PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: PIDA1003

Project Name	TN-Competitiveness and Export Dev. (P132381)
Region	MIDDLE EAST AND NORTH AFRICA
Country	Tunisia
Sector(s)	Central government administration (30%), General industry and trade sector (30%), Other domestic and international trade (20%), Othe r industry (15%), SME Finance (5%)
Theme(s)	Export development and competitiveness (40%), Trade facilitation and market access (30%), Micro, Small and Medium Enterprise support (20%), Other Private Sector Development (10%)
Lending Instrument	Specific Investment Loan
Project ID	P132381
Borrower(s)	Republic of Tunisia
Implementing Agency	Ministry of Commerce and Handicraft
Environmental Category	C-Not Required
Date PID Prepared/Updated	13-May-2013
Date PID Approved/Disclosed	12-Jun-2013
Estimated Date of Appraisal Completion	17-May-2013
Estimated Date of Board Approval	30-Jul-2013
Decision	

I. Project Context

Country Context

With the election in October 2011 of a Constituent Assembly, and the formation of a new Government, Tunisia has successfully completed the first phase of its political transition to a multi-party democracy. In January 2011, the “Jasmine Revolution” led to a wave of protests that ended the 23 year rule of President Zine El Abidine Ben Ali, ushered in a new political and economic era. The revolution was fueled by widespread anger and frustration over lack of social and political inclusion, governance and corruption problems, mounting unemployment and the rising cost of living. On October 23, 2011, ninety percent of the 4.1 million registered voters participated in the elections of a Constituent Assembly. The Chair of the Constituent Assembly announced in April 2012 that he expects the draft Constitution to be ready by end-October 2012. Once the new Constitution is adopted, there will be a fresh round of elections under the new Constitution. The Constituent Assembly Government announced in March 2012 that new national elections would be held under the new Constitution, likely in March 2013, and no later than end-June 2013.

The continued social unrest during most of 2011, Eurozone crisis of confidence and the war in Libya have impacted negatively economic performance in 2011. The previous Interim Government sought to mitigate the revolution's impact on the economy and to boost recovery using a combination of fiscal and monetary policy measures. In spite of the sound policy response, the combination of political uncertainty, social tensions and strikes, the European crisis and the Libyan crisis significantly impaired economic activity. As a result, economic growth was negative at -1.8 percent in 2011. FDI, already low from the 2008 global financial crisis, dropped by a further 25 percent (in nominal terms).

The immediate challenge for Tunisia is to ensure economic and social stability, in a situation where the short term economic outlook remains uncertain. GDP growth is projected at 2.4 percent in 2012, but the rhythm of recovery will depend on the government's ability to manage the social and political tensions within Tunisia, the execution and effects of the large fiscal stimulus, and the extent of the European recession which will affect tourism, exports and FDI.

A steep increase in unemployment is the most urgent socio-economic issues for Tunisia to resolve, and is a major aspect of youth frustration that led to the January 2011 Revolution. The already large pool of unemployment continued to increase in recent years, as economic growth has been inadequate to generate sufficient jobs to absorb new entrants to the labor market. With the economic downturn of the past year, the unemployment rate increased from 13 percent in 2010 to 18.9 percent in 2011 (or approximately 740,000 people). This now appears to have stabilized and has decreased to 18.1 percent by the first quarter of 2012. The unemployment of individuals with higher education degree is 20 percent and that for individuals aged 20-29 years about 27 percent, both exceed a national average of roughly 14 percent (World Bank 2010). Further demographic trends suggest that unless the pace of economic growth accelerates substantially, unemployment will continue to worsen over the decade.

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Sectoral and institutional Context

Sectoral context

To reduce unemployment, the government needs to adopt structural reforms to transform the economy from a low-wage, low value-added economy to a knowledge-based and skill-intensive economy. Under the current structure of the economy, the response of overall employment to growth is bound to be low and a significant GDP and export growth rate may not necessarily reduce unemployment significantly. In effect, intense utilization of low-skilled labor and low value addition rates are still the main characteristics of the current production system in Tunisia. As a consequence, Tunisia needs to move further up the value chain in traditional industries and promote new investments in skill-intensive sectors to increase value addition, increase productivity and higher value added exports in order to durably reduce unemployment (World Bank 2010). Promoting economic diversification in untapped sectors such as information technology, manufacturing and health care and aligning skills development to meet future labor market needs will be needed.

The social turmoil associated with the revolution and the Eurozone slowdown has affected several sectors of the Tunisian economy. The tourism sector was particularly affected as a result of the revolution and experienced a contraction of 33 percent during 2011. Similarly the mining sector (mostly phosphate) was severely affected by the social tensions and strikes for most of 2011, which led to a sharp decline of its exports by 30 percent (in real terms). Most industrial production

declined during the first quarter of 2011-12 due to the political change and social tensions. However most of the key exporting sectors recovered from the second quarter, driven in particular by the mechanical and electrical industrial production, which grew by 5 percent in 2011 (in nominal terms), while the textile industry stagnated (0.5 percent in nominal terms). On the other hand, thanks to a good rainy season, agricultural production grew by 9 percent in 2011 (in nominal terms), which partially compensated poor performance in other sectors.

Exports as an engine of growth still face constraints. Tunisia's growth and development successes over the past decades has largely been fueled by export of goods and services which grew at an average yearly rate of about 5.3 percent between 1997 and 2007 . For Tunisian exports to remain a significant engine of growth and contribute their share in unemployment reduction, several challenges need to be fully recognized and addressed with a view of developing exports and climbing the technological ladder:

-Although the export structure has slightly diversified over time, Tunisia's main export markets remain almost unchanged and have moderate growth prospects. While over the last decade, the structure of Tunisian exports has slightly diversified, Tunisia's export markets have remained highly concentrated. In effect, the European Union (mostly France, Italy and Germany), accounts for 75-80 percent of Tunisia's exports. Only 8 percent of Tunisia's exports are shipped to Maghreb partners – of which 4 percent now goes to Libya. Exports to non-Maghreb Arab partners, SSA and other countries are minimal. The current concentration of export markets may lead to a slower than expected development of exports given growth prospects in these markets ;

-Financing of exports remain an issue, especially for smaller SMEs and new exporters. Available survey data from ITCEQ show that Tunisian companies typically consider access to and cost of bank financing to be two of the greatest barriers to their growth. At the export level, in Tunisia – like in many other countries – SMEs were particularly affected by the global financial crisis, and export diversification was made more difficult (World Bank 2009). In Tunisia, 34 percent of the surveyed firms reported that access to pre-export financing was a problem (World Bank 2009).

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-Although SME finance is relatively large, financing of exports remain an issue, especially for smaller SMEs and new exporters and challenges in SME finance are foreseen). The 2012 FASP founds that banks remain the primary financiers of SMEs, but the growths of leasing and private equity are welcome alternatives. The important share of SMEs in bank loans (23 percent) is offset by a credit to GDP ratio, which is below its potential, credit allocation remains disappointing (NPL ratios on SMEs portfolios average 25 percent and 29 percent for state-owned banks only), and challenges to SME finance can be anticipated (risk aversion in a difficult environment, increased government financing by banks, additional loan concentration linked for instance to large investment programs).

-Supply chain issues still impose significant transactions costs on Tunisian firms. A recent study (2010) found that for some key exporting sectors in manufacturing and services, logistical costs account for 20 to 73 percent of gross margins. Overall, even if Tunisia's score on the World Bank’s Logistics Performance Index 2010 is above or at par with the overall Middle East and North Africa average, the country still lags behind in terms of “Logistics Competence” compared to its regional peers and remains way below the best world performer (Germany). In addition, in specific areas, recent requirements on export markets such as improved traceability of products (especially for those of agro-industrial origin) create additional constraints on the domestic supply chain. Finally,

despite impressive and remarkable improvements at Custom's level (average clearance time which was 3.26 days in 2005 is around 0.5 days now, and around 15 minutes for exported good), there is still room for improvement in terms of import and export control procedures. As a result of all the above, Tunisian exporters still suffer from lost export opportunities;

-Exporting sectors – which are still dominated by manufacturing and tourism – remain largely labor intensive and have low value added generation. Textiles and clothing, leather and footwear (henceforth TCLF) and the mechanical and electrical sectors combined account for about 65 percent of exports. In effect, while the ratio of exports to GDP is 47 percent, in terms of exporting, the manufacturing sectors generate less than 15 percent of GDP (World Bank 2010). This can be explained by the fact that Tunisian exporters still largely remain sub-contractors for large foreign companies and few of them become direct exporters (a transformation which would have the added advantage to reinforce domestic linkages and increase the value added of their exports). As a result, Tunisian exporters still largely continue to produce relatively simple goods that can be easily replaced with similar products from lower cost locations like China, India, and Bangladesh. It is therefore not surprising to see that Tunisia has been losing market shares in recent years for traditional exports such as articles of apparel and accessories or footwear.

As a consequence of the previous weaknesses, Tunisia is a net exporter and increases its market share in growing markets in only 2 of its top ten exported products. Besides further improvements in the overall investment climate of Tunisia and the legal framework governing the private sector and exports , there is a need i) to help firms access new markets (product and market diversification) and consolidate their positions on existing ones, ii) allow SMEs to have better access to export finance, iii) improve internal supply chains, and iv) climb the technological ladder to further expand Tunisian exports and contribute to increased employment generation. These observations provide the rationale behind the proposed project.

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Institutional context

The current government has prepared a socio-economic development strategy. The strategy seeks to consolidate the aspirations of the population as expressed in the revolution and pave the way for a stronger economic growth and jobs creation, with a focus on lagging regions. In order to boost economic growth the government has developed a medium-term plan based on five main pillars: First, the strategy outlines an ambitious program of economic and social reforms. Second, the government action will focus on the modernization of the infrastructure. Third, promoting a more balanced development across regions. Fourth, consolidating social and human development. Fifth, promoting the sustainable development and an efficient use of national resources.

Government structure: Besides the Ministry of Finance which defines the tax policy (including export incentive of various kinds) and oversees the Custom's department which is critical for trade facilitation, three technical ministries play a key role – along with several specialized agencies under their control – in implementing the export strategy of the country. The Ministry of Commerce and Handicraft is in charge of the services sector, exports promotion (via the CEPEX, the public EPA) and control functions (competition, technical controls) while the Ministry of Industry and Technology deals with the upgrading of the sector, SME issues and technical support to the sector (via the INORPI and other agencies). The Ministry of Transport is responsible for transport policy, regulation of transport services, and the development of rail, maritime, air and urban transport. The development and management of the road network is the responsibility of the Ministry of

Equipment, Housing and Land Planning.

All the above Ministries have had, and still have, collaboration with international agencies, including the World Bank. The Ministry of Commerce and Handicraft was the implementing institution for two previous EDPs funded through World Bank SILs. Customs and CEPEX were key partners in these two projects. In the late 1990s, the Ministry of Industry implemented the PAISI project and has an on-going technical relationship with the Bank, having requested in recent years several studies. The Ministry of Transport has a good relationship with the World Bank and has received technical assistance in recent years in selected areas, including the development of a transport strategy. All these institutions are stable, have clearly defined mandates, technical and upper management staff is of high quality. All have a long working relationship with the World Bank, including project implementation.

II. Proposed Development Objectives

The project development objective is to help increase and diversify exports by supported enterprises in the identified sectors.

III. Project Description

Component Name

Support to improve the business climate and the diffusion of innovation for trade competitiveness

Comments (optional)

Component Name

Provision of financial and non-financial services to export enterprises

Comments (optional)

Component Name

Support to the ministries of trade and investment for coordination and management of the project

Comments (optional)

IV. Financing *(in USD Million)*

Total Project Cost:	74.60	Total Bank Financing:	51.00
Total Cofinancing:		Financing Gap:	0.00

For Loans/Credits/Others	**Amount**
Borrower	3.60
International Bank for Reconstruction and Development	51.00
LOCAL BENEFICIARIES	20.00
Total	74.60

V. Implementation

The Project Coordination and Management (PCMU) of the Minister of Trade and Handicrafts will have the overall responsibility for coordinating the project. The PMCU will have specific

responsibility in implementing all activities related to Government entities (Customs, MT, COTUNACE, INNORPI under Component 1, and Sub-Component 2.1. and Component 3 of the project.

CEPEX will be responsible for implementing Project Components 2.2. Innovation and Export Development Fund (FIDEX) and Sub-Component 2.3 Strengthening of the Export Promotion Center (CEPEX). CEPEX will implement FIDEX with the necessary autonomy in financial management, procurement and monitoring and evaluation. The fund will be implemented under the supervision of a Selection Committee chaired by the Director of CEPEX and made up of representatives of the MTH, the ministries of finance and industry, COTUNACE and representatives of private sector associations (UTICA, TACT, FIPA [Foreign Investment Promotion Agency].

VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01		×
Natural Habitats OP/BP 4.04		×
Forests OP/BP 4.36		×
Pest Management OP 4.09		×
Physical Cultural Resources OP/BP 4.11		×
Indigenous Peoples OP/BP 4.10		×
Involuntary Resettlement OP/BP 4.12		×
Safety of Dams OP/BP 4.37		×
Projects on International Waterways OP/BP 7.50		×
Projects in Disputed Areas OP/BP 7.60		×

Comments (optional)

VII. Contact point

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