

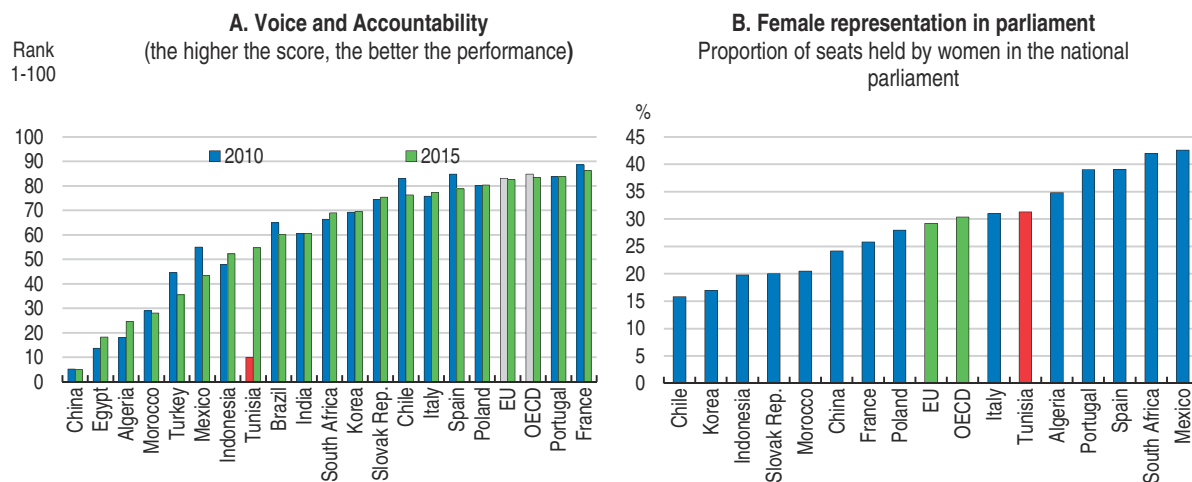
## Assessment and recommendations

- *Solid progress for several decades in the political, social and economic fields*
- *Growth is going to become stronger, but inflationary pressures and the twin deficits persist*
- *Policies to restore macroeconomic balances without halting growth*
- *Returning Tunisia to a path of inclusive and robust growth*


## Solid progress for several decades in the political, social and economic fields

Tunisia is firmly committed to a process of democratisation since the fall of the political regime in power since 1987. From independence in 1956 until the “revolution for freedom and dignity” at the end of 2010, Tunisia had only two presidents, and few elections were truly democratic. In October 2011, the country held elections to designate the constituent assembly responsible for drafting a new constitution. That constitution was adopted in January 2014, and parliamentary and presidential elections were organised at the end of that year. The democratic leap since 2010, measured by the World Bank indicator of citizens’ capacity to participate in political life as well as their freedom of expression and association, has been significant. This indicator also places Tunisia in a favourable position compared to other countries of the region, and to many emerging countries (Figure 1). In addition, there is a higher proportion of women in the Assembly of the Representatives of the People than in most OECD and emerging countries.

Figure 1. **Political transition: significant progress toward democracy**



Source: World Bank, Worldwide Governance Indicators; and World Bank, World Development Indicators (WDI).

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This democratic renewal has gone hand-in-hand with frequent changes of government. The presence of a well-formed administration has nevertheless served to ensure continuity of the State during these changes. Moreover, successive governments have broadly shared the same economic agenda – the programme of major reforms. The Carthage Pact was concluded in July 2016 by nine political parties and representatives of the principal labour unions and employer associations. A government of national unity, comprising representatives of the Pact’s signatory parties, was formed in August 2016. The essential components of this Pact are to combat terrorism and corruption, to speed growth and employment, to bring the public finances under control, to implement an effective social policy, and to promote regional development.

While there is a broad consensus on the need for reforms, implementation of the reforms has run up against economic and political constraints. Political fragmentation has made it difficult for the Assembly of the Representatives of the People to adopt the reforms proposed by the government (Council of Economic Analysis, 2016). Moreover, there is often a delay in implementing laws adopted by the Assembly as implementation decrees, which are the responsibility of the executive, are published belatedly.

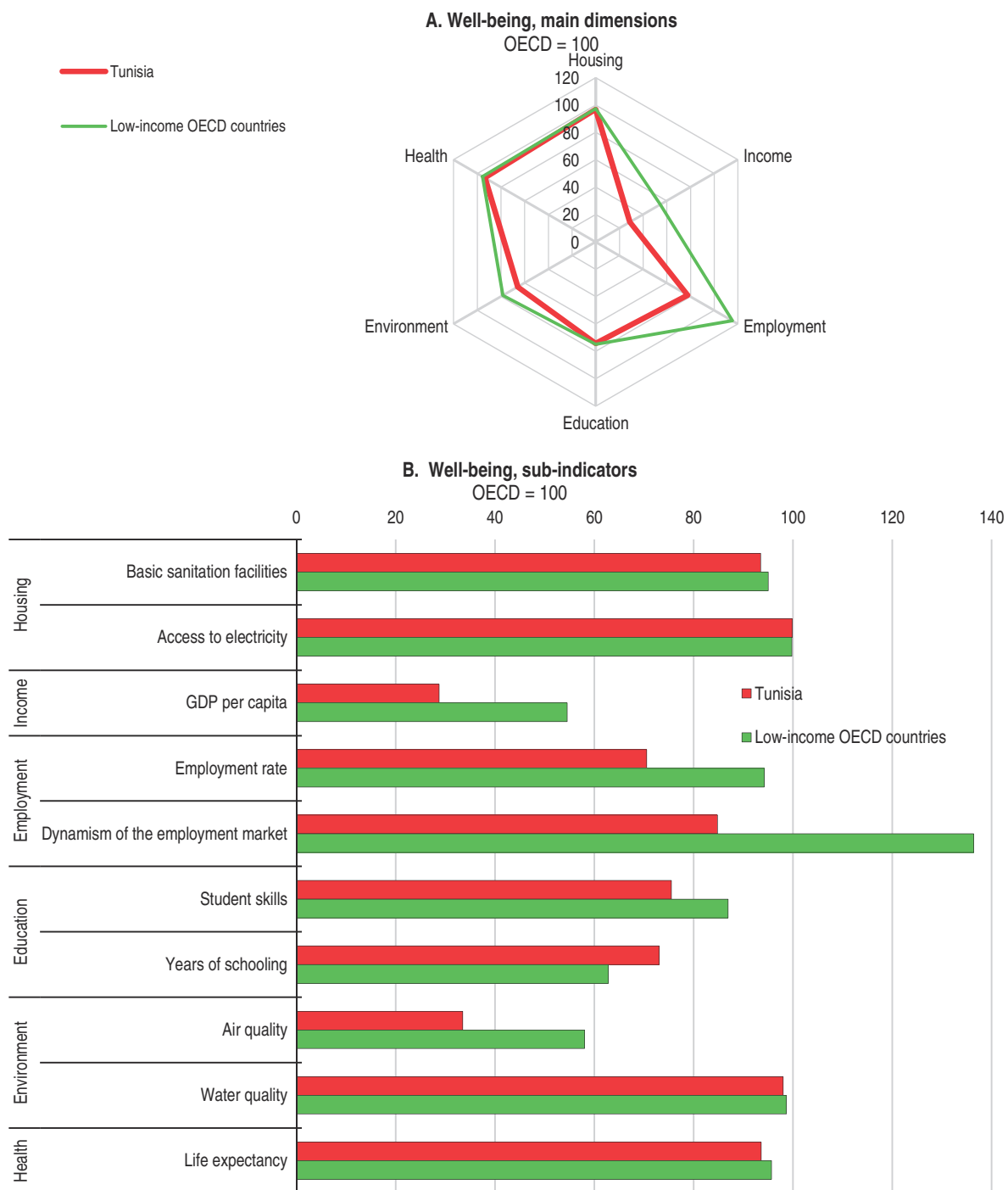
Inclusiveness has been a major concern in Tunisia since its independence. The Code of Personal Status, adopted in 1956, makes Tunisia the most progressive country in the Arab world in terms of women's rights. Schooling, in particular for girls, was also made a national priority much earlier than in the majority of emerging countries. The plan launched by the President in mid-2017 to give men and women equal inheritance rights goes in the same direction. Access to basic public services, such as electricity and water, is notably higher than in the majority of emerging countries. The basis for social protection was laid as early as 1960, with a "pay-as-you-go" retirement pension scheme and a relatively high-quality health system. A system of social benefits for workers who lost their jobs for economic and technical reasons was introduced in 1997. A national programme of transfer payments and free or cheap healthcare for poor and low-income families has been introduced. Tunisia is therefore more favourably positioned than other emerging economies in terms of its population's well-being, especially in the dimensions of health, housing and basic infrastructure (Figure 2).

The numerous social programmes adopted since the 1970s have helped to reduce poverty (Figure 3). The low poverty rate is particularly impressive in comparison with other countries of the Middle East and North Africa (MENA). Thus, the country's economic growth has benefited the majority of Tunisian households, including the poorest ones, which have seen their consumption rise at a faster pace than the wealthier segments (World Bank, 2016).

Labour market inequalities and regional disparities have persisted and have even been widening (Chapter 2), and they helped to precipitate the revolution of 2011. Women's participation, while higher than in most MENA countries, remains low. The unemployment rate is high, especially for young people and women. For those who have a job, there are important differences in status and income between public sector employees, private sector employees, and employees in the informal sector (who have no social coverage at all). The interior regions of the country suffer from low levels of activity, high unemployment rates, and lower-quality public services. They are also poorly linked to the main economic sectors on the coasts.

Since independence, Tunisia has accorded the State an important role. The economic model was built around an active industrial policy to foster the development of certain sectors of activity, large enterprises, and public banks. This statist development model became gradually more open to foreign trade and to foreign direct investment, beginning in 1972 with a new investment code that instituted a favourable tax and customs regime for enterprises devoted exclusively to export – the so-called "offshore system". The Agreement of Association with the European Union in 1995 accelerated the process of opening. Private initiative and business creation have been encouraged since the mid-1990s, with a wide range of financial and tax measures for small and medium-sized enterprises. At the same time, Tunisia has experienced several waves of privatisation, notably in the mid-1980s and in 2006-2007, as well as regulatory reforms. Some of these

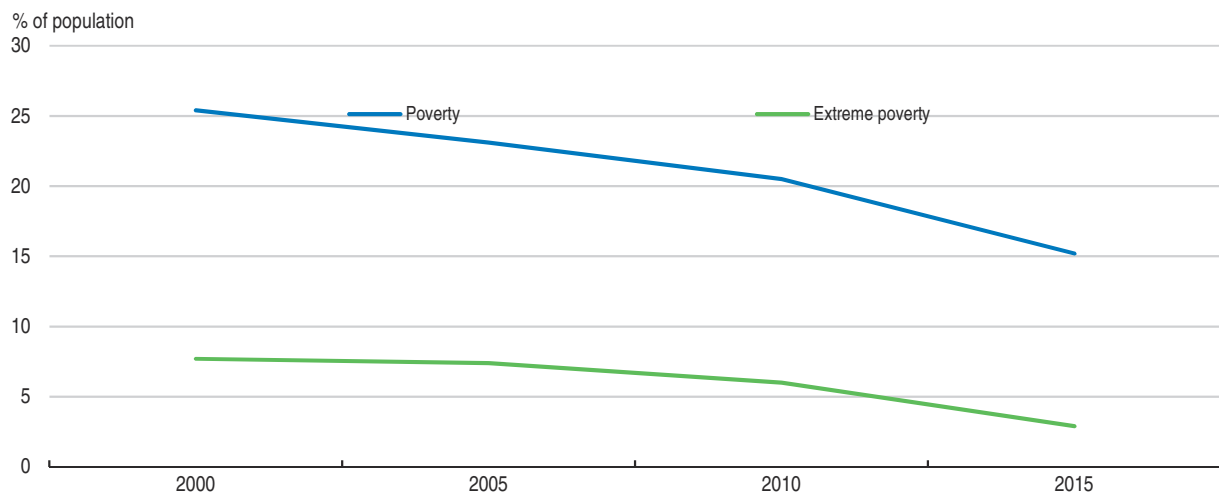
Figure 2. Indicators of well-being are fairly high, except for employment and income



Note: The variables used for these dimensions are the following: i) Housing: share of population with access to improved sanitation and share of population with access to electricity; ii) Income: GDP per capita expressed in purchasing power parity; iii) Employment: employment rate and share of unemployed without paid work for at least one year; iv) Education: average outcomes from PISA tests in reading, mathematics and science, and share of the over-25 population with at least an upper secondary school education; v) Environment: inverse of the average annual concentration of PM2.5 and share of population with access to an improved drinking water source; vi) Health: life expectancy at birth.


Source: World Bank, World Development Indicators, INS, OECD PISA database, UNESCO.

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Figure 3. **The poverty rate has declined**

Note: The poverty rate is defined as the percentage of the population earning less than TND 1 706 or USD 712 per year (in 2015). For extreme poverty, the threshold is TND 1 032 or USD 431 per year.

Source: INS.

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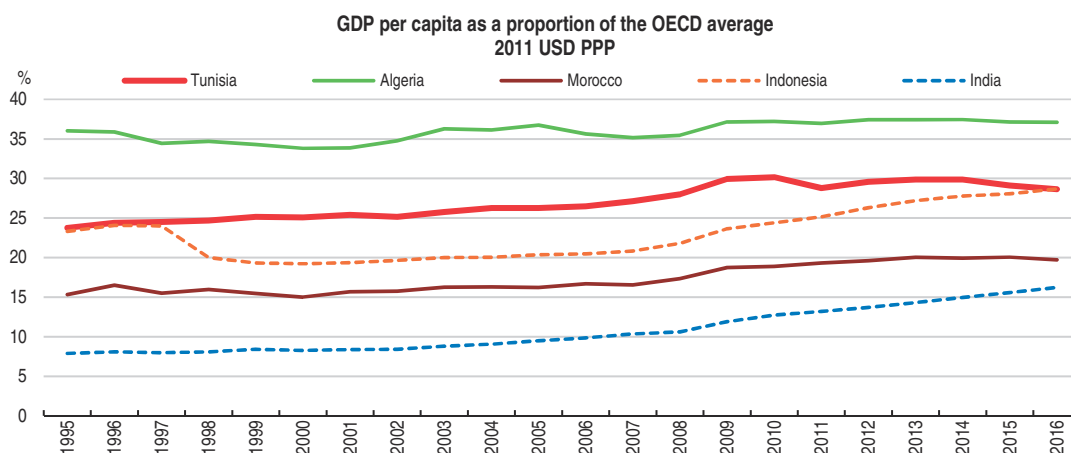
reforms have however been seen as smacking of cronyism, by reinforcing the control of important families over the economy (Rijkers et al., 2014).

After accelerating during the 1990s, the process of economic convergence came to a temporary halt (Figure 4). Growth faltered after 2010. Business investment as a percentage of GDP has been on a downward track since the beginning of the century (Chapter 1), and this has weighed upon productivity, job creation and the improvement of living standards. The sharp growth in public employment and wages sustained demand, but led to twin deficits (fiscal and trade) that have reached critical levels. The slowing of economic activity is also a reflection of exceptional circumstances – labour strife and terrorist attacks – that have affected the production and export of oil, gas and phosphates, as well as the tourism sector. It is estimated that if these sectors had continued to grow at the same rate as before 2011, average GDP growth for the 2011-16 period would have stood at 2.6%, all things being equal, rather than the 1.7% increase observed. The economic slowdown has however been less severe than in other countries that have been through major political transitions, such as Spain, Poland and Portugal (Figure 5.A).

The Tunisian economy also suffered from the impact of the crisis in Libya, which was its number two trading partner after the European Union. Libya was an important market, especially for agri-food and construction. While it is true that the influx of Libyan refugees, with average revenues which were much higher than in Tunisian households, boosted consumption, the Libyan crisis also precipitated the return home of around 60 000 Tunisians, most of whom originally came from deprived regions, thereby exacerbating unemployment and regional inequalities. Flaring tensions in the region also affected investment and tourism in Tunisia, leading to an increase in military and security spending. Overall, the World Bank estimates that the Libyan crisis resulted in a fall in growth of one percentage point over the period 2011 to 2015 (World Bank, 2017).

The normalisation of the domestic and external situation should allow recovery of growth, as well as an improvement in the balance of payments and the fiscal balance. Such

Figure 4. The process of economic convergence has been gradual

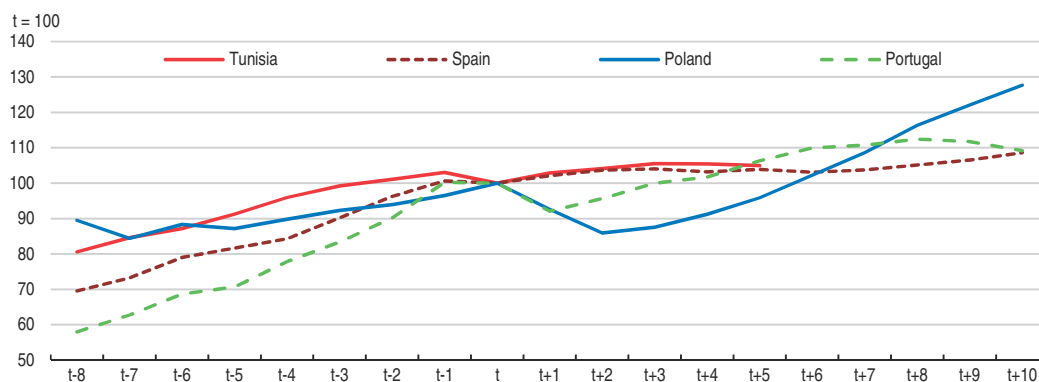


Source: World Bank, World Development Indicators (WDI).

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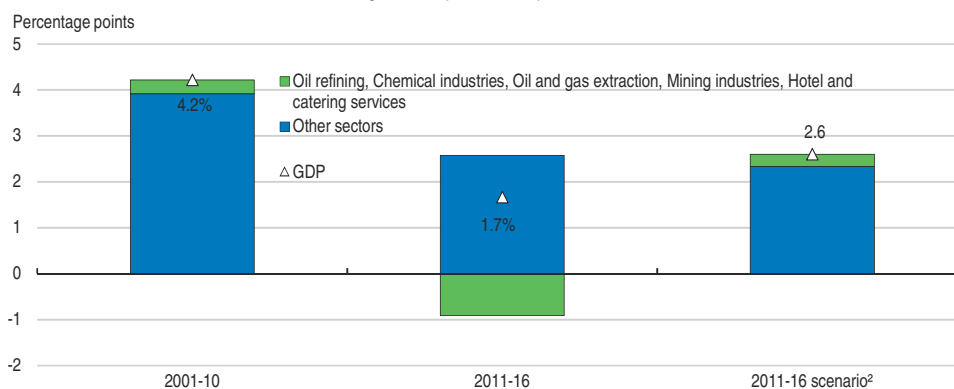
Figure 5. The Tunisian economy has been resilient

A. Income per capita continued to grow after 2010<sup>1</sup>



B. Exceptional circumstances had a significant impact on growth

Sector contributions to growth: impact of exceptional circumstances



1. Time t corresponds to the year of regime change: 1974 for Portugal, 1975 for Spain, 1990 for Poland, and 2011 for Tunisia.
2. The scenario shows growth that would have been achieved if exceptional circumstances had not affected tourism, extraction, and mining processing activities.

Source: OECD Economic Outlook 102 Database; OECD calculations.

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normalisation will however not be enough to spark a sustained pace of growth, to make a significant dent in unemployment (a key factor for inequality in Tunisia), and to return the public debt to a sustainable path.


Tunisia and the IMF signed a USD 2.9 billion Extended Fund Facility agreement in 2016 to address the underlying vulnerabilities. This agreement calls, in particular, for promoting more vigorous and more equitably shared economic growth by shoring up macroeconomic stability, reforming public institutions (especially the civil service), facilitating financial intermediation, and enhancing the business climate.

Tunisia could make more of its comparative advantages. It has a relatively well-trained workforce and a strategic geographic situation, between Europe and Africa. It will be an essential partner in the reconstruction of Libya. Its economy is open to trade and to foreign investors. Some parts of the economy are particularly robust, notably the offshore sector. In this sector, the number of enterprises grew by a factor of more than 13 between 1996 and 2016, while the number of firms in the onshore sector less than doubled. Enterprises in the offshore sector accounted for 78% of non-energy exports in 2015, and 34% of formal employment. The output of the offshore sector has been diversified toward more complex products than the traditional textile and clothing business, with the steady progression of the engineering and electrical industries. The outlook for growth to 2025, based on the sophistication and diversification of products (The Atlas of Economic Complexity) is highly favourable (Figure 6). In terms of innovation, Tunisia is the leading African and MENA zone country in the Bloomberg Innovation Index, ranking 43<sup>rd</sup> out of 200 countries in 2018. To capitalise on these assets, Tunisia will have to undertake reforms that will unleash private initiative and help to exploit the country's comparative advantages.

Figure 6. **Medium-term growth outlook based on the complexity of the economy**



Source: The Atlas of Economic Complexity, 2015. Harvard Center for International Development.

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The main messages from this first OECD economic review of Tunisia are the following:

- To return public debt to a sustainable path will require a combination of gradual fiscal stabilisation and structural reforms capable of sustaining growth. As the tax-to-GDP ratio is already high, fiscal consolidation will have to focus on public spending and be enshrined in a medium-term horizon. Tax justice must be reinforced and the bias of

subsidies in favour of wealthy households must be corrected. The governance of State-owned enterprises needs to be reinforced, and their financial performances significantly improved.

- To revive economic activity, and create jobs, the pace of structural reforms must be quickened. Priority needs to be given to improving the business climate it will be easier to achieve gains doing this rather than modernising the Labour Code. To this end, the regulatory, administrative and financing constraints facing businesses must be lifted, and a level playing field must be created for public and private companies. Opening the economy to competition should help as well to reduce established positions and speed the dissemination of new technologies. Better logistical performances and facilitation of external trade should make it possible to attract more foreign investment and to move further along global value chains. The predictability of regulation, including tax regulation, is also important for investors.
- Job creation and regional development are the key factors behind more inclusive growth. In order to cut unemployment and to create high-quality jobs, the social contributions that now weigh upon paid employment must be lightened. Policies that promote women's participation in the labour market and their employment, and that provide better guidance on training courses that help ensure employment should be implemented. A new regional development policy is needed, one that can capitalise on the specific advantages of each region, notably through the introduction of conditions conducive to business designed to attract investors. Measures to encourage worker mobility, such as improvements to infrastructure and public transport in isolated regions, are also needed.

## **Growth is going to become stronger, but inflationary pressures and the twin deficits persist**

### ***The economy is gaining strength***

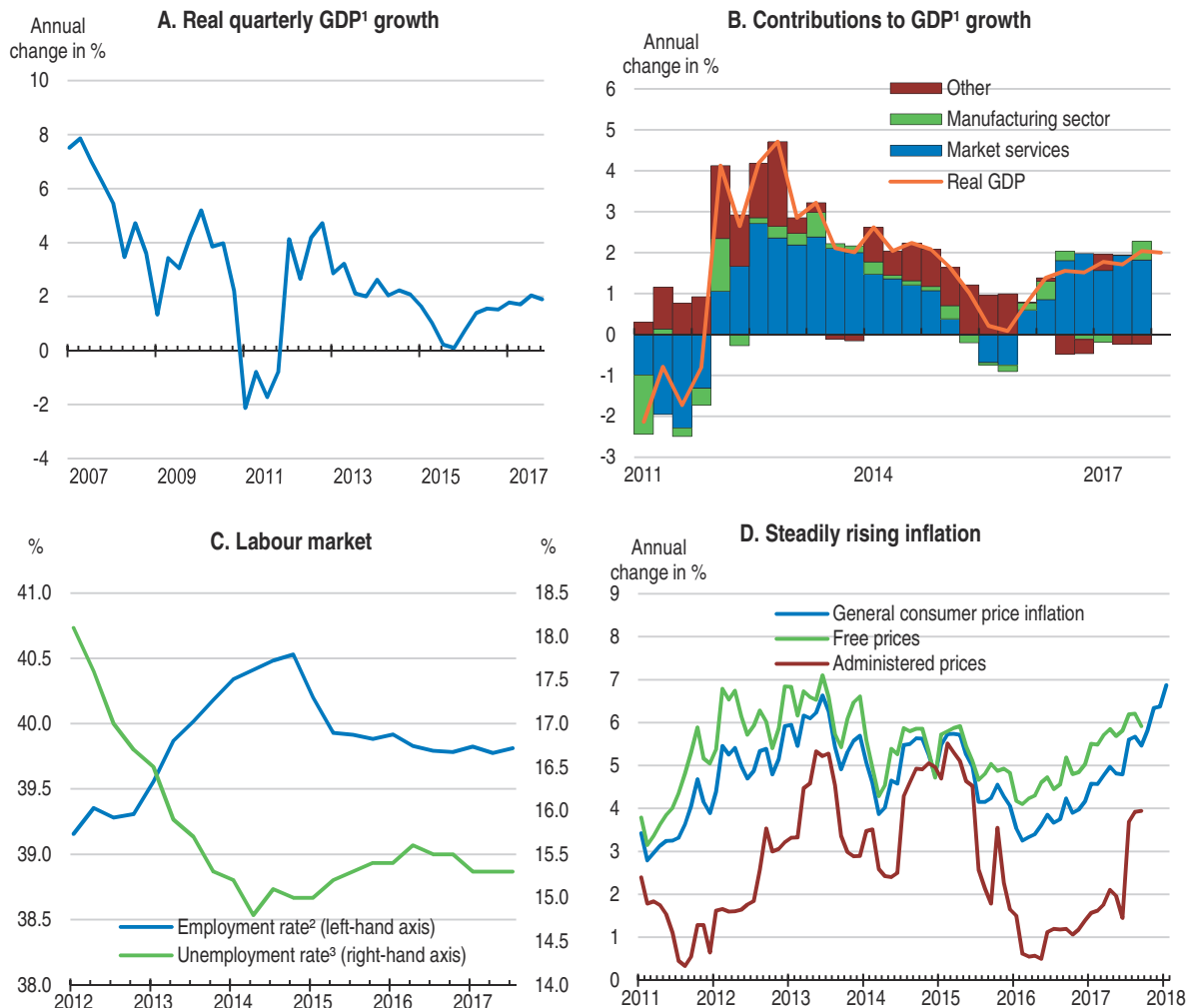
Economic activity has been recovering since 2016, driven by good harvests and the strong performance of the services sector, especially tourism and transport (Figure 7). In 2015, growth slowed as a result of temporary factors that were specific to certain sectors. Industrial performance was affected by labour unrest, especially in the chemicals industry, mining and hydrocarbons production. The output of oil and gas also suffered from declining reserves, the closing of some fields for maintenance, the paucity of foreign direct investment (FDI), and the absence of new discoveries (Central Bank of Tunisia, 2017). The terrorist attacks of 2015 had a heavy impact on the tourism sector, although tourist arrivals recovered in 2017 with the lifting of traveller alerts in several European countries.

### ***Job creation is weak and unemployment remains high***

The weakness of economic activity in recent years has stymied any substantial growth in employment. The employment rate (defined as the labour force divided by the total working-age population [aged 15+]) has been on a downward track since mid-2014, dropping to around 40% in the second quarter of 2017 (Figure 7.C). The unemployment rate is high: it stood at 15% of the economically active population in mid-2017, and in 2016 it was as high as 30.5% among young graduates of higher education.

Inflation has resumed its upward track since April 2016, and now stands at more than 6% year-over-year at the end of 2017 (Figure 7.D). Inflationary pressures are essentially a reflection of the devaluation of the dinar as well as higher wages and salaries, which have



Figure 7. **Macroeconomic indicators**

1. GDP at factor cost.

2. The Employment rate is calculated as the labour force divided by the total working-age population (aged 15+).

3. The Unemployment rate is calculated as the number of unemployed people as a percentage of the active population. Unemployed people are persons of working age who are without work, available for work and that have taken active steps to find work. The active population is defined as the total number of unemployed people plus the employed civilian workforce.

Source: INS; OECD Economic Outlook 102 Database.

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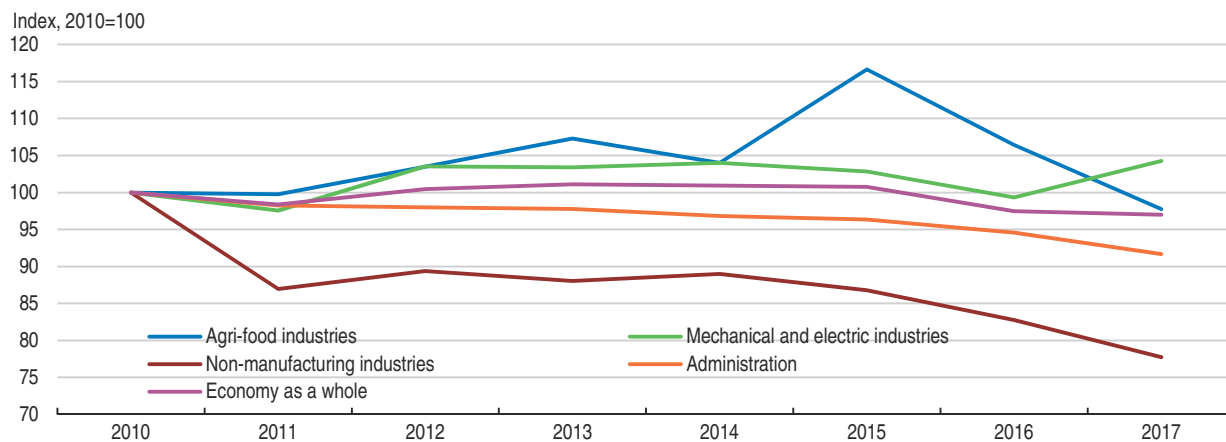
boosted consumption. In fact, real wages have risen faster than productivity in 2016 and 2017, especially in government, the agri-food industries, and hydrocarbons (Figure 8). The wage agreement signed in March 2017 foresees an increase of 6% for 2016 (with retroactive effect to August 2016) and a similar increase as of May 2017. Some sectors are facing difficulties in applying these salary increases, even if they have been granted a derogation to defer their application.

### **It is proving hard to reverse the current account deficit**

External payments have been affected since 2011 by social unrest and greater insecurity in the wake of the revolution, and by the Libya crisis. The current deficit has deepened significantly to an average of 9.1% of GDP between 2013 and 2017, compared to 3.1% of GDP between 2006 and 2010.


Figure 8. **Real wages have outpaced productivity**

Index of labour productivity/real wages



Note: An increase in the index indicates that wages are growing faster than productivity.

Source: ITCEQ.

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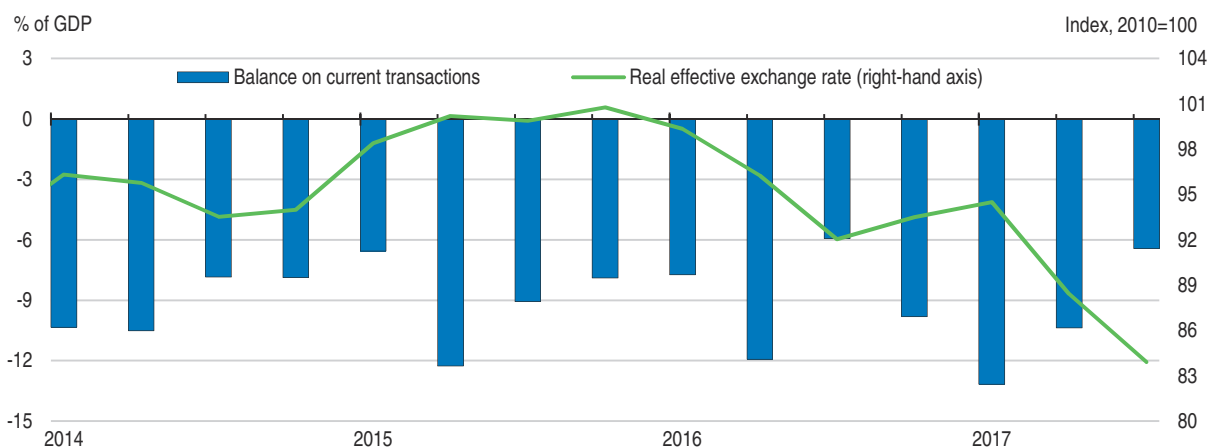
The trade deficit increased from 13.2% of GDP in 2010 to 16% of GDP in 2017, mainly as a result of uncontrolled imports, especially of consumer goods, and a downturn in exportations in some sectors such as extractive industries.

The energy balance has been largely in deficit in recent years as a result of declining volumes in domestic production, the increase in domestic consumption and the decrease in investment activity in the oil and gas exploration and development sectors. Export volumes of phosphates and derivatives have fallen sharply since 2011 as a result of ongoing social unrest at production and transport sites. Nevertheless, manufacturing exports, especially in the electromechanical industries, have performed well over the last two years as a result of stringer demand from European Union countries.

The longstanding surplus on the services balance has fluctuated substantially since 2011 as a result of the decline in tourist activity and transport after the 2015 terror attacks. However, the improvement in security conditions in the past two years has gradually restored the previous situation. Despite the financial crisis and unemployment levels prevailing in the host countries, remittances by Tunisians living abroad are high. In 2016, they amounted to 4.4% of GDP, which represents almost the double of foreign direct investment.

The devaluation of the dinar has not yet led to a reduction in the current deficit (Figure 9). Since October 2017, in a bid to stem the decline in foreign currency holdings, economic actors importing non-essential consumer goods are no longer allowed to use bank loans for these operations.

Tunisia's external debt, over three-quarters of which is medium- and long-term debt, has increased recently, and stood at 70% of GDP at the end of 2016 (IMF, 2017). Given its structure – low average interest rate, relatively long maturities, and relatively large proportion of concessional debt – the external debt should be robust to most shocks, with the exception of major real exchange rate depreciation (IMF, 2017). In November 2017, foreign exchange reserves were barely at the level allowing them to cover three months of imports of goods and services.

Figure 9. **The devaluation of the dinar was not enough to reduce the current deficit**

Note: A decline in the real effective exchange rate signifies an increase in competitiveness.

Source: Central Bank of Tunisia; and INS.

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### Growth will strengthen in 2018 and 2019, but risks persist

Growth should reach 2.8% in 2018 and 3.4% in 2019 (Table 1). Business investment will benefit from the simplification of procedures inherent in the new investment law, while exports will benefit from the recovery in European markets. Inflation rose in the second half of 2017 and tension has continued in 2018 due to the impacts of currency depreciation, rising wages and the increase in VAT. Nevertheless, it should ease relatively as of 2019. Unemployment will fall but certain groups – women, young people and graduates – will still face great difficulties. The current deficit will decline slightly as tourism recovers and exports resume as expected.

Table 1. **Recent developments and projections**

	2014	2015	2016	2017	2018	2019
	Current prices in billions of TND	Percentage change in volume (2010 prices)				
<b>GDP at market prices</b>	80.8	1.1	1.0	2.0	2.8	3.4
Private consumption	55.9	3.2	3.3	3.3	3.2	2.9
Public consumption	15.1	4.4	2.5	0.8	0.2	0.2
Gross fixed capital formation	16.4	-0.5	2.4	3.3	5.4	6.6
Final domestic demand	87.4	2.7	3.0	2.8	3.0	3.1
Exports of goods and services	36.3	-5.3	-0.3	3.2	5.0	5.6
Imports of goods and services	45.2	-2.6	3.1	5.6	5.0	4.6
Net exports <sup>1</sup>	-8.9	-0.9	-1.7	-1.5	-0.5	0.0
<i>Memorandum items</i>						
GDP deflator	-	3.2	5.1	6.0	6.9	5.4
Consumer price index	-	4.9	3.7	5.3	6.4	5.0
Unemployment rate (% of active population)	-	15.2	15.5	15.4	15.2	14.7
Current account balance (% of GDP)	-	-8.9	-8.8	-10.1	-9.5	-9.0

1. Contributions to changes in GDP in volume, effective amount for the first column.

Source: OECD Economic Outlook No. 102 Database, adjusted for the most recent available information.

Recent developments in agriculture and agri-food suggest that the farm sector could contribute more than expected to growth. On the other hand, social unrest could dampen

growth. The lack of security in certain zones still poses a risk for investors and tourists. The continued increase in oil prices could adversely affect inflation, the public finances, and the balance of current payments. The Tunisian economy may also have to face shocks whose potential repercussions are difficult to integrate into forecasts (Table 2).

Table 2. **Events which could affect economic performance**

Shock	Possible impact
Worsening of political instability	Greater political instability would slow the pace of structural reforms, underline investors' confidence and increase pressure on the budget balance and the balance of payments.
Sudden deterioration of security in the region	An increase in insecurity or a deterioration of the situation in Libya would affect the economy, and in particular the tourism sector, which is highly labour intensive.
Increase in protectionism in partner countries and decline in world trade	The export sector would be affected, and job creation along with it. The resulting increase in unemployment would reinforce inequalities and social tensions.

## Policies to restore macroeconomic balances without halting growth

### **Create conditions for the transition to a medium-term explicit inflation targeting system**

Since 2006, the principal objective of monetary policy has been price stability, with an implicit target of 4% which corresponds to the long-term average. The interest rate on the money market is considered the key instrument of monetary policy. The control exercised over prices – administered prices represent around a quarter of the consumer price index – nevertheless limits the transmission of monetary policy. Taking into account the increase in inflationary pressures since 2016, the central bank increased its policy rate in April and in May 2017, bringing it to 5%, and again in March 2018 to 5.75%. The authorities are ready to raise the policy rate yet further if inflationary pressures persist.

In order to anchor inflationary expectations, an explicit inflation target should be adopted by the central bank, mirroring the many OECD countries and emerging economies which have successfully deployed an inflation targeting system: they include South Africa, Canada, Chile, Colombia, India, the Philippines, the United Kingdom, and Sweden. Nevertheless, this targeting can only be introduced when certain preconditions have been achieved, such as a solid banking system, developed financial markets, macroeconomic stability and the opening of the capital account.

Since 2011, the central bank has made efforts to stimulate the interbank foreign exchange market and reduce its intervention as much as possible. To this end, a series of reforms were put in place, such as the removal of the obligation of the collateralisation of actual operations for foreign currency/dinar operations between approved intermediaries, the authorisation for banks to sell foreign banknotes in exchange for currency, and the liberalisation of interest rate hedging between approved intermediaries in order to encourage the approved intermediaries to embrace their role as market makers. Accordingly, the pegging to a basket of currencies was removed in April 2012 and replaced by a fixing arrangement representing the average of market participants' quotes.

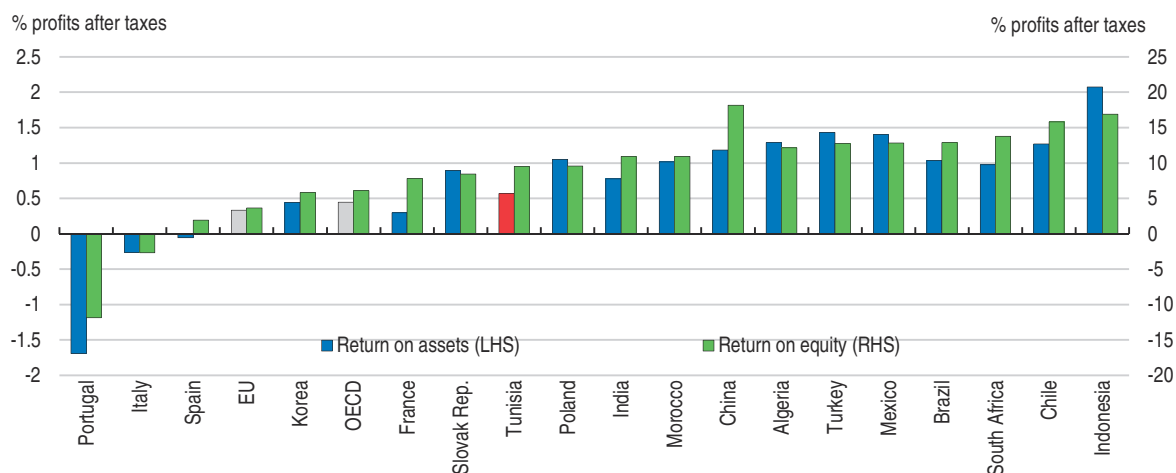
While current account operations are completely free, certain restrictions remain on the capital account. The planned simplification of procedures for transferring the assets of non-residents, boosting the thresholds for investments abroad by residents, and harmonising the operation of regulated accounts of resident individuals will allow further

opening of the capital account (Central Bank, 2017b). Tunisia is aware that, before the capital account is fully opened, it must reinforce its macroeconomic stability, develop its financial institutions, and step up prudential surveillance (IMF, 2015).

### Improving banks' health

The banks perform an essential function: they conduct more than 90% of financial intermediation, while the insurance companies and microcredit institutions still play only a marginal role. The number of universal banks, at 24, is relatively high, given the country's size. They are often of small scale and their profitability is weak (Figure 10). Moreover, businesses struggle to obtain access to bank financing. The lending rate has increased since 2010, but it remains low in comparison to OECD countries (Figure 11).

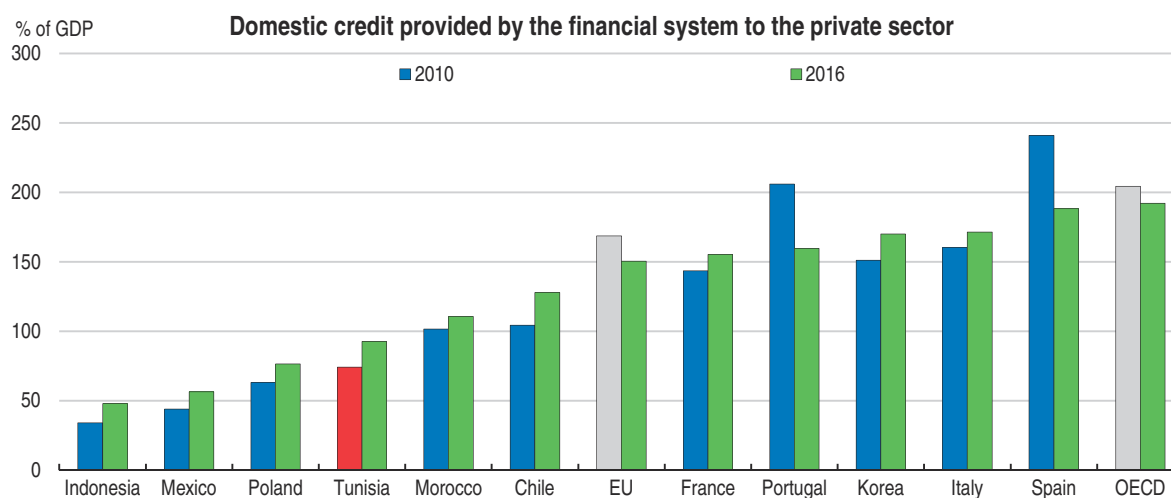
Figure 10. **Bank profits in international comparison, 2015 or latest year available**



Source: World Bank Global Financial Development database.

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Figure 11. **The rate of lending is higher but remains weak**

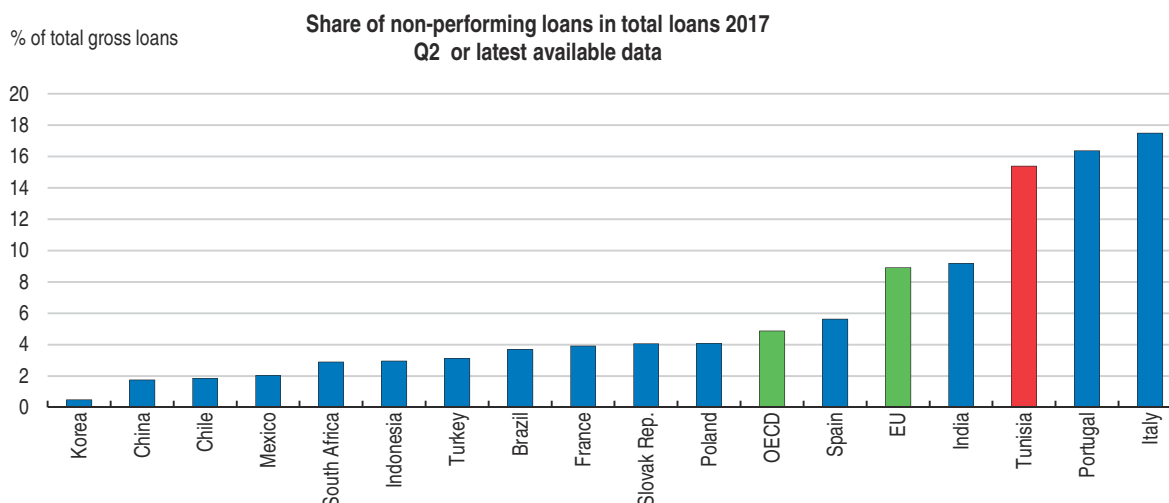


Source: World Bank, World Development Indicators (WDI).


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Between 2010 and 2016, the proportion of non-performing loans (NPLs) in total loans rose from 12% to 15.4%, which is high in comparison to OECD countries (Figure 12), and it actually reached 20% in the public banks. These NPLs are to be found for the most part in the agriculture and tourism sectors. The weaknesses of bankruptcy procedures, which allow inefficient companies to avoid paying their debts but to continue doing business, instead of obliging them to restructure or to leave the market, have aggravated the problem of NPLs. Since 2012, the central bank has several measures to strengthen the banking sector. The regulations governing provisioning have been tightened. The statutory solvency ratio has been increased. In addition, a plan to restructure the public banks has been launched with the recapitalisation of three large public banks and the disposal of minority shareholdings in some mixed banks. A banking law was adopted in 2016: among other things, it introduces a bank resolution mechanism, a “lender of last resort” device, and a deposit guarantee fund. Moreover, the new law on the central bank has reinforced its powers of banking supervision. These measures have helped to reduce the sources of vulnerability in the sector.

Figure 12. **Non-performing loans are significant**



Source: IMF financial soundness indicators database, and Central Bank of Tunisia.

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The existence of a significant portion of non-performing loans tends to constrain resources and impede their efficient allocation. Experience in many countries suggests that there is no one solution for all countries. Resolution tools can include individual restructurings of banks, resolution units within the banks (Poland in 1990), an asset management company (AMC) (Sweden in 1993) specific to one bank or an AMC for the country as a whole, managed by the authorities (Asian countries in the 1990s, Spain in 2012, Ireland) (Baudino and Yun, 2017).

The Tunisian authorities have abandoned their plan to create an AMC. For the time being, they must implement legislative changes to facilitate the winding down of NPLs in the public banks. Currently, in fact, the managers of public banks can be taken to court if they negotiate the restructuring or abandonment of NPLs, and this poses an obstacle to their resolution. The banks thus retain in their portfolio assets of companies that have a low probability of survival, and this slows the reallocation of resources towards more productive enterprises. The bankruptcy law, which was adopted in 2016 but has still not yet been fully

applied, should help to facilitate the winding down of NPLs. An effective resolution process for NPLs should be accompanied by an efficient judicial system, particularly as it relates to bankruptcies.

In order to stabilise the banking sector and support credit supply more effectively, a consolidation of the banking system would seem necessary. Consolidation would enable significant economies of scale by relying on the progress of information technologies and on a more prudent diversification (Hughes and Mester, 2013). A disengagement by the State, which still has a presence in almost a dozen banks with shareholding interests running from 10% to 87%, could favour this tendency. The authorities should also reconsider the ceilings on interest rates, which limit competition and make it difficult to set risk premiums. A draft amendment to the law on excessive interest rates has been submitted to the Assembly of Representatives and is expected to be examined at the start of 2018. Lastly, the structures for financing investment in the country's hinterland need to be improved. Nevertheless, the interest shown in the Bank of the Regions project, which seeks to improve access to financing for micro-enterprises and SMEs in these regions, should be reassessed in light of the banking sector's fragmentation and the institutions already existing in this niche.

### ***Consolidating public finances while preserving growth and reinforcing social justice***

#### ***Fiscal outcomes have deteriorated***

Public deficits and debt are higher than in most emerging countries (Figure 13). The deterioration in public finances reflects both cyclical and specific effects. After 2010, government revenues suffered from the slowing of economic activity, the shutdown of certain mining operations and the strong advance of parallel trade. Public spending has risen in order to address the challenges of insecurity and to respond to social demands. Recruitment into the public service was massive between 2011 and 2013 (Figure 13.E). In fact, Parliament adopted an “exceptional” law in 2012 promoting access to public administration positions for persons wounded during the revolution, as well as those covered by the general amnesty of 2011. There has been a sharp increase in salaries in the public administration (Figure 13.F). In total, the remuneration of public servants has grown by more than four percentage points of GDP since 2010, reaching 14.6% of GDP in 2016 (Table 3), a level that is historically unequalled and is much higher than in most other countries (Figure 13.D). The influx of Libyan refugees also weighed on spending on subsidies on basic products.

#### ***Pressures on future spending: pensions, implicit liabilities and decentralisation***

The pay-as-you-go retirement pension system will generate additional pressure on the public finances, in the absence of reform. The Social Contract adopted by the government and the social partners in 2013 reaffirms Tunisian society's preference for the pay-as-you-go retirement pension system. Social security fund spending on pensions has risen sharply, to almost 6% of GDP in 2016, reflecting in part the ageing of the population. While life expectancy has risen rapidly, moving from 70 to 75.5 years between 1990 and 2016, the legal age of retirement has remained fixed at 60 years. As a consequence, the number of workers making pension contributions – a key indicator of the system's viability – has dropped sharply, particularly in the public sector (Figure 14.A). The proposal to increase the legal retirement age to 62 by 2019 will help to relieve pressure, without necessarily guaranteeing the viability of the system.

Table 3. **Fiscal outcomes:**<sup>1</sup> **principal data**  
(% of GDP<sup>2</sup>)

	2005	2010	2015	2016	LF2017 <sup>4</sup>
A. Total revenues	21.6	23.4	23.4	22.8	24.0
Tax revenues	18.9	20.1	21.9	20.7	22.2
Non-tax revenues <sup>3</sup>	2.7	3.3	1.5	2.1	1.8
B. Total spending	24.5	24.5	28.2	28.9	29.5
Current spending	15.7	15.9	20.4	20.4	20.8
<i>Of which wages and salaries</i>	11.0	10.8	13.7	14.6	14.1
Subsidies/Compensation	1.9	2.4	3.4	2.4	2.8
Food	1.0	0.9	1.8	1.7	1.6
Transport	0.3	0.3	0.5	0.5	0.5
Oil and gas	0.6	1.2	1.1	0.2	0.7
Capital spending	6.0	6.8	5.7	6.0	6.3
Loans	0.3	-0.1	0.3	0.3	0.1
Interest payments	2.5	1.8	1.9	2.2	2.3
C. Deficit = A-B	-2.9	-1.0	-4.8	-6.1	-5.5
<i>Memorandum item:</i>					
Grants	0.2	0.1	0.3	0.1	0.3
Privatisations	0.4	0.0	0.0	0.4	0.0
Proceeds from confiscations			0.1	0.1	0.2

1. Central government. Social security income and expenditure do not feature.

2. GDP 2016 and 2017 figures from the Ministry of Finance.

3. Excluding grants, privatisations and confiscated revenues.

4. Budget Law for 2017.

Source: Ministry of Finance.

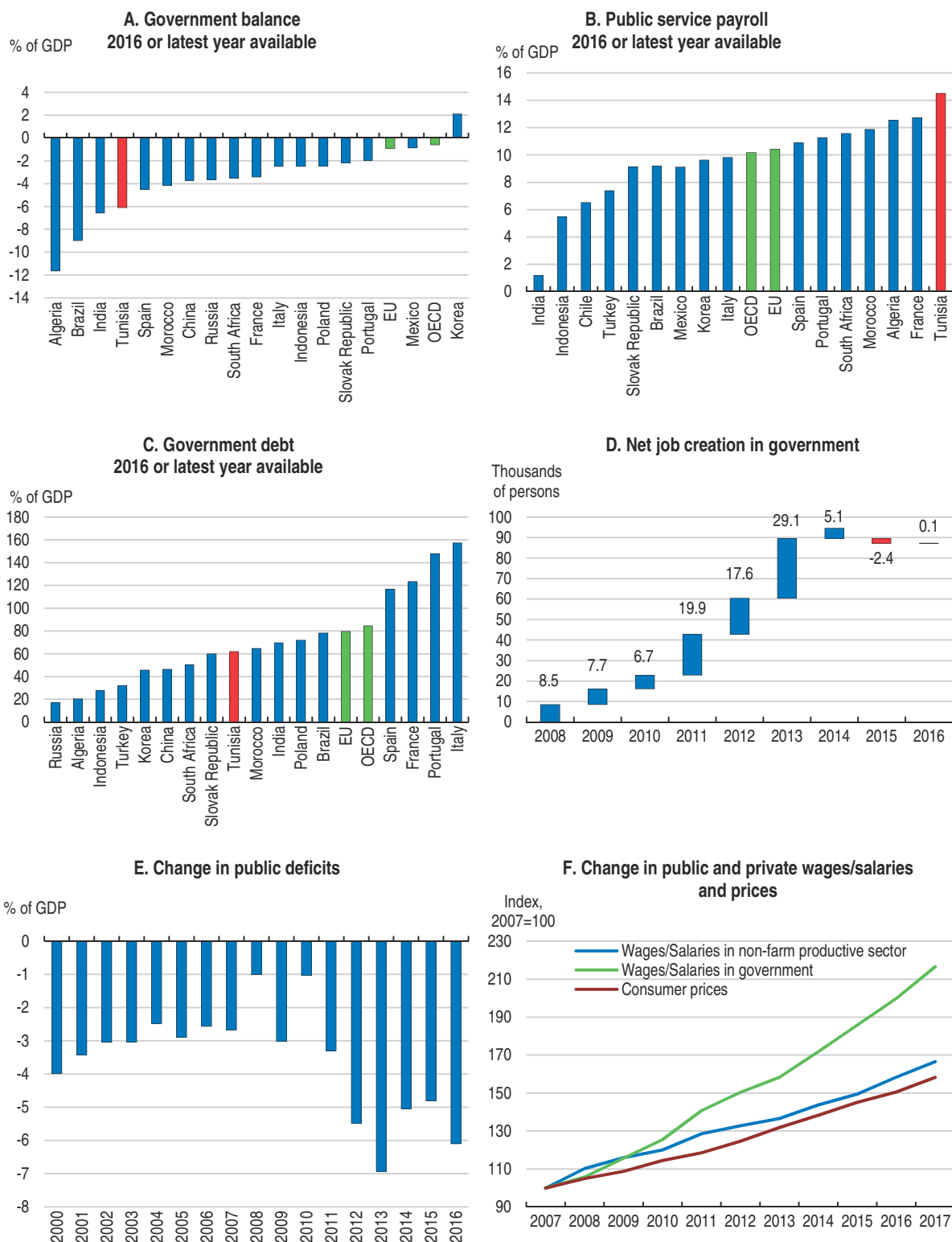
Quite apart from the retirement age, the calculation of pension rights is generous. The replacement rate is high (Figure 14.B), particularly in the public regime where pension rights are moreover calculated on the basis of the last salary. Pensions are indexed to salaries, whereas they are partially indexed to prices in most OECD countries. The Tunisian Social Security Fund (CNSS) also suffers from under-declaration and under-collection. Despite an increase in contribution rates, the deficit in the social security funds stood at around 1% of GDP in 2017.

The implicit liabilities associated with State-owned banks and enterprises could lead to a further jump in public spending. The implicit liabilities associated with public enterprises, notably in the form of debts guaranteed by the State, and the recapitalisation needs of the public banks, stood at 12% of GDP in 2016 (IMF, 2017). To control costs, the government has established performance contracts with the five main public enterprises. Experience to date has been unconvincing, however, as by limiting price adjustments and imposing obligations to create jobs or raise salaries, the government has made it difficult for the public enterprises to return to financial viability. In April 2017, the government adopted a strategy to restructure public enterprises with a view to re-establishing their financial viability. In the future, the adjustment of prices to cost-recovery levels, combined with control over the payroll and improving the management performance of these enterprises, would seem to be unavoidable components of the return to financial viability for public enterprises.

The new Constitution includes a process of decentralisation which may place additional pressure on public finances. While decentralisation should help to bring policy decisions closer to citizens and thereby respond more effectively to people's needs, it is likely to generate additional spending. Experience from Spain and France in fact suggests that the decentralisation process is often accompanied, at least initially, by a hike in public

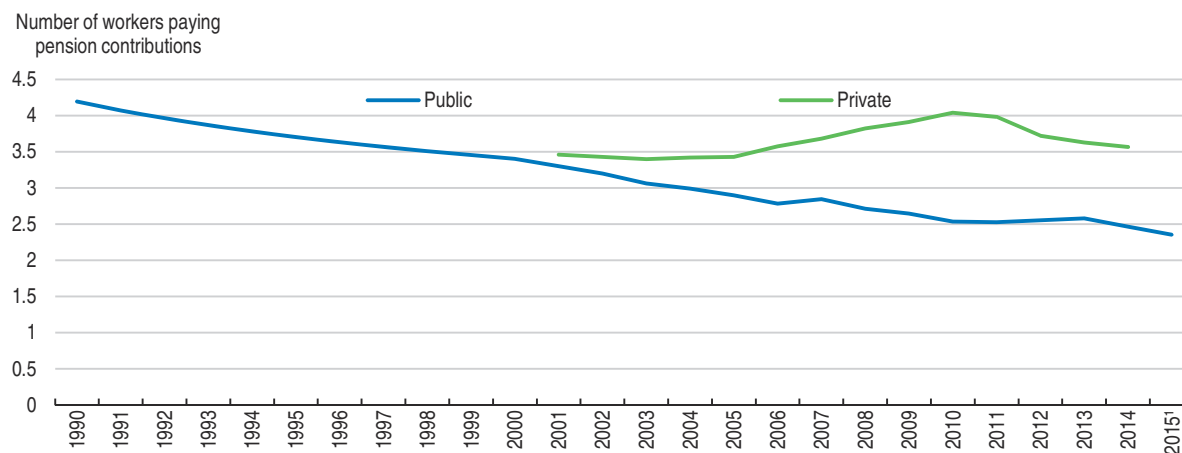
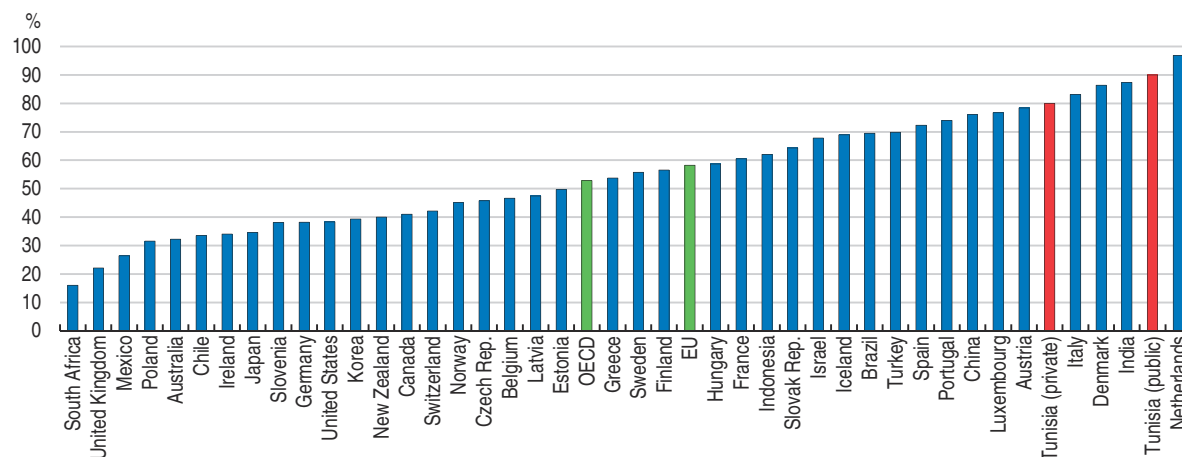


Figure 13. Tunisia needs to return its public finances to a more sustainable path



Source: Ministry of Finance; INS; OECD Economic Outlook 102 Database; IMF World Economic Outlook Database; BCT; and ITCEQ.

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Figure 14. **The pension regime is generous but unsustainable****A. The number of workers contributing to the financing of the pension regime is falling steadily****B. The gross replacement rate is high, 2014**

1. The data for 2015 are projections by the Tunisian government.

Source: Government of Tunisia; OECD Pensions Outlook 2015; and OECD Database on pensions.

StatLink  <http://dx.doi.org/10.1787/888933693111>

spending (Joumard and Giorno, 2005; Jamet, 2007). The reallocation of employees from the central government to the local authorities is often incomplete, and duplications are numerous. In Indonesia, decentralisation came up against the lack of expertise at the local level. The level of quality of local public services is highly uneven, and bribery is a serious issue (Vujanovic, 2017). To minimise these pitfalls, decentralisation will have to be gradual in order to facilitate the reallocation of resources, and to increase the capacity for managing and mobilising decentralised collective resources.

### Restoring public finances to a sustainable path

In the absence of reforms, the persistence of high fiscal deficits and weak economic growth will lead to a further increase in the public debt. The ratio of public debt to GDP rose from 41% in 2010 to 62% in 2016. Nearly 2/3 of this debt is financed by foreign currency loans, most of which are concessional, which reduces debt service but increases external vulnerability. The ratings agencies have downgraded Tunisian sovereign debt, which has

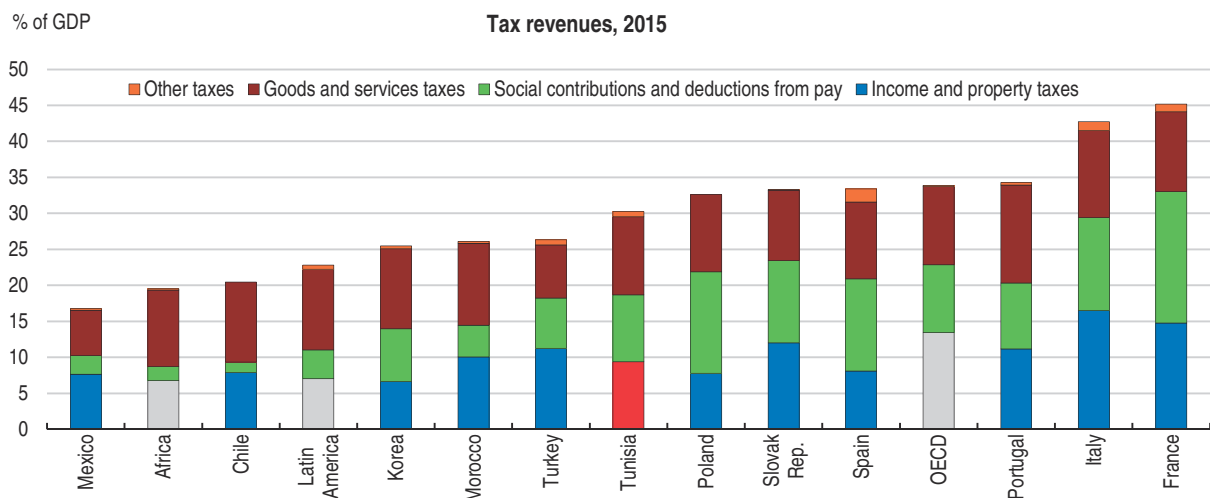
not been “investment grade” at Fitch and Standard & Poor’s since 2012, and since 2013 at Moody’s. Moody’s further downgraded the rating of Tunisian sovereign debt in August 2017. The government has undertaken to put in place reforms in order to, between now and 2020, i) reduce the deficit from 6.1% of GDP in 2016 to 3%; ii) maintain public debt at below 70% of GDP and, iii) reduce the payroll to 12.5% of GDP.

Several options can be envisaged for restoring the sustainability of the debt, based on the effort at fiscal stabilisation and also on structural reforms capable of strengthening growth. OECD simulations suggest that simultaneous pursuit of a gradual fiscal adjustment and a reform of the regulations of the goods and services markets could neutralise the temporary adverse impacts of fiscal adjustment on economic activity, and set the public debt/GDP ratio on a downward track (see Box 3 below).


### *In light of the heavy fiscal burden, Tunisia must promote tax efficiency and fairness*

The compulsory contribution rate has increased since 2010, despite the unfavourable economic setting. At more than 30% of GDP, the sum of taxes and social contributions is higher than in all countries in Africa and most emerging countries (Figure 15). This partially reflects broader coverage by public services and the better quality thereof, in particular for healthcare. A further increase of taxes and social contributions has been established for 2018. Efforts to combat tax fraud and evasion are commendable. They are reducing tax inequalities. At the national level, the government has made efforts to gradually abolish the flat regime for artisans and professionals, to create a tax police as of the autumn of 2017, and has prepared a strategy for combating tax evasion and fraud of social security contributions. Efforts to expand the tax base, in particular for VAT by eliminating various exceptions, are also moves in the right direction. At the international level, in 2012 Tunisia signed the Convention on Mutual Administrative Assistance in Tax Matters and the Memorandum of Understanding with the OECD. It has also been a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes since 2012 (OECD, 2016a). At the start of 2018, Tunisia signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS).

Figure 15. **Tax revenues are relatively high in comparison to other emerging countries**



Source: OECD Revenues Database.

StatLink  <http://dx.doi.org/10.1787/888933693130>

Taxation weighs disproportionately on salaried employment, and discourages the creation of quality jobs. Salary-based social contributions are high, and employees pay the bulk of income tax. The hike in the VAT rate planned for 2018 will minimise the growth impact of higher taxes: OECD studies (Johansson et al., 2008; OECD, 2017c) show in fact that consumption taxes have a less negative impact on growth and on job creation than direct taxes on income and profits. Nevertheless, the budget law for 2018 introduces a “social solidarity” contribution of 1%, to be paid by individuals and businesses filing tax returns, in order to finance the social security fund deficit. The creation of a high council for the financing of social protection is also planned, mainly tasked with ensuring the diversification of financing sources for the social security funds, and with proposing apposite measures for guaranteeing the financial equilibrium of the social security regimes. While the increase in social contributions may be the only short-term solution for reducing the deficit in the social funds, it will be important going forward to avoid introducing new taxes on labour and on businesses, or raising their rates further, for they will depress growth and quality job creation (Chapter 2). New taxes also increase collection costs.

The tax base will have to be broadened to increase public revenues. Increased transparency is needed with regard to the cost and beneficiaries of tax incentives and the publication of the report on tax expenditure which is expected in 2018 will be a first step in this direction. There are certain fiscal incentives (in particular for home ownership) that should be reconsidered, as they divert savings from more productive investment and tend to benefit the wealthiest households (Chapter 1). The savings thus achieved could be redirected in part to improving the supply of housing for the poorest members of society. As well, some of the tax incentives for investment should be assessed and adjusted, or even eliminated if they are found to be inefficient.

The fight against tax fraud and evasion should be stepped up nationwide in order to increase tax fairness. According to a recent study, more than half of registered taxpayers do not file tax returns, and among those who do, under-reporting is blatant (Haddar and Bouzaïene, 2017). Closer cooperation between the taxation and the control directorates should improve the cross-checking of information and boost the recovery rate, which is currently low. Creation of the Large Businesses Directorate is a move in this direction. Systematic and random controls would be useful. As well, a tax information, control and enforcement campaign should be launched among licensed professionals.

### ***Improving the sustainability, equity and quality of public spending***

The government’s objective is to lower the fiscal deficit in order to stabilise the public debt at below 70% of GDP by the year 2020, while boosting investment spending and social outlays. The budget law for 2018 reaffirms these priorities (Box 1). Public servants’ salaries, interest payments and subsidies absorbed two-thirds of government spending in 2016, leaving little room for investment in social and physical infrastructure, its maintenance and efficient operation, and for programs in favour of the poorest population. What is needed, then, is to improve the quality of public spending in order to make it more equitable and supportive of inclusive growth.

To bring the payroll under control, the government has limited net job creation in the public service since 2014, and it has been encouraging early retirement (Figure 12.D). In 2017, the government announced its intention to cut wage and salary costs from 14.5% of GDP in 2017 to 12.5% in 2020, by replacing only one retiring employee in four and deploying

### Box 1. Budget law for 2018

The main measures in the Budget law for 2018 are as follows:

#### Income tax and tax on corporations

- Exemption from Corporation tax and Income tax for recently established enterprises, and for enterprises with a certificate proving that an investment declaration was submitted in 2018 and 2019, for four years as of the effective start of activity.
- Reduction in rate of corporation tax from 25% to 20% for SMEs.
- Increase in the rate of tax on dividends from 5% to 10%.
- Introduction of a “social solidarity” contribution to be paid by individuals and businesses.
- Income tax reduction for families.
- Tightening of the flat-rate tax regime.
- Simplification of the conditions for granting tax relief on capital reinvestment.

#### Indirect taxes

- Increase of 1 percentage point in the different rates of VAT, and extension of the VAT base to sales of properties built exclusively for residential purposes, with the exception of social housing.
- Increase from 20% to 30% in the customs duties for some products, and introduction of customs duties for others.
- Revision of excise duties on some goods.
- Introduction of a holiday tax in hotels.

#### Others

- Payment by the State of employer contributions for the recruitment on open-ended contracts of young graduates from higher education in regional development zones.
- Creation of a special fund for farmers to cover natural disasters.
- Strengthening of measures to combat smuggling and tax fraud, notably with the creation of a general directorate of taxes, public accounting and recovery.

In January 2018, the Assembly of Representatives of the People adopted the draft law on the voluntary retirement of public sector employees. Under the law, officials wishing to leave the civil service are entitled to 36 months of salary as an early retirement premium, provided that they have paid into social security funds for five years. To counter social concerns, the government has also taken a certain number of measures in favour of families in need: A 20% increase in the subsidy for each family in need and approval of a minimum retirement pension of 180 dinars per month; doubling of the subsidy for deprived disabled children; extension of free healthcare to unemployed people; creation of a home loan guarantee fund for citizens with irregular income.

a voluntary departure programme under which each person reaching the age of 60 between 2018 and 2021 will be entitled to an enhanced retirement pension. The effect on total spending may be fairly minimal in the short term, especially since the voluntary retirement programme has attracted fewer volunteers than expected (just 6 400 requests). On the other hand, the partial replacement of persons leaving for retirement could well be effective over the medium term, but care will have to be taken to maintain an adequate level of supervisory and managerial staff.

The reform of subsidies, which represented 3.4% of GDP in 2015, is essential for making public spending fairer and more efficient. Prices of certain goods, in particular foodstuffs and energy products, have been kept artificially low in order to preserve household purchasing power. Producers and distributors of the products concerned receive financial compensation from the State. Although the subsidies may help to attenuate poverty, they are of greatest benefit to the wealthiest households (ITCEQ, 2017; Araar and Verme, 2016). Moreover, they create market distortions and tend to fuel the parallel economy and incite bribery, which often hit poorer households hardest. By way of example, illegal exports of subsidised projects (such as pasta, couscous, sugar and milk), intercepted on their way to Libya by customs and border police, amounted to 1.1 billion dinars in 2015 (World Bank, 2017).

Measures have been taken to reduce subsidy costs. The subsidy on sugar and vegetable oil is no longer granted to the respective industries, as of 2017, and power subsidies to energy-consuming industries such as cement factories have not been paid since 2013. Electricity prices were raised in 2017, and now contain a surcharge applicable beyond a basic consumption threshold. This system of “social pricing” involves cross-subsidies from the wealthiest (large consumers) to the poorest. The automatic adjustment rules for hydrocarbon prices, adopted in 2016 to shield the budget from rising oil prices, have been partially applied. A similar rule was applied more systematically in Morocco, however, while India and Indonesia were removing petrol subsidies. As a result, the recovery of oil prices and the depreciation of the dinar weighed on the cost of subsidies in Tunisia in 2017.

The question of targeting poses a dilemma for any reform that seeks to make subsidies more equitable. The “social pricing” introduced for electricity and water could be replicated in the case of gas. Setting rates in this way protects the most vulnerable households, while others pay a higher price beyond the basic consumption threshold. This would also help to reduce over-consumption and thereby protect natural resources.

Social pricing is however hard to apply for some goods, especially food products. The government has begun work on revising the subsidies for basic food products and the rationalisation of expenditure with a view to maintaining the subsidies for basic food products while controlling the distribution channels and diversifying the products on sales. The database of poor and low-income households, launched by the Ministry of Social Affairs in 2012 to better target the different social assistance programmes, could be used as a mechanism for channelling subsidies to the poorest families. The implementation of the database has however proved to be more complicated than expected.

International experience suggests that errors of inclusion and exclusion are often considerable (Coady et al., 2004). In Colombia, the targeting of social measures, especially in health, has been affected by manifest errors (Joumard and Londoño Vélez, 2013): almost 20% of the poorest households were not registered, and were therefore excluded, while a quarter of beneficiaries were not poor. Similarly, research in Indonesia has revealed that just one third of subsidies for basic food products are in fact benefiting the poorest households that were being targeted by the programme, and over half of poor households are not benefiting from the subsidies to which they are entitled (OECD, 2015a and 2016b).

Replacing the current system with a cash transfer would improve both equity and efficiency. In Tunisia’s case, a study (INS and CRES, 2013) found that a flat-rate cash transfer, equal in amount for all, would be more effective than subsidies in reducing income inequalities. The experience of India, which has taken this approach and combined it with a financial inclusion objective (Box 2), offers a model that Tunisia could usefully

consider by introducing the principle of targeting at the earliest opportunity. The political risks involved in reforming the subsidy system are significant. It is essential to deploy a communication strategy that emphasises the advantages of the reform in terms of social fairness and macroeconomic stability. In the meantime, regular adjustment of product prices is needed to prevent further pressure on the budget.

### Box 2. India's experience in reforming subsidies

**General principle:** The Indian reform of subsidies is based on a unique biometric identification number (Aadhar) and the opening of bank accounts for all households that do not have one. "Market" prices are applied, the subsidy to businesses is eliminated, and households receive the equivalent of the average subsidy, which is paid into their accounts with a bank transfer. The reform is being introduced gradually across the national territory, after tests at the state level.

**The LPG example:** The replacement of the subsidy on bottled gas by a direct bank transfer, of the same size for all, has been extended gradually across India since 2014. This reform has been accompanied by a sharp reduction in subsidy costs because of the drastic drop in fraud. The reform has also encouraged financial inclusion and removed the bias against poor households which, in the past, purchased less gas than did the wealthy ones, and consequently received less in the way of subsidies (Tripathi et al., 2015). To improve targeting, in March 2015 India launched a campaign ("Give it up") to encourage the wealthiest households to forgo their gas subsidy in the name of social equity. In 2017, a million Indian households had renounced the subsidy.

**Other subsidies:** Tests are now under way in some states to replace food and fertiliser subsidies by direct transfers to households, with preliminary results that appear fairly favourable (Gangopadhyay et al., 2015).

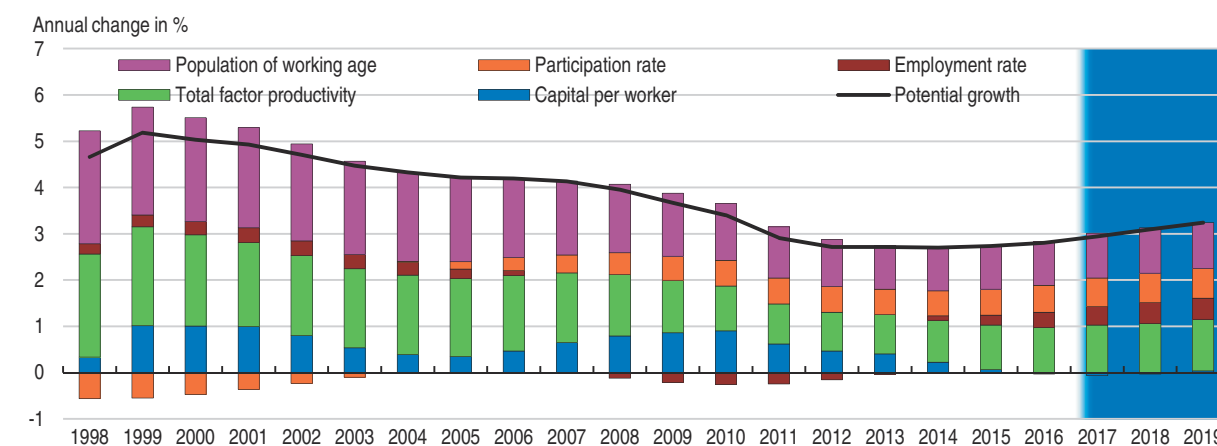
Public spending sustainability and quality improvement can only be achieved in the medium term. A budgetary rule setting a ceiling on spending should be introduced, with medium-term targets covering current spending, on one hand, and investment in social and physical infrastructure, on the other hand, to protect the latter. Tunisia already has medium-term expenditure frameworks (CDMT) for public spending programmes, as well as a medium-term fiscal framework that sets limits on total spending over three years. These ceilings need to be imposed systematically when it comes to budget preparation (OECD, 2017a). To improve the effectiveness of public investment, the government must avoid dispersing its resources between too many different ministries, and should set out consistent selection criteria that comply with the 2016-20 National Development Plan. It will also be important to avoid overspending in budget execution, as has been occurring for several years.

The introduction of a spending target should be based on the setting of priorities. To this end, several countries have put in place systematic spending reviews that make it possible to give priority to programmes with the highest economic and social impact. The role and resources of the Auditor General (*Cour des Comptes*) and the General Authority for Monitoring Public Programmes could be extended here. The adoption and application of the new organic budget law, which institutes budget management by objective, should also help to improve the efficiency of public spending (OECD, 2017b).


## Returning Tunisia to a path of inclusive and robust growth

To revive the convergence process, Tunisia needs to promote private investment and make better use of its comparative advantages, in particular its relatively well-qualified workforce. More investment will generate the creation of formal employment which in turn will improve the standard of living of many Tunisians. The potential for growth, which was rapid until the beginning of this century, has declined under the impact of falling investment and productivity (Figure 16). The low rate of female participation offers significant potential for growth, but unemployment and underemployment remain serious issues. The revival of investment and the creation of quality jobs are priorities. In light of the fiscal constraints, this will require a redeployment of the private sector.

Figure 16. **Contributions to economic growth**  
Breakdown of potential growth



Source: OECD Economic Outlook 102 Database.

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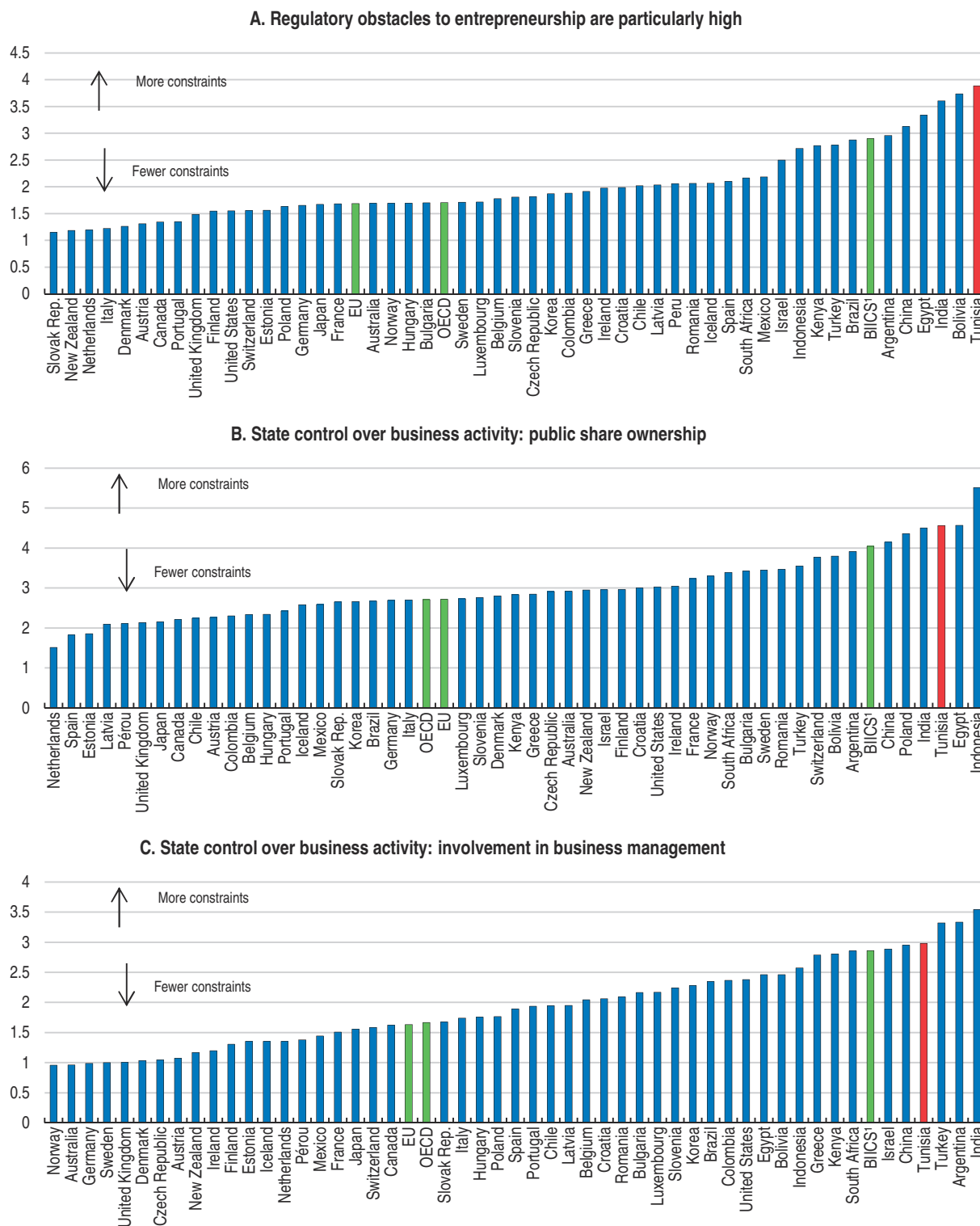
### Promoting business investment by improving the regulatory and institutional framework

The investment rate has been dropping since the early years of this century. This decline reflects essentially a stalling of business investment, whereas investment by households and governments has stood up fairly well (Chapter 1). The decline accelerated after 2010, reflecting uncertainties surrounding the development of new institutions, and insecurity linked to terrorist acts. Nevertheless, business investment suffers from several structural factors, in particular the proliferation of regulations and authorisations and the inefficiency of logistical services. On both of these fronts, Tunisia's position in world rankings has deteriorated noticeably.

The OECD indicator of product market regulation (PMR), produced in collaboration with the World Bank, shows that licenses and pre-authorisations, as well as the cumbersome administrative procedures that accompany them, are particularly restrictive (Figure 17.A). Restrictions on business entry, investment and activity create situations of rent for local businesses and discourage companies from improving the quality of the services they supply. They also promote corruption, which ranks among the top three factors that are most detrimental to the country's business climate (WEF, 2017a). Corruption increases businesses' costs, undermines the confidence of the public and investors, and affects the



Figure 17. **Product market regulations are particularly restrictive**



1. Data show the simple averages for the following countries: Brazil, India, Indonesia, China and South Africa.

Note: Data refer to 2016 for Tunisia and 2013 for other countries.

Source: OECD-World Bank Product Market Regulation Database.

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poorest sectors of the population by diverting resources away from more productive applications, such as essential public services. Lastly, regulatory and administrative constraints impede the creation of jobs and wealth, they burden people's well-being, and they exacerbate inequalities.

The fight against corruption and good governance are key government objectives and enshrined in the Carthage Pact. Several measures have been taken. The national anti-corruption authority, which is provisional, and the legal and financial have been allocated human and financial resources for their operations. In 2017, 94 corruption cases were referred to the courts. A new law protecting whistle-blowers was adopted. Training and awareness raising programmes for civil servants were organised. A draft law against unlawful enrichment was submitted to the Assembly of the Representatives of the People. There is now an urgent need to put in place the independent constitutional body responsible for good governance and fighting corruption, and to reform the audit and inspection system in the public sector (OECD 2014). Together with its anti-corruption initiatives, Tunisia joined the Open Government Partnership (OGP), a platform designed to encourage citizen's participation, transparency, integrity and accountability. These principles need to be further strengthened (OECD, 2015d).

State-owned enterprises dominate many sectors, and direct State intervention in the economy is heavier than in OECD countries and in most emerging economies. In addition to the network sectors, such as electricity, telecommunications and rail transport, enterprises controlled by the State have long operated in banking, phosphates and fertilisers, mining and refining, construction materials, ironworks and steel, and paper. The recent confiscation of private enterprises and assets, linked to fraud and embezzlement under the former regime, has reinforced the State's dominant position in certain sectors, especially telecoms.

The operating deficits of public enterprises have widened, impeding their capacity to maintain existing equipment and to invest in new projects. Called upon by the government to take on their subcontractors' employees and to hire those wounded in the revolution, many public enterprises have seen their staffing levels rise by over 50% since 2010.

According to the new *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, (OECD, 2015b), improving effectiveness and transparency in the sector of public enterprises would offer substantial advantages, especially in countries in which state ownership is extensive. Governance issues arise when state-owned enterprises have the dual objective of practising economic activities and carrying out a political mission. In these cases, the enterprises can face undue political interference, leading to the dilution of responsibilities, a lack of transparency and the loss of efficiency in the operation of the enterprise. Furthermore, the lack of surveillance may increase the probability that employees work for their own interests. On the other hand, subjecting state-owned and private enterprises to equitable rules will encourage the development of a strong, competitive economy.

It is also important to strengthen the integrity and independence of regulatory agencies in the network sector and to facilitate access to new operators. The new *OECD Practical Guidance against Undue Influence and Creating a Culture of Independence for regulators* (OECD 2017g) proposes measures for establishing and maintaining the regulators' capacity to make objective, impartial, coherent and expert decisions.

In Tunisia, in addition to introducing performance contracts for state-owned enterprises, the government might also entrust some activities to the private sector, should

it prove to be more effective, especially in network maintenance (electricity, water, etc.), the production of electricity, water desalinisation, and the construction and operation of wastewater treatment plants.

In some sectors, the State also intervenes by fixing prices or restricting the number of firms that can operate. This State intervention is more frequent in Tunisia than in most countries covered by the OECD indicator in product market regulation (Figure 17.C). Shielded from competition, these firms have little incentive to produce services of better quality.

The introduction of structural reforms will revive investment, boost job creation, and sustain incomes for all Tunisians. The new investment law applied in April 2017 supports the principle of freedom of investment by reducing the field of activities subject to authorisation. A decree establishing the list of activities subject to authorisation, the list of administrative authorisations required for carrying out projects, and the timeframes, procedures and conditions for the granting thereof was due to be issued at that start of 2018. The list will be reviewed before 2020 as part of the execution of the programme for simplifying procedures for granting authorisations, abolishing them and replacing them with specifications. It will also make procedures more predictable. The new competition law of 2015 expands the role of the Competition Board (*Conseil de la concurrence*), reduces investigation times in cases of concentration, and tightens the penalties. In the long run, this should improve Tunisia's position in international business climate rankings.

It would be desirable to go further, by simplifying authorisations, licenses and permits more drastically, and improving information on the rules and procedures to follow in creating and managing an enterprise. It is important to establish cross-cutting policies designed to improve the quality of regulations, including systematic and thorough reviews of existing rules. The aims of these cross-cutting policies are to reduce unnecessary regulatory burdens on enterprises; to put in place a new evidence-based approach to regulation using stakeholder involvement; and to improve transparency and access to regulations. The legal obstacles to the entry of competitors in certain sectors should be reconsidered. At the same time, there is a need to reduce the competitive distortions induced by government intervention, including its price controls.

OECD simulations for Tunisia indicate that lowering the barriers to entry and improving conditions of competition would increase national income by around 1¾% in five years, and by close to 5% over 20 years, with a positive impact on investment, productivity and employment (Table 4). Combined with a gradual budgetary adjustment, regulatory reforms would spur growth and put public debt back on a sustainable trajectory (Box 3).

### Box 3. Regulatory reform: impact on growth and debt sustainability

#### Regulatory reform to spur growth...

Some product market regulations are significantly stricter in Tunisia than elsewhere. Their reform would stimulate competition and entrepreneurship and hence also support growth. The room for improvement is especially great in the following areas:

- Authorisations, licenses and permits:
  - ❖ Provide a “one stop shop” for obtaining information on licenses and permits, and introduce a “silence is consent” rule.
  - ❖ Establish a programme to reduce the number of licenses and permits required by the government.

### Box 3. Regulatory reform: impact on growth and debt sustainability (cont.)

- Administrative burden posed by regulation:
  - ❖ Publish proposed changes to rules and procedures in a systematic manner.
  - ❖ Introduce a programme with explicit objectives for reducing the administrative burden on enterprises.
- Opening the capital of public enterprises to the private sector:
  - ❖ Partial opening, without ceding powers of control, in the electricity and gas sectors.
  - ❖ More complete opening, or full retreat from public ownership, in the telecoms and manufacturing sectors where the State is still present, as well as in the commerce sector (where the State owns the wholesale markets).
- Governance of public enterprises:
  - ❖ Limit the access of public enterprises to forms of financing not available to private businesses.
  - ❖ Make the Ministry of Finance, or an independent agency, responsible for managing State shareholdings in public enterprises.
- Price control:
  - ❖ Re-examine, and if necessary abolish, price controls on gasoline, tobacco, cellular communications and other products, as well as controls on the fees charged in air transport and the regulated professions.

These reforms would lead to a fall of 20% in the OECD's price regulation indicator for Tunisia. After the reform, the indicator would remain slightly higher than the average for emerging countries, and would be significantly higher than the average for countries in the OECD.

Table 4. **Economic gains from reducing obstacles to competition**

Estimated impacts on GDP and the main components of supply (compared to a no-reform scenario)<sup>1</sup>

Horizon	GDP	Total employment	Investment	TFP <sup>2</sup>
<b>Increase in level of each variable as a percentage of the initial level</b>				
<b>5 years</b>	1.7	0.4	2.7	1.2
<b>10 years</b>	2.4	0.5	3.8	1.7
<b>20 years</b>	4.8	0.6	9.0	3.4
<b>Average increase in growth rate in percentage points</b>				
<b>20 years</b>	0.25	0.03	0.43	0.15

1. The impacts on GDP, employment, investment and TFP are based on the experience of OECD countries. Recent studies even suggest that the impact of structural reforms on growth is higher in emerging countries (OECD, 2017f). This would suggest that the impacts in the table are underestimated for Tunisia.

2. Total factor productivity.

Source: OECD Secretariat estimates.

#### ... and put public debt back on a sustainable trajectory

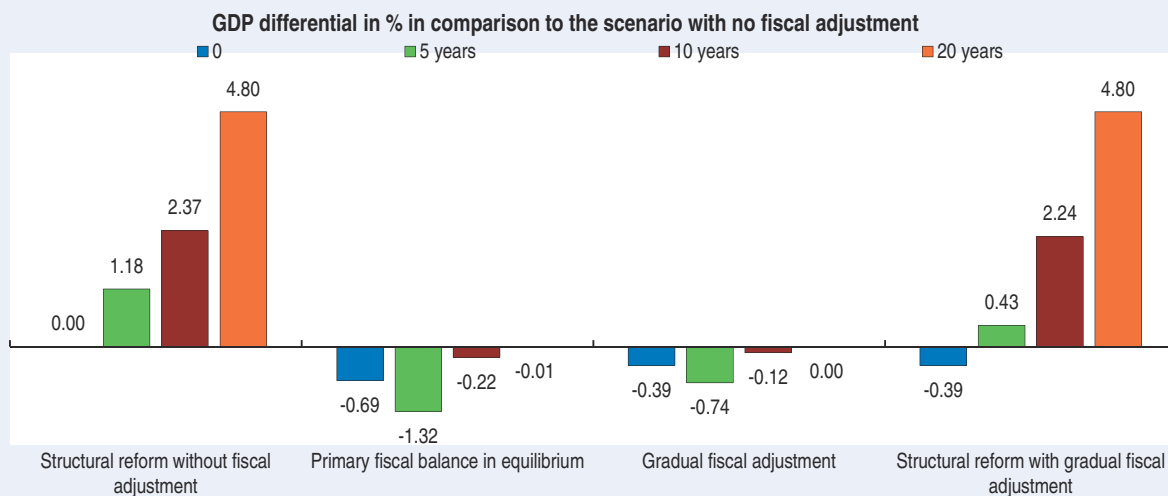
By supporting growth, these structural reforms would allow the country to restore its public debt to a sustainable trajectory. Debt sustainability depends on the rate of economic growth, inflation, the debt's interest rates and the budget deficit.

The OECD Secretariat has simulated the impact of improved competition conditions and the budgetary adjustment on growth and the public debt (Figures 18 and 19). Five scenarios were selected:

1. **Benchmark scenario – no budgetary adjustment and no structural reform.** Economic growth moves towards its potential rate (estimated by the OECD to be 2.8% in the absence of major structural reforms), inflation (measured by the GDP deflator) stabilises at around 4.2% (i.e. slightly above the implicit inflation target), and the nominal effective interest rate on public debt moves towards the effective rate of 4.9% seen during the period from 1990 to 2016. In this scenario, the public debt comes to over 100% of GDP in 2040.

### Box 3. Regulatory reform: impact on growth and debt sustainability (cont.)

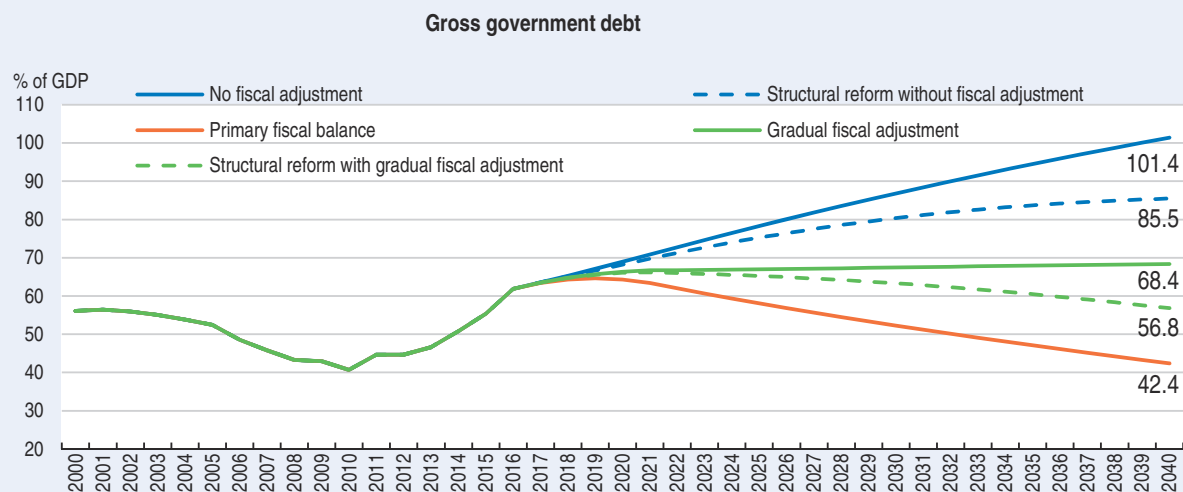
Figure 18. Impact of the different reform scenarios on growth



Source: OECD estimates.

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Figure 19. Changes in the ratio of public debt to GDP: past and future scenario



Note: The accounting treatment of certain government deposits was modified to bring it into conformity with international practices, and this raised the gross debt in 2016.

Source: OECD estimates.

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- Scenario with reform of the goods and services market but no budgetary adjustment.** Product market regulations are relaxed. Structural reforms increase the economic growth rate by almost 0.25 percentage points to close to 3.1%. In this scenario, Tunisia's income (GDP) is around 5% higher than in the scenario with no reform, and as a proportion of GDP, the public debt would amount to 85% in 2040.
- Scenario with drastic budgetary adjustment (return to zero for the primary balance in five years) and no structural reform of the goods and services market.** The ratio of public debt to GDP falls tangibly, approaching its pre-2011 level, but the economic and social costs of the budgetary adjustment are significant. After five years, the level of income is considerably lower (by 1.3%) than in the scenario with no reform.

**Box 3. Regulatory reform: impact on growth and debt sustainability (cont.)**

4. **Scenario with structural budgetary adjustment of around 2% of GDP (the primary deficit being reduced gradually to 1.5% of GDP over a five-year period) with no reform of the goods and services market.** The public debt stabilises at around 68% of GDP, but the level of income is lower (by 0.7%) than in the scenario with no reform.
5. **Structural budgetary adjustment of around 2% of GDP (towards a primary deficit of 1.5% of GDP) combined with reform of the goods and services market.** The debt falls to 57% of GDP in 2040. Tunisia's income is 5% higher than in the scenario with no reform. The negative impact of the adjustment – through budget multipliers – is rapidly neutralised.

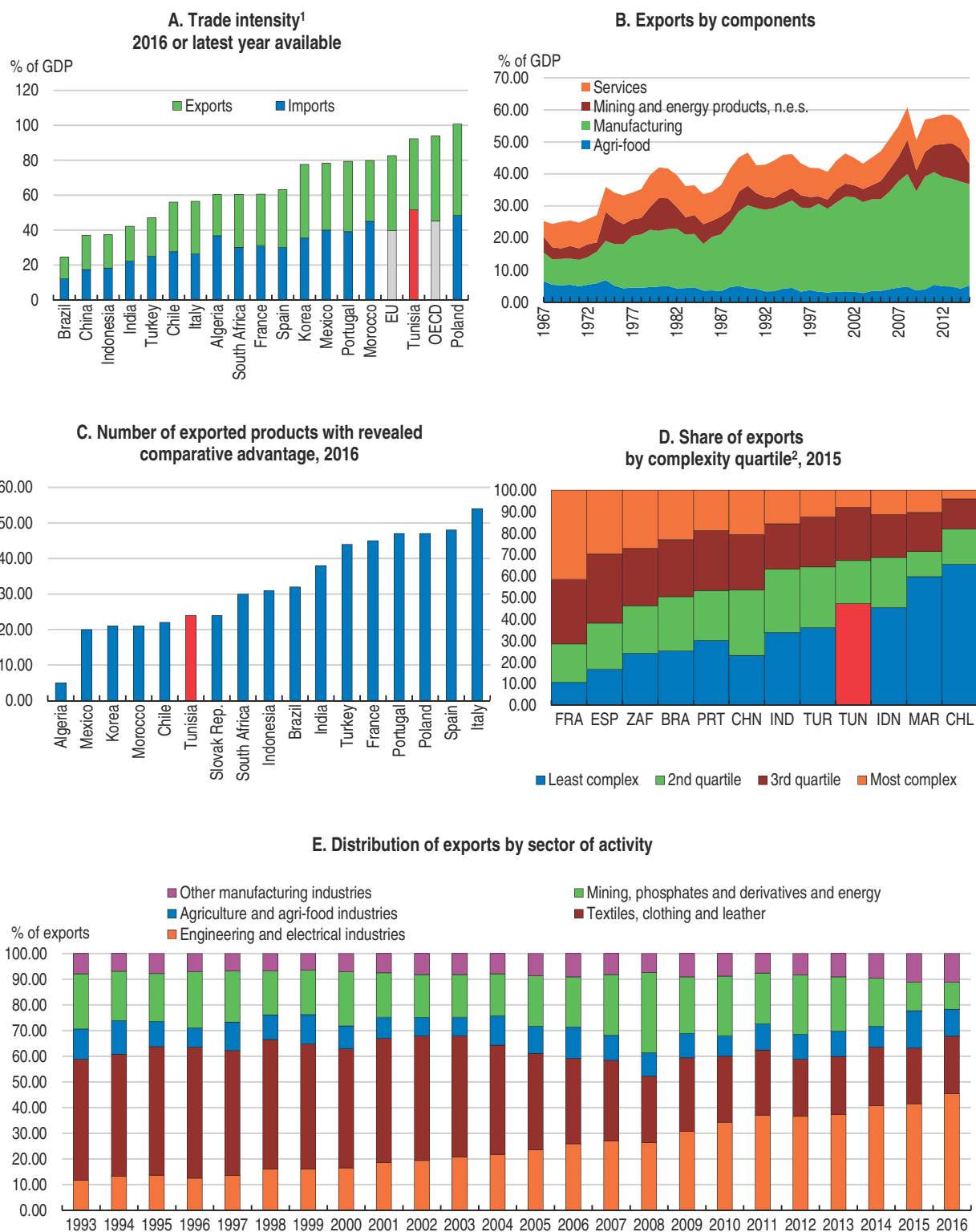
**Trade openness has promoted growth and employment in offshore companies**

Recent OECD studies suggest that trade can improve the population's well-being (OECD, 2017d). On one hand, it enhances the purchasing power of consumers by giving them access to a broader range of goods and services, often at lower cost. The poorest households are often those that benefit the most, as they devote a larger portion of their income to products of mass consumption (Fajgelbaum and Kandhelwal, 2016). On the other hand, trade generates productivity gains by giving firms access to a broader range of inputs, encouraging the dissemination of foreign knowledge, and helping to expand markets. In the OECD zone, an increase of one percentage point in trade openness translates into 0.2% growth in multifactor productivity after five years and 0.6% over the longer term (Egert and Gal, 2017).

In Tunisia, the strategy of integrating the country into global value chains has relied on the progressive liberalisation of trade, the signature of free-trade agreements, and the creation of an attractive regime for companies engaged entirely in exports – the so-called “offshore regime”. Tunisia joined the World Trade Organisation in 1995. In 1996 it signed an association agreement with the European Union aimed at the gradual dismantling of tariff and non-tariff barriers, and it obtained the status of privileged partner. Negotiations on a “deep and comprehensive free-trade agreement” are now under way. Tunisia signed a free-trade agreement in 2004 with Turkey, and it was fully in effect as of 2014. The tariff regime has also been simplified, reducing the number of tariff bands from 54 in 2003 to 3 in 2017.

Tunisia's participation in global value chains has progressed significantly since the mid-1990s. Trade intensity, measured by the share of exports and imports in GDP, approached the OECD average in 2016, and was higher than that for many emerging countries (Figure 20.A). The share of manufactured goods in total exports rose to 76% (Figure 20.B), well above the level observed in Egypt, Morocco and the majority of other countries in the region. Moreover, the product structure of exports has become more diversified (Institut de la Méditerranée, 2014). Among countries of the Maghreb, Tunisia has the greatest number of exported products with revealed comparative advantage (Figure 20.C). Tunisian exports have also moved up the complexity scale (Figure 20.D). Thus, in 2016 Tunisia ranked 52nd worldwide on the scale of complexity, which reflects the sophistication, diversity and specificity of exports according to the Atlas of Economic Complexity, thus, outstripping all the countries of Africa but South Africa. Exports of products from the pharmaceutical, plastics and engineering and electrical industries have performed particularly well, reflecting long-standing investments in the education sector, especially in science and engineering.

Figure 20. Tunisia's positioning in global value chains has progressed



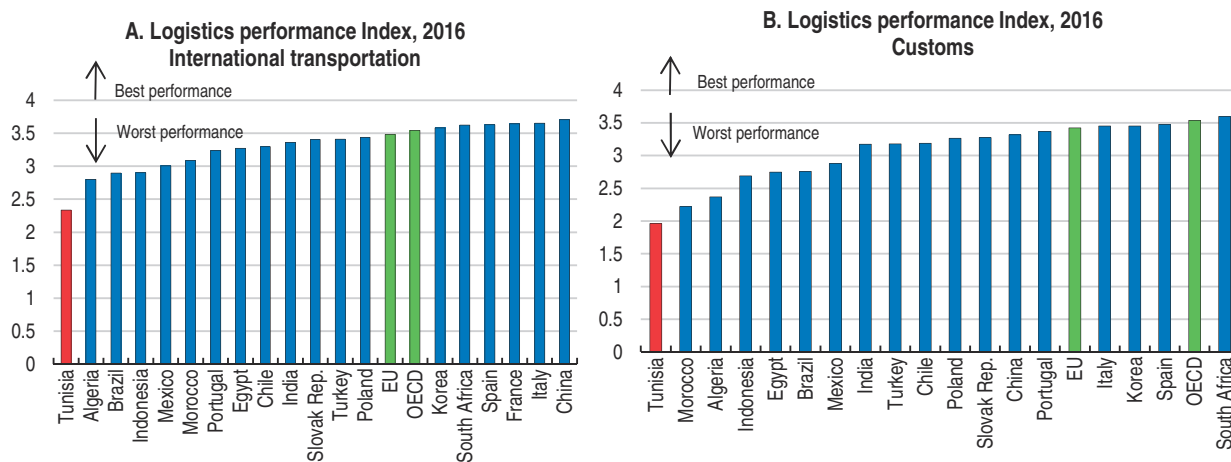
1. Trade intensity is measured by the total of imports and exports as a % of GDP.

2. The degree of complexity is defined in Hausmann et al. (2007), "What you export matters", *Journal of Economic Growth*, Springer, Vol. 12(1).  
Source: National Statistics Institute; World Bank, World Development Indicators (WDI); UN Comtrade database; OECD Trade in Value Added (TiVA) Database; and OECD calculations.

Tunisia is not exploiting all the potential advantages of trade openness. Companies in the offshore sector – which are exempt from customs duties on imports and exports, pay a reduced tax rate, and enjoy simplified administrative procedures – have been very active. In 2016 they accounted for 78% of merchandise exports excluding energy, and that share has been rising sharply. Their share in formal salaried employment of the private sector has doubled since 1996 to 34%. Due to its status, the offshore sector has little interrelationship with the rest of the economy. Firms can import their inputs without customs duties, provided their total production is re-exported. In 2017, they acquired the right to conduct up to 30% of their sales within the national territory. Nevertheless, cumbersome administrative and customs procedures limit the spill-over effect of exports onto enterprises of the onshore sector. In fact, low-technology products such as agricultural, energy, mining and phosphate products account for more than 60% of the exports of onshore firms.

To improve its integration into global value chains and create more and better jobs, Tunisia must reduce trade barriers further and remove regulatory, customs and logistical obstacles. The efficiency of logistics services in port facilities is low, and this impacts the quality and the availability of maintenance and transport services for goods (Figure 21). Tunisia has been outpaced by its direct competitors with respect to key indicators such as waiting times at the border or the efficiency of customs services. OECD data on trade facilitation suggest as well that border procedures applied to onshore firms have deteriorated (Figure 22). Moreover, Firms that do not operate in the offshore regime suffer from multiple customs duties, often accompanied by verifications of the type of goods being imported and a great deal of red tape. This generates costs and hurts the export competitiveness of onshore firms.

Figure 21. **Logistical performance has deteriorated**

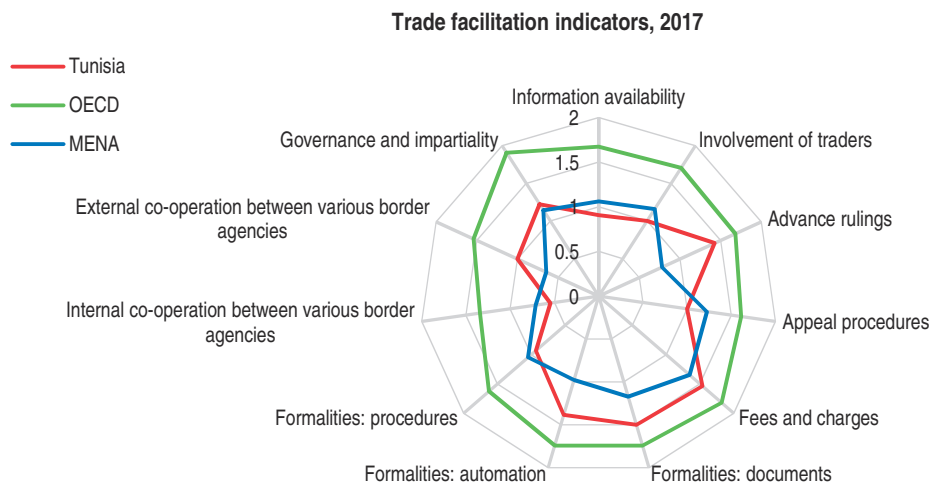


Note: The global score on the logistics performance index reflects perceptions of a country's logistics based on the efficiency of customs and border clearance, the quality of trade infrastructure and related transport infrastructure, the ease of arranging shipment at competitive prices, the quality of infrastructure services, the ability to track and trace consignments, and the frequency with which shipments reach their destination on time. The index runs from 1 to 5, with a higher score representing a better performance. For groups of countries, see the World Bank website.

Source: World Bank Logistics Performance Index database.


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Figure 22. **Trade could be facilitated**

Note: The OECD Trade facilitation indicators measure the relative economic and trade impact of trade facilitation measures currently under negotiation in the World Trade Organization (WTO) on trade flows and trade costs. The indicators vary between 0 and 2, the higher is the value of the indicator the better is the performance.

Source: OECD Trade facilitation indicators Database.

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### **Encouraging all citizens to participate in economic life in order to reduce inequalities**

#### **Unemployment is high and informal employment is widespread**

The unemployment rate is high, especially among young graduates. In 2016, the unemployment rate stood at 15.6% of the economically active population, and was higher than the OECD average or that of MENA countries. At around 35%, the unemployment rate for youth (15 to 24 years) is above that for the majority of OECD countries and emerging countries. Graduates of higher education face a worse unemployment rate than do persons with primary or secondary schooling. There is a significant mismatch between the skills acquired by young Tunisians and employers' needs, which represents an obstacle to their employability. Employers need to be more involved in the design of programmes.

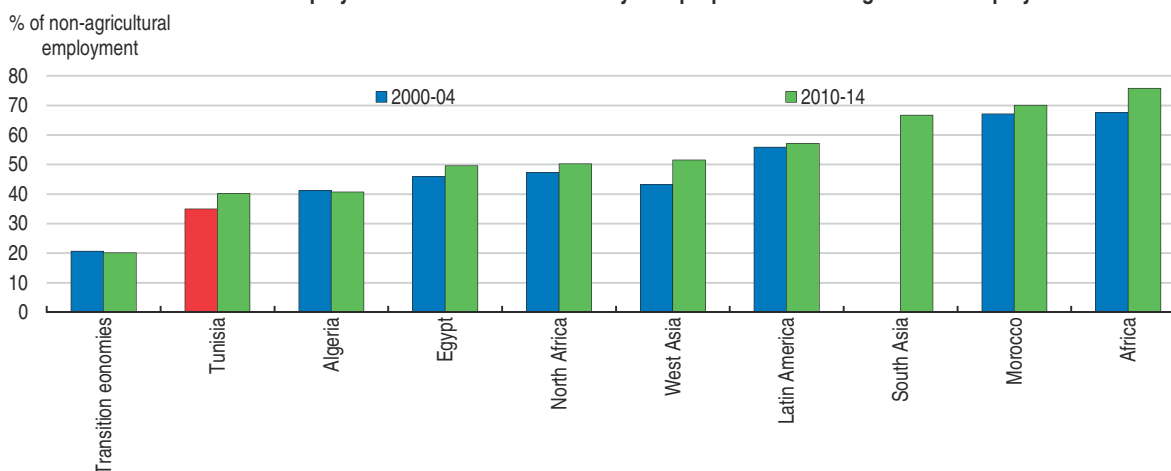
While microbusinesses and self-employment play a big role in job creation, just 2% of young people aged between 18 and 24 were involved in setting up a company in 2012 (Belkacem and Mansouri, 2013). Compared to their peers in OECD countries, young Tunisians are less likely to state that they have access to training and financing. Even though Tunisia has a relatively well developed system for supporting business creation, providing information, training, financing and monitoring services during the first two years of activity, efficiency gains remain possible. Furthermore, there is a need for better medium- and long-term assistance to young entrepreneurs, especially women, who face many obstacles when setting up a business (OECD, 2015c).

The public sector recruitment policy, which gave priority to the long-term unemployed, seems to have aggravated the problem of unemployment among graduates. This clearly represented an incentive to turn to the employment agency and await a job in the public sector, which offered a higher salary, job security, and more generous social benefits (OECD, 2015).


Many Tunisians must put up with precarious working conditions. Informal employment is widespread and, depending on sources and definition, may represent between 30% and

45% of total employment (World Bank, 2014; CRES, 2016). Although this rate is lower than the average for the countries of Latin America and Asia, it is nonetheless higher than for countries of the OECD or countries in transition (Figure 23). A high rate of informality usually generates inequalities, as people working in this sector have lower earnings, insecure working conditions, and little access to the financial system. In Tunisia, young people are more likely to be informally employed (CRES, 2016). Workers are for the most part hired on fixed-term contracts (FTC), given the small size of companies (over 90% of enterprises have fewer than 10% employees), and the rigidity of regulations on terminating open-ended or permanent contracts.

Figure 23. **Informal employment is widespread**  
Employment in the informal economy as a proportion of non-agricultural employment

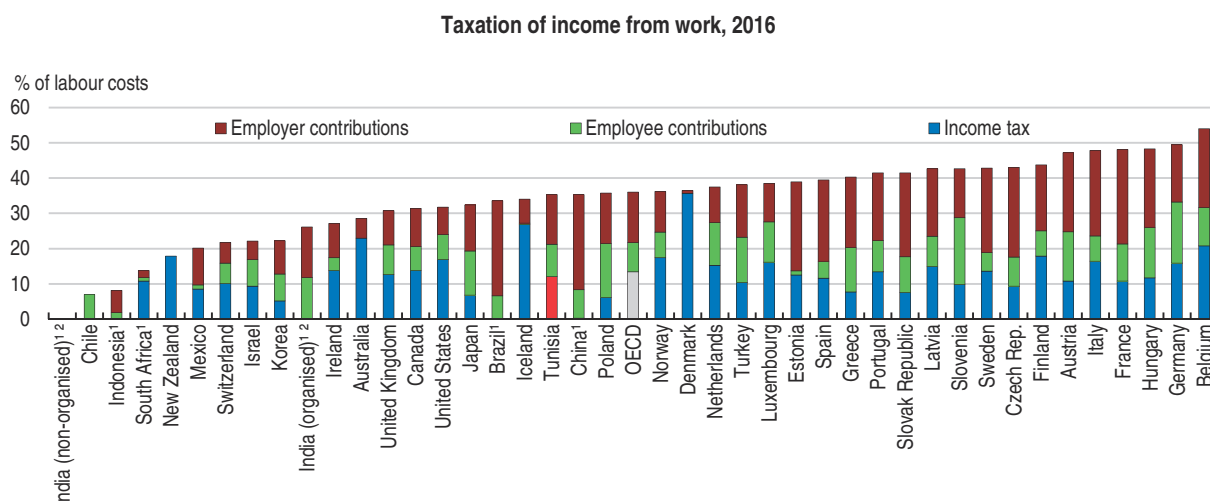


Source: World Bank Enterprise Survey.

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Social security contributions are relatively high (Figure 24) even if the related advantages are also relatively generous for a small number of social security regimes. This encourages a shift to the informal sector, as employers may be reluctant to declare workers, and independent workers may prefer to operate in the informal sector. International experience suggests that lower taxation of labour can boost job creation in the formal sector. For example, in 2012, Colombia implemented a tax reform that eliminated or reduced certain contributions on wages and salaries, and this led to an increase in formal employment.

There are some labour market regulations and practices that, even though they tend to discourage stable job creation in the formal sector, seem more difficult to reform at the present time without sparking protests that could block the reform process. Thus, for example, the wage negotiation process is a lengthy one. Wage increases apply to all sectors, sometimes retroactively, whatever the economic situation of the sector or the size of the firm. This can induce employers to automate production processes in order to reduce their need for workers. Moreover, while regulations governing redundancy for persons on permanent contracts are stricter than in many emerging countries and trading partners, workers on temporary contracts have little protection. This results in a dual labour market, with protected groups on one side and vulnerable groups on the other, and there are few possibilities for moving between these groups.


Figure 24. **Social contributions depress formal employment**

1. Data refer to 2010 for Brazil, China, India and South Africa, and to 2009 for Indonesia.

2. The non-organised sector in India corresponds to companies with fewer than 20 employees. Companies with more than 20 employees have to comply with the law on pension funds for employees and other provisions, and to this end pay social security contributions.

Note: The scenario considers a single person with no children earning 100% of the average wage.

Source: OECD revenue statistics and Ministry of Finance.

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### **Gender differences: a mixed record**

Tunisia is a leader among countries of the MENA region in efforts to achieve gender equality (World Economic Forum, 2017). The Personal Status Code confirms the principle of equality between men and women in socioeconomic, cultural and political life. Since that time, successive reforms have advanced the rights and the status of women. In August 2017, the President of the Republic opened a debate on a proposal to introduce gender equality with respect to inheritance.

These policies have borne fruit, but significant disparities between men and women persist on the labour market. The female employment rate is one of the highest in the MENA region, but it still falls well short of that for the OECD (23% versus 63%). The proportion of women holding management positions in the public and private sectors is the highest among MENA countries, at 14.8% (OECD, 2017e). Whereas the female enrolment rate at all levels of education is today 10 points higher than that for men (71% versus 61%, Daghari, 2017), the unemployment rate is higher for women than for men (22% versus 12% in 2015). The gap between the male and female employment rate is generated by discriminatory attitudes on the part of employers which are based on socio-cultural values. In the provinces, the high rate of unemployment among women may also be caused by their lower mobility, which prevents them moving house to take up a job, and by the distance to the nearest job centre. A further factor is that women often take qualifications that are less in demand on the labour market. Overall, women work in lower-skilled jobs than men with the same level of qualification (Stampini and Verdier-Chouchane, 2011). Female entrepreneurs face many obstacles in Tunisia, the most significant being: i) cultural barriers to starting a business; ii) a lack of collateral for bank loans, since women own little property in their own right; and iii) the general scarcity of women in the working population and in executive posts (OECD, 2015c).

The supply of female labour could be stimulated by policies in favour of child day care and education. For lack of funding, the number of public day-care centres has declined

sharply since the 1980s, even if some have been rehabilitated since 2015. Efforts are also under way to improve the country's network of early education structures with a view of increasing the rate of coverage to 53% in 2020 from 35% in 2015. This extended coverage could help increase the level of female participation (defined as the number of active – in work or unemployed – divided by the number of women of working age [15-64]) to the target of 35% in 2020 compared to 28% in 2015. It is essential to pursue this work so that the poorest households can have access to quality child care at lower cost.

Several programmes and initiatives have been launched with the aim of strengthening the social, economic and political empowerment of women, and especially women from rural areas. These mainly revolve around promoting female participation in the labour market and female, strengthening the involvement of women in public and political life, fighting educational wastage among young girls from rural areas as well as violence against women.

### ***A financial inclusion strategy is needed***

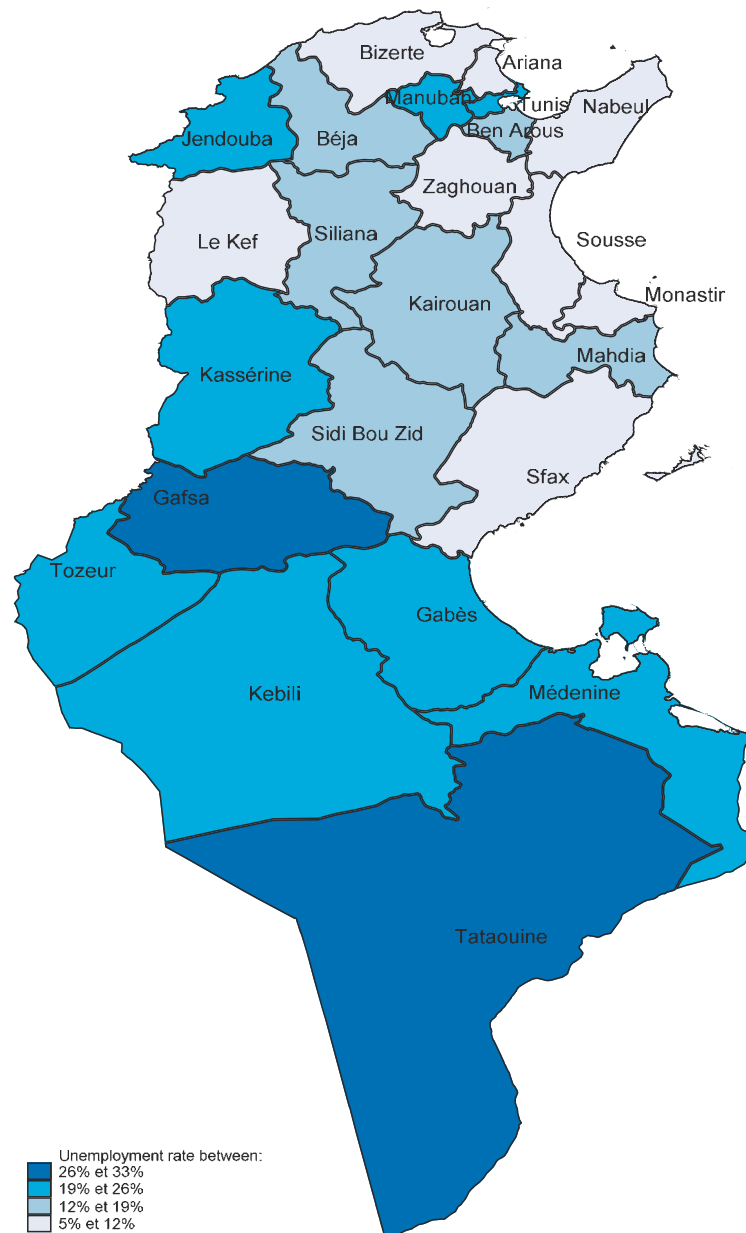
The supply of inclusive financial services is fragmented, incomplete and not very accessible (World Bank, 2015). Only 27% of Tunisians have an account in a financial institution, and fewer than 7% have a credit card, a figure that is low in comparison with emerging countries and OECD members. Many firms identify access to credit as one of the key constraints on their development (Chapter 1). Financial services are at a rudimentary stage of development, and are concentrated in the coastal regions, although the post office maintains a presence in the regions that allows rural people and those living in isolated zones to have access to financial services. Yet with a quarter of its agencies still not connected to the central server, with relatively restrictive opening hours, and with minimum deposit amounts, the post office does not yet offer solutions for micro-savings (regular withdrawals and deposits of very small amounts) or means of payment that are easy to use (World Bank, 2015). The services offered by the banks are not geared to micro and small enterprises or to low-income people, given the high costs of maintaining an account and the collateral demanded for loans.

In 2016 the authorities launched a financial inclusion strategy which is due to be implemented in the 2018-22 period, aimed, among other things, at promoting digital finance, micro-insurance, the social and solidarity economy, and financial education. In 2011, a law was adopted regulating the micro-finance sector and allowing the introduction of a new legal form for microfinance institutions in addition to the creation of a new regulatory watchdog for the sector. In 2016, a Financial Inclusion Observatory was created within the central bank with the main mission of evaluating and monitoring changes in access to financial services. Many emerging countries have introduced measures that Tunisia could copy. For example, Brazil, Colombia and India have promoted financial inclusion by opening bank accounts for everyone and depositing social allowances to those accounts. A study into financial inclusion was launched at the end of 2017 in order to determine, using indicators, the level of financial inclusion. This study will be duplicated in the future by the Financial Inclusion Observatory in collaboration with the INS. Lastly, the draft law on the promotion of start-ups was approved at the end of 2017 by the Council of Ministers. It aims to simplify administrative procedures, facilitate access to funding, encourage entrepreneurship and create the right conditions for the breakthrough of start-ups at the international level.


### **Regional development: allowing each region to exploit its comparative advantages**

Improvements in living standards have been observed across all regions of Tunisia. The poverty rate has dropped and access to basic infrastructure and public services has improved. Nevertheless, the economic choice to favour the export sector has led to a concentration of activities in the coastal areas, leaving the inland regions behind. Those regions generally depend on a narrow range of basic products, and they are little integrated into global value chains. The unemployment rate in these regions is much higher than in the coastal areas (Figure 25).

Figure 25. **The unemployment rate varies greatly among regions**



Source: INS.

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Since 2011, the government has restated the priority given to regional development. In order to succeed in this effort, multidimensional policies (covering such aspects as education, innovation, infrastructure and institutional factors) will have to be adopted with a view to capitalising on the specific assets of each region and improving its competitiveness, while ensuring coordination among the different levels of government (OECD, 2012). To this end, a potential regional development strategy, based on other successful experiments, might see the authorities promoting the development of regional centres or “clusters” in the country’s interior. They would draw support from urban centres, in order to harness the economies of agglomeration that only cities of a certain size can generate, using their high productivity and their ability to attract productive investment. The ripple effects of these poles would allow them to serve as engines for development in their respective regions, by creating trading markets and economic integration both at regional and national level.

Modernising the institutions responsible for regional development by providing them with highly skilled officers and financial and decision-making autonomy would enable the deployment of the new strategy. These independent institutions would be fully dedicated to identifying public and private investment opportunities in the region, establishing a suitable climate for private investment by reducing bureaucracy, helping investors, and setting up their projects quickly. They would also be responsible for evaluating the strategy, in order to adjust it as necessary according to the results obtained and the actual conditions in the field. The upgrading of infrastructure and public services in the regions of the interior would reduce inequalities, boost living standards, and make those regions more attractive. Proper governance of the different levels of government is also essential.

A decentralisation plan is under study. Worldwide, it can be observed that countries with the greatest level of decentralisation often have a higher standard of living, as measured by GDP per capita (OECD, regional database). The Tunisian decentralisation project could help to increase participation and bring decisions closer to the citizens, and respond more effectively to local circumstances and preferences. It could also serve to reduce regional disparities by encouraging better use of local resources (Bartolini et al., 2016). Yet this plan will have to be implemented gradually, with due regard to the managerial and financial capacities of the different levels of local government. It is also important to enhance the mobility of workers from declining regions to the more dynamic regions. The National Development Plan 2016-2020 includes a large public investment intended to reinforce links between the regions by developing a road network. Mobility can also be reinforced by a suitable housing policy that would, for example, promote the rental market while reducing the tax bias in favour of owner-occupancy.

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