. **The New Constitution promulgated on Jan 27, 2014, includes clear commitments to decentralization** and proposes fully devolved and empowered LGs with autonomy for executing their mandates of providing local services according to transparent principles of participation by, and accountability to, their citizens. The changes mandated by the Constitution regarding local governance are transformational, as they effectively reverse the highly centralized previous structure, whereby central oversight and approval ("*tutelle*") was exercised on all facets of local government accountability, decision-making, and capital works and service delivery-related investments. The Constitution recognizes the decentralization processes as the fundamental basis for the organization and distribution of power in Tunisia, and as an essential step to achieve a more efficient and closer administration to citizens. The first article dedicated to LGs states that "local power is based on decentralization" (Chapter VII, Article 131).

It further states that LGs (particularly municipalities and regional governments) are chosen by universal, free and transparent vote, and will have their own legal personality, together with administrative and financial independence.

II. Sectoral and Institutional Context

4. **Tunisia is one of the highest urbanized countries in the Middle East and North Africa**. In 1975, the country's rate of urbanization was already 50%; today, roughly 70% of the country's 11 million citizens live in towns and cities, most of them on the coastal Mediterranean belt. Tunisia's urban sector is the most vibrant contributor to the national economy, accounting for more than 85% of the country's GDP. If Tunisian municipalities are very different in terms of size[1], they all share – to varying degrees – some common attributes**: they have few responsibilities, play a relatively minor role in urban/local development, enjoy limited decision-making powers, and currently have very limited connection with their citizens.** Their economic contribution has been growing during the last decade at a slower rate than the overall economy and presently accounts for 1.2% of GDP (and 4% of total public expenditures), compared with 15%in Morocco and 20% in Turkey. The national government spends TND 2,000 per capita (operating costs and investments combined) while municipalities spend TND 75 per capita (reported to population of municipalized territories). Moreover, there has been a downward trend in the relative weight of municipal expenditure between 2002 and 2012. While GDP increased 7.1%and the national budget grew 9% a year, municipal revenues increased only 6.1% a year—only about 1% above the inflation and demographic growth rates. In parallel, municipal investments have been shrinking. Between 2002 and 2012, they declined by 2 % and amounted to only 2.6% of all government investments.

5. **Tunisia has a long tradition of LGs, governed by elected municipal councils, and with a formally clear set of responsibilities. However, a highly centralized oversight system of "tutelle" has constrained their decision-making and independence.** Under normal circumstances, Tunisian municipalities are governed by a council, directly elected for a 5-year mandate, and an executive headed by the mayor, elected among the councilors (except Tunis, where the mayor is named by decree among the councilors). The most recent municipal elections were held in May 2010 – but following the January 2011 Revolution, all municipal councils were dissolved and replaced by Special Delegations (SDs).

6. **As in all inter-governmental fiscal systems, that of Tunisia has always included an important center-to-local transfer component**. The clearest element of this Inter-Governmental Fiscal Transfer (IGFT) system has been the FCCL, managed by the DGPCL. The total budget envelope of the FCCL is decided every year and then allocated to all municipalities on the basis of a formula. FCCL allocations to municipalities are, in effect, general purpose block grants, the use of which is entirely at the discretion of municipalities.

7. **LGs face an increasingly serious issue of growing municipal debt, driven largely by the requirement that they borrow from the CPSCL to finance their capital investments.** Consequently, although LGs appear to have relatively stable net operating surpluses at around 9% of recurrent revenues, the extent of the problem is hidden by repeated rescheduling of the debt under the direction of the Ministry of Economy and Finance, and by supplements provided through exceptional transfers to cover increasing recurrent costs, including debt obligations to the CPSCL for investment loans (exceptional transfers are now regularized through the newly created *Fond de Cooperation* – FDC).

8. **Beyond the formula-based allocation of the FCCL, the central government also provides municipalities with capital budget transfers in the form of investment-by-investment capital grants, which are less predictable and transparent.** These capital grants are usually linked to municipal borrowing from the CPSCL and to the 5-year Municipal Investment Plan (the PIC, currently for the period 2010-14), through which municipalities commit themselves to implementing investment projects. Financing for these PIC investments is mobilized from CPSCL loans to municipalities, central government subsidies (managed on behalf of the center by CPSCL) and own-source municipal revenues. Central government capital grants (effectively "hidden" inter-governmental fiscal transfers) thus account for about a third of municipal investment expenditures.

9. **The Tunisian municipal sector has developed over the last decade, yet its institutional performance to meet its municipal infrastructure delivery responsibilities and respond to the increased demand for services is still at a relatively early stage of development, and needs to be reinforced**. Despite those capital investments to support basic infrastructure delivery in urban areas, access to and quality of municipal services are far to be sustainable. Municipal service delivery is deteriorating in most cities and particularly in lagging behind regions with significant impacts on quality of life, urban environment, and public health as well as on key economic activities such tourism. A recent cross-sectoral score card undertaken on public services in Tunisia showed a widespread dissatisfaction with services provided by municipalities and that municipalities were ranked the second worst public service provider behind public healthcare.

10. **In line with the decentralization agenda recently introduced in the new Constitution, the government has recognized that reforming the PIC process offers new opportunities** to: (i) address, in the short-term, key elements of the decentralization agenda that would have significant impact and that lend themselves to immediate initiatives while the broader and longer-term aspects are being formulated; and (ii) concurrently focus on critical municipal service investment priorities. The government has also recognized, after more than 20 years of operation, that the effects of the existing PIC system as governed by Decree 97-1135 have resulted in perverse outcomes inconsistent with the original objectives of the grant, and not aligned with the decentralization policy reflected in the new Constitution. Specifically, the Government intends to: (i) transfer decision-making authority on the selection of investments in local services to municipalities, through a process whereby municipalities can be held accountable to their electorates; and (ii) underpin this with a capacity support system targeting areas of municipal performance requiring strengthening that is delivered on-the-job and on a just-in-time basis in response to municipality demands.

A. Relationship to the CAS/CPS and Rationale for Use of Instrument

11. **The proposed Urban Development and Local Government Operation is consistent with the Bank's Interim Strategy Note** (ISN) for 2013-14. The ISN spells out a set of three broad areas for Bank engagement and, within those areas, a number of Driving Objectives (DOs) that the Bank will pursue. The proposed operation is fully aligned with the ISN's second area of engagement: promoting social and economic inclusion. Within this second area, the operation addresses driving objective 5, improving access to basic services for under-served communities. About half a million people or 8% of urban population living in disadvantaged neighborhoods are targeted through the proposed program. The proposed operation is also generally in line with the ISN's third area of engagement: strengthening governance through voice, transparency and accountability. The operation's focus on local governance institutions, decentralization, and significantly strengthening participatory democracy at LG level directly supports this.

12. **The World Bank has a long history of engaging with the government of Tunisia** in the municipal development sector, addressing issues such as low access to LG infrastructure and basic

services, an absence of training support for LGs and limitations in access to LG finance. The previous three Bank-funded municipal development projects in Tunisia have been successful but limited attention was given to institutional development and LG accountability. The mostly "infrastructure" approach is no longer sustainable as decentralization, empowering LGs and local governance emerged as top national priorities. Since the January Revolution and particularly through the ongoing Tunisia Urban Technical Assistance Program, the Bank has developed a good record of engagement with decentralization and local government issues and has established ongoing dialogues with both Central and Local Governments.

13. **Rationale for use of the PforR instrument**. The Program-for-Results (PforR) financing has been identified as the most appropriate lending instrument to support the Tunisia 5-year Municipal Investment Program, with a view to enhance the impact of the Bank's financial and technical support and increase the overall results orientation of the Initiative. It would also support the Government in: a) improving the efficiency of the government expenditures in support to municipal investment; b) using program systems and procedures; promoting results orientation of the overall program by establishing clear links between Bank disbursements and delivery of results; and c) fostering improvement actions and delivering results, including through the mobilization of technical assistance.

III. Program Scope

14. The government program consists of state financial support to municipal infrastructure delivery and institutional strengthening program covering 264 municipalities for the period 2014-2018. Through this program, the government intends to shift from a purely "infrastructure delivery" approach to more focus on LG performance and accountability**.** To this end, the government's program aims at: (i) strengthening LG institutional capabilities while transforming their relationship with their citizens through measures that are designed to foster transparency, participation and accountability; and (ii) improving the municipal infrastructure delivery with special attention to disadvantaged communities.

15. The Program supported by the Bank would encompasse three primary activities: (a) performance-based capital grants for municipal infrastructure delivery; (b) targeted capital grant for improving access to basic municipal service in disadvantaged neighborhoods; and (c) capacity support for improved LG institutional development.

A. Performance-based Capital Grants for Municipal Infrastructure

16. The grants would be performance-based to incentivize LGs to achieve improved standards of institutional performance in key areas of their municipal functions. Under the Program, 264 municipalities will receive performance-based grants from the CPSCL (on behalf of the state) to support priority investments in urban infrastructure that have been identified and reflected in their participatory 5-year and annual municipal investment plans. The municipalities will be responsible for planning and implementing sub-projects financed with performance-based grant funds, and grant funds will be reflected in the revenues and expenditures of their annual budgets.

17. Performance-based grants will be allocated to the municipalities according to a transparent and predictable formula. These allocations are weighted by LG population and fiscal potential, subject to the application of an adjustment factor to ensure that each municipality will receive at least the equivalent of the envelope received during the previous PIC. These allocations are for planning purposes and the actual annual disbursement of funds will be made on the basis of: (i) meeting the MMCs; and (ii) each city's performance measured against a set of criteria.

B. Targeted Capital Grants for Improving Access to Basic Municipal Service in Disadvantaged Neighborhoods

18. This conditional/targeted capital grants represents a vehicle for the government to address policy priorities. Currently, government priority is focused on upgrading service levels in disadvantaged neighborhoods. A total of TDN 225 million has been allocated under the conditional grant for the PIC 2014-2018 period to improve access to basic service services in 114 LGs comprising 229 neighborhoods.

C. Capacity support for improved LG institutional development and accountability (US$17 million)

19. Given the likely heterogeneous demand from municipalities, capacity and technical support will be provided based on an annual Capacity Development Plan to address the needs identified during a specific capacity needs assessment that was carried out during Program preparation. The four broad areas pre-identified as requiring capacity building support at the city level include: (i) municipal investment prioritization and planning; (ii) own source revenue enhancement; (iii) project quality, including procurement and environmental and social management; and (iv) assessment management systems and mechanisms for operations and maintenance.

20. The program will also support the introduction of several initiatives which will strengthen government's decentralization, participatory governance and transparency agenda as established under the new Constitution. The Program will also support the design and launch of a new e-Platform (*Portail des Collectivités Locales*) which will make budget, procurement and audit information for all LGs as well as the results of LG performance assessments accessible to the public. Progressively, the E-Portal will also host LGs' information on Participatory Planning and Participatory Budgeting processes.

IV. Program Development Objective(s)

21. The development objective of the Program is: (i) to strengthen Local Governments' performance to deliver municipal infrastructure, and (ii) to improve access to services in targeted disadvantaged neighborhoods.

V. Environmental and Social Effects

22. An Environmental and Social System Assessment (ESSA) for the Program has been conducted by the World Bank in order to examine Tunisia's existing environmental and social management systems for municipal infrastructure projects and to ensure their consistency with the core principles outlined in OP/BP 9.00 Program-for-Results Financing.

23. Overall, the assessment concludes that the proposed activities and the applicable systems are in many ways consistent with the core principles of OP 9.00. However, there are some areas that need further strengthening. The Program activities that are likely to have environmental and social effects are those related to: (i) delivery of municipal infrastructure; and (ii) improving access to basic infrastructure in disadvantaged neighborhoods. These activities include roads and paving, construction, rehabilitation and upgrading, street lighting, sewerage extension/connection to public network, storm water drainage, solid waste collection, parks and some recreation facilities, markets and slaughterhouses, and other environmental improvements.

24. Based on the type, scope and scale of works allowable under this program, adverse effects are expected to be typical construction impacts that are site-specific and generally limited to the construction

phase. Similarly, given the scope of activities, it is highly unlikely that resettlement would occur, although land acquisition may be required for the construction of infrastructure works, for example in widening roads in the existing rights-of-way or acquiring land for new market areas. This has the potential to impact land, assets, property, crops, and shared community facilities such as water points, community roads, and roadside markets. Because of the significant geographic dispersion of the participating municipalities and the scale of proposed investments, cumulative effects of the Program as a whole are unlikely. A screening process for all projects includes criteria to exclude certain types of projects (e.g. new landfills and wastewater treatment plants) as well as projects of a scale that would include significant negative impacts that are sensitive, diverse, or unprecedented on the environment and/or affected people (such as slaughterhouses which are excluded from financing and ineligible under the Program).

25. The system for environmental and social management of the Program will be largely based on the existing legal, regulatory and institutional system for environmental and social assessment and management in Tunisia. The Program will draw on experience on similar programs over the past 20 years in Tunisia. The government agency responsible for supporting the funding of municipal investment plans (CPSCL) has developed an Environmental Assessment Manual (2003) with Bank assistance for the management of such investment plans. The draft ESSA has found that the Tunisian system for environmental and social impact assessment is well established and relatively comprehensive, reflecting international practices. This system is in general sufficient to ensure that potential impacts will be identified and managed. However, some gaps and limitations must be addressed for compliance with the provision of the new constitution and the requirements of the OP 9.00. In addition, the system is constrained by human resource gaps at various levels, and its implementation is at times inadequate as personnel frequently lack the required qualifications (e.g. to make site inspection visits, or to adequately carry out consultations).

26. From a social perspective, gaps and weaknesses have been identified in involuntary resettlement, as well as in participation and social accountability practices. There is a need to upgrade the CPSCL's recently produced draft Resettlement Guidelines (*Plan cadre d'acquisition de terrains, 2013*) and to provide appropriate guidance to municipalities, particularly in regards to the resettlement and compensation of non-authorized commercial occupants of public lands and rights-of-way. Guidance on citizen engagement in development investments and activities and on the use of grievance and redress mechanisms is also lacking. Municipalities will also need to ensure that people affected by loss of land and assets – in the unlikely event where this should occur in the context of basic infrastructure sub-projects – are properly compensated and assisted in the restoration of their livelihoods. Importantly, attention needs to be paid to improving the transparency and accountability of implementing organizations. Guidelines need to be developed for effective participation and consultation with affected residents. Municipalities participating in the Program will also need to adopt effective grievance and redress mechanisms.

VI. Financing

27. A proposed Program for Results financing of USD 300 million would support the implementation of the Program.

VII. Program Institutional and Implementation Arrangements

28. Taking into account the fiscal nature of the reforms introduced under the Program, the Ministry of Finance (MoEF) is responsible for the Program and consequently the activities under the Program are financed directly by the MoEF through its annual budget. The MoEF will be responsible for the financing of the Program activities and this will include ensuring that Program resources are budgeted for and disbursed within the Program expenditure framework according to existing state budget procedures.

29. Sectoral coordination is ensured by an Inter-Ministerial Committee (IMC) which was established in July 2013 to oversee coordination of the Program, and is chaired by the Minister on charge of Local Governments within the Ministry of Interior (MoI). It is supported by the DGCPL, which will serve as the Secretariat to the IMC.

30. The CPSCL is mandated under the Decree and according to the Organic Law for Local Governments to administer the capital grant transfers to LG. The process of the Capital Grant transfers is detailed in the Program Operations Manual. The CPSCL will coordinate the day-to-day implementation of the Program, facilitate the timely completion of inter-dependent functions to be performed by the several supporting agencies, and integrate reporting requirements. The CPSCL will be directly responsible, through its regional offices, for the execution of the technical assistance (just-in-time support) activities of the capacity building program (as described above).

31. At local level, LGs will plan and implement investments financed under the Program, building on the well-established systems and procedures developed during the last 20 years with support from the three previous Bank's funded Municipal Development Projects. As these LGs are the project owners for individual investment projects, funding from the grants will be reflected in the revenues and expenditures of the LG annual budgets. The LG will prepare the annual municipal investment plan for the Program, consolidated with the annual budget plan of the LG. The annual budget is discussed and approved by the municipal council and the annual municipal investment plan and the annual budget will be disclosed after adoption. The LG will be responsible for approval of feasibility studies and basic designs, detailed designs and cost estimates and procurement plans.

VIII. Contact point

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