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Chapter 1

Reviving investment

Since the early 2000s, the investment rate has declined, driven by the decrease in business investment. Its level is low compared to some other emerging countries. The main factors are: excessive product market regulations, associated with complex administrative procedures, unpredictable taxation, increasing difficulties for the passage of goods through customs and their maritime transport, and a financial system that is unfavourable to young companies and fast-growing ones. Removing these constraints is essential to boost business investment and, with it, productivity, job creation, competitiveness and the purchasing power of all Tunisians. The new Investment Law, by simplifying the licensing regime, is a step in the right direction but will need to be fully implemented and accompanied by further reforms. It would also be desirable to better target government actions to support investment, including a systematic evaluation of the impact and beneficiaries of tax incentives, particularly those for housing. At the same time, there is a need to better manage existing infrastructure and prioritize infrastructure projects.

Introduction and main conclusions

Business investment has dropped by more than five percentage points of GDP since 2000, holding back the economy's gains in productivity, job creation, growth and competitiveness. On the other hand, investment in housing has stayed vigorous, supported by generous tax and financial incentives. Government investment has also remained steady, and the majority of Tunisians enjoy a relatively high coverage rate in physical infrastructure by comparison with most emerging economies.

The revival of investment is a major objective of the government, as indicated in the 2016-2020 Development Plan, the holding of the Tunisia 2020 Conference in November 2016, and Tunisia's participation in the G20 initiative for the Compact with Africa, the main objective of which is to promote private investment.

Stimulating business investment and private initiative will demand efforts to reduce regulatory and administrative constraints – in particular, the many licenses, authorisations to practise and administrative authorisations required, the constraints in the area of price setting, and restrictions on competition in certain areas. These constraints have created situations of economic rents for existing businesses and have inhibited the incentive of businesses to improve the quality of the services they provide. In the end, these constraints are harmful to public well-being, and they reinforce inequalities between individuals employed by "protected" enterprises and other workers.

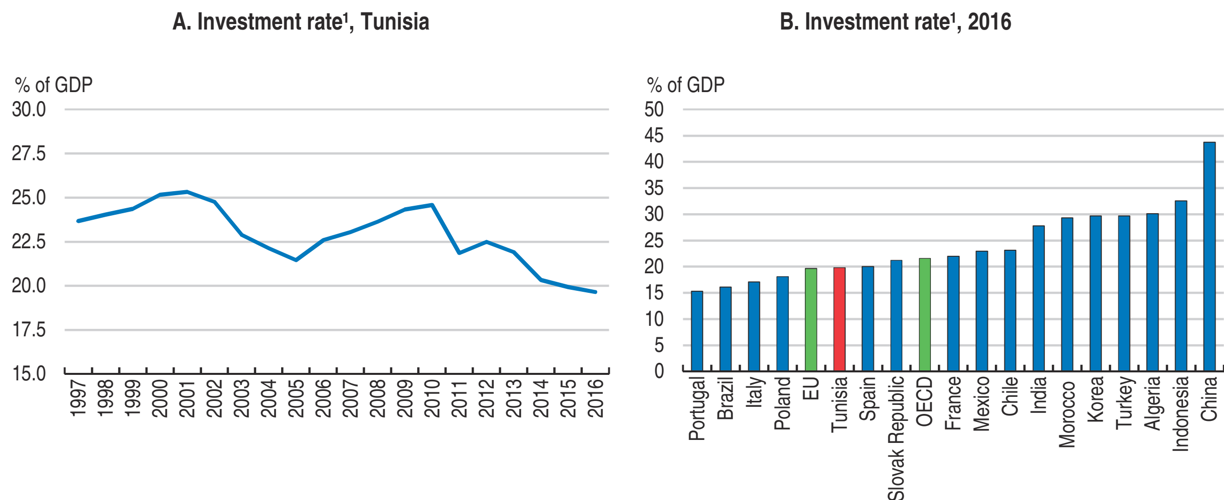
Fostering greater investment will also mean making Tunisia more competitive in global value chains, through measures to facilitate trade and make logistics services more efficient. Surveys of business leaders stress the importance of these constraints, and serve to highlight Tunisia's deteriorating position in international rankings.

The new law on investment simplifies the authorisations regime and is clearly a step in the right direction: it should be promptly and fully implemented. At the same time, financial conditions conducive to business creation and growth must be put in place. It would also be advisable to improve the targeting of government action in investment, especially as the public finances are exhausted. Some financial and tax subsidies for housing purchase are inequitable and they divert household savings from more productive investments, while the supply of housing for the poorest population groups is insufficient. Existing infrastructure also needs to be better managed, with more attention to prioritising future investments and promoting private sector participation.

The investment rate has declined

The investment rate has been on a downward path since the year 2000 or so, and its decline has accelerated since 2011 (Figure 1.1A). Although Tunisia is not the only country to have recorded such a decline, some countries have been able to keep their investment rate on a rising trend – China and Morocco are two notable examples. In Tunisia, gross fixed capital formation amounted to 20% of GDP in 2016, short of the OECD average and below the level observed in most emerging economies (Figure 1.1B).

Figure 1.1. **The investment rate has fallen since the start of the century**



1. Gross fixed capital formation.

Source: INS; *OECD Economic Outlook 102 Database*; IMF, World Economic Outlook Database; and Eurostat.

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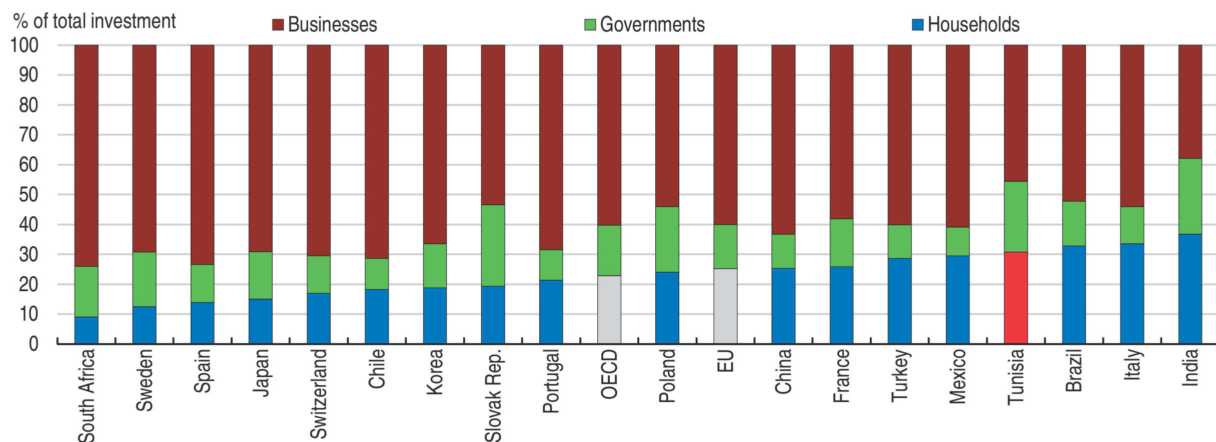
Investment by households and governments has remained vigorous

Housing dominates investment

Household investments have remained vigorous, and their share in total investment is high (Figure 1.2). The bulk of household savings goes into real estate investments, reflecting a cultural factor – a penchant for bricks and mortar – but also a scarcity of attractive and relatively secure investment opportunities. Thus, nearly 80% of Tunisians are homeowners, according to the 2014 census, a high level in comparison to most OECD countries (Figure 1.3).

Figure 1.2. **Investment is dominated by households and governments**

Investment by institutional sector, 2016 or latest year available



Note: The "household" sector comprises households, individual businesses and non-profit institutions serving households. Household investment in housing represents around 18% of total gross fixed capital formation.

Source: INS; and *OECD Economic Outlook 102 Database*.

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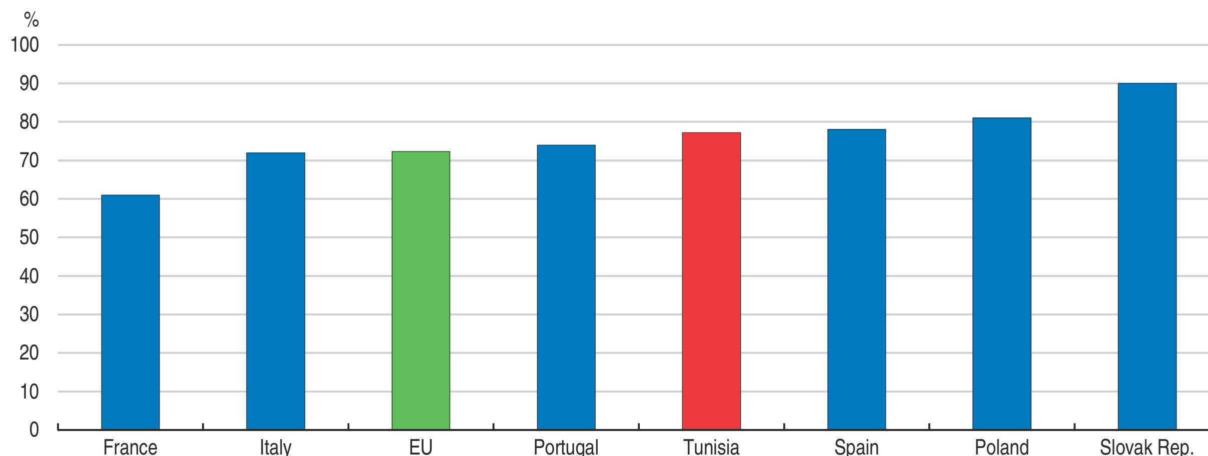
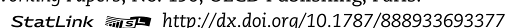
Figure 1.3. **A large proportion of Tunisians are homeowners**

Share of owner occupier households, 2014



Source: Whitehead, C. and P. Williams (2017), "Changes in the regulation and control of mortgage markets and access to owner-occupation among younger households", *OECD Social, Employment and Migration Working Papers*, No. 196, OECD Publishing, Paris.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Home purchasing by households is promoted by various tax and financial incentives. In response to the rapid rural exodus that began in the early 1970s, the government instituted a policy that includes various tax and financial incentives to facilitate access to housing. Individuals are allowed to claim interest payments on loans granted to finance the purchase of a first home not exceeding 200 000 dinars in price as a deduction from taxable income. As well, interest earned on housing savings accounts as well as capital gains upon first transfer are fully tax exempt. Tunisia has been strengthening these measures in support of housing investment in recent years, even though mortgage interest adaptability tends to favour the better-off classes, recognising that the propensity to buy a home rises with income. Information on the budget cost and the beneficiaries of these incentives is unfortunately not available, but we do know that lending to households has in fact remained relatively vigorous in comparison to bank loans to business (see the Assessment and Recommendations chapter).

The "first home" programme, launched in 2017, has reinforced the advantages accorded to investment in real estate. It facilitates access to ownership for middle-class families (those whose income ranges between 4.5 and 10 times the guaranteed minimum wage, the SMIG). This programme offers households financing for up to 20% of the price of a dwelling under advantageous conditions (interest rate of 2% and grace period of five years), and this financing can be regarded as a personal contribution ("self-financing") for bank loans. In addition, the budget law for 2018 creates a home loan guarantee fund giving access to property for households with irregular income.

Government intervention in the housing market has not reduced the imbalances between housing supply and demand, which are in fact worsening. The scarce supply of social housing has pushed low-income families into the informal market on urban peripheries. A central feature of urban development is the proliferation of clandestine building lots or subdivisions with no collective infrastructure or facilities (Ministry of Equipment, Housing and Land Use Planning, 2015). These irregular subdivisions impose a high cost on government, as they are subsequently integrated into urban rehabilitation and

outfitting programmes. Moreover, the stock of vacant housing is sizable (estimated at 600 000 units in 2016), representing in some cases a "passive" financial asset that the owner deliberately keeps empty, and in other cases newly built, but unsold, properties and secondary residences. At the same time, real estate prices are soaring (with prices for houses and apartments up by an average of more than 12% annually over the period 2012-15, according to the INS). This inflation can be laid in part to the scarcity of available building lots, resulting from cumbersome administrative procedures involved in the application and revision of urban development plans (Kamoun, 2017).

To improve people's housing conditions, Tunisia will have to refocus its efforts on social housing. Expenditures in the form of tax and financial incentives for home purchases should be reallocated to expanding the supply of housing affordable to the low-income population. Experience in OECD countries shows that such incentives divert investment away from the productive sector and often lead to rising real estate prices (OECD, 2011). Moreover, owner-occupants tend to be less mobile than tenants in rental accommodation. Home purchase subsidies thus affect adjustments on the labour market. As well, mortgage interest deductibility favours the middle and wealthier classes, as the propensity to buy a home rises with income. Thus, tax incentives in favour of ownership do nothing to reduce income inequalities, and may even aggravate them.

To improve access to affordable housing for low-income populations, it would be well to increase the stock of real estate supply, and in particular fully-finished properties, by simplifying subdivision procedures and planning requirements, to speed up the review procedures for urban development plans, and lastly to simplify and curtail administrative procedures for building permits. This would allow for a rapid growth in the stock of real estate supply, the lack of which in comparison with demand is contributing to the upsurge in the price of housing and land in urban areas.

Government investment has remained strong

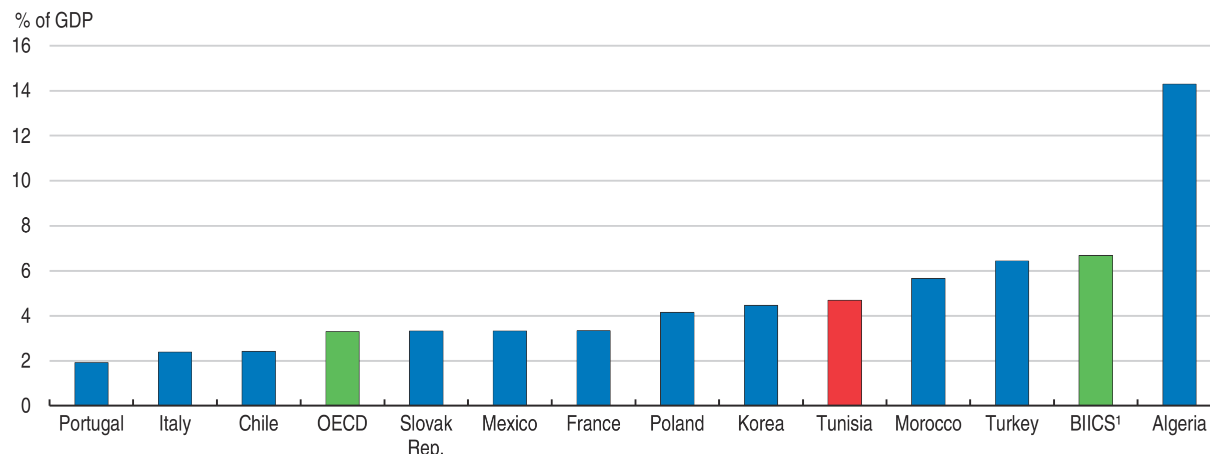
At 4.7% of GDP, government investment has been relatively high since 2011. It exceeds the level observed in OECD countries (Figure 1.4). Tunisians today enjoy nearly universal access to basic services – 99.8% of homes have electricity and 89% have drinking water, according to the 2014 census – even if regional disparities persist (Chapter 2). The density of the road network (kilometres of surfaced roadway per 1000 inhabitants) is the highest in the Maghreb. A World Bank survey carried out in 2013-14 found that few Tunisian businesses complain of power outages or water restrictions (Table 1.1). The transportation and supply of water and electricity does not seem to be a major constraint. Thus, Tunisia is clearly better positioned than other countries in the MENA region in terms of most types of infrastructure.

Although the accessibility and availability of infrastructure services does not pose major constraints for most Tunisians and businesses, the quality of those services and their proper operation sometimes fall short. Thus the number of days needed for a business to obtain an electricity connection is high (89 in Tunisia compared to an average of 41 in the MENA zone). It takes more than a week to clear a container from the port of Radès, compared to three days in parts of the Mediterranean basin. Some businesses indeed report the need to pay bribes in order to speed procedures (World Bank, 2014a).

Business investment has retreated, slowing growth and job creation

The decline in the rate of business investment observed since the beginning of this century has accelerated since 2011 (Table 1.2). Weak foreign demand has no doubt played a

Figure 1.4. **Public investment spending has remained relatively high**



1. Data represent simple averages for the following countries: Brazil, India, Indonesia, China and South Africa.
Source: IMF, World Economic Outlook Database.

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Table 1.1. **Infrastructure constraints as reported by businesses**

	Tunisia	MENA countries	Morocco	Egypt	India
Firms suffering power outages (%)	11.6	57.3	35.0	38.0	55.4
Firms that have or share a generator (%)	4.3	41.0	11.2	6.4	46.5
Number of days to obtain a power connection	89.3	41.2	13.8	76.9	21.9
Firms citing power supply as a major obstacle	8.6	38.6	24.5	18.8	21.3
Firms suffering water restrictions (%)	1.0	21.0	1.3	4.5	4.3
Firms citing transportation as a major obstacle (%)	7.6	21.7	26.9	17.8	9.6

Source: World Bank Enterprise Survey.

Table 1.2. **Gross fixed capital formation by agent and sector**

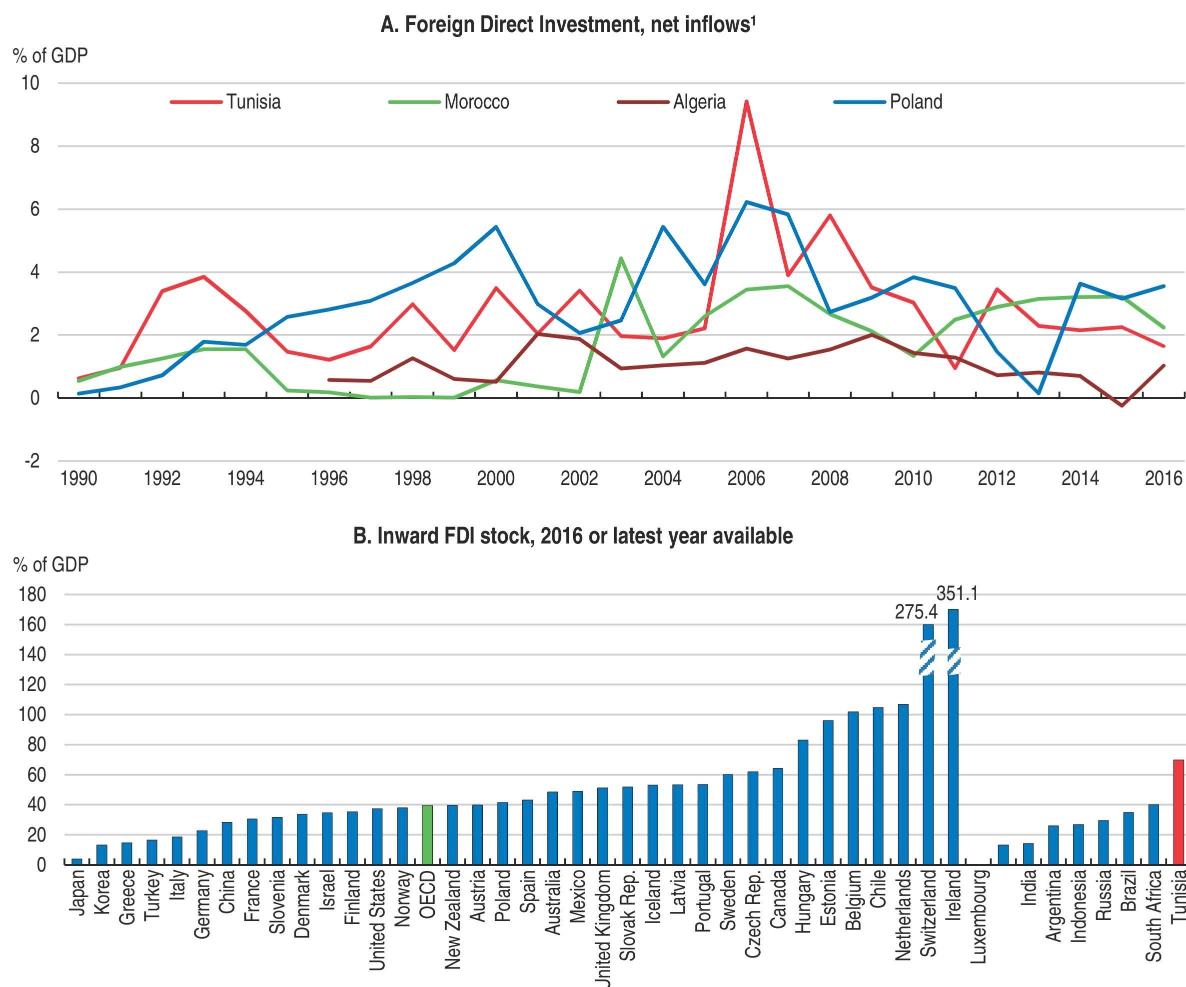
Gross fixed capital formation (GFCF)	2000 (% of GDP)	2010 (% of GDP)	2016[1] (% of GDP)	Gap 2000-16[1] (percentage points of GDP)	Gap 2010-16[1] (percentage points of GDP)
Total GFCF	25.2	24.6	19.2	-6.0	-5.4
GFCF of nonfinancial companies	14.0	12.2	8.8	-5.2	-3.4
Of which:					
Private	9.5	8.1	6.0	-3.5	-2.0
Public	4.5	4.1	2.8	-1.7	-1.3
GFCF in selected sectors:					
Oil, natural gas and bituminous products	0.9	3.0	1.5	0.6	-1.5
Manufacturing industry	3.1	3.2	2.0	-1.1	-1.2
Of which:					
1) Textiles, clothing and leather	0.9	0.3	0.2	-0.7	-0.1
2) Mechanical and electrical industries	0.5	0.5	0.5	0.0	-0.1
Tourism (hotels and catering)	1.1	0.7	0.3	-0.8	-0.4
Transportation	3.8	3.3	2.3	-1.5	-1.0
Housing	3.6	4.0	3.5	0.0	-0.4

1. For the lines "GFCF of nonfinancial companies" and its breakdown into "Private" and "Public", the latest available year is 2015.
Source: OECD calculations based on official Tunisian data.

role through the "accelerator" effect (Dhaoui, 2016; Zribi et al., 2016). But the lack of political stability, which is a decisive factor in business investment, has also encouraged a wait-and-see attitude among investors. Certain sectors have been particularly affected. Mining investment was hit hard, first by a paralysis in phosphate production and transportation beginning in 2011, due to strikes and labour unrest, and then by falling commodity prices. Investment in the tourism sector and in textiles as a percentage of GDP has fallen by a factor of 4 since the year 2000, a development that is particularly damaging as these sectors are highly labour-intensive. The manufacturing sector accounted for only 11% of total investment in 2016, and its contribution to economic growth has been negative since 2011. Its share of GDP is now weak in comparison to many OECD and emerging countries. Some sectors – especially the mechanical and electrical industries – have however exhibited some dynamism.

Foreign direct investment (FDI) has stood up rather well since 2011. As a percentage of GDP, flows have returned to the level they had reached before 2007-08 – the surge seen at the end of the 2000s reflects a series of privatisations. The result is that FDI flows as well as stocks are relatively high (Figure 1.5). Tunisia can in fact draw on a number of assets.

Figure 1.5. **Flows and stock of foreign direct investment are relatively high**



1. Three-year moving average.
Source: World Bank, World Development Indicators (WDI); OECD, FDI Main Aggregates database; IMF, World Economic Outlook database; and IMF, Balance of Payments database.

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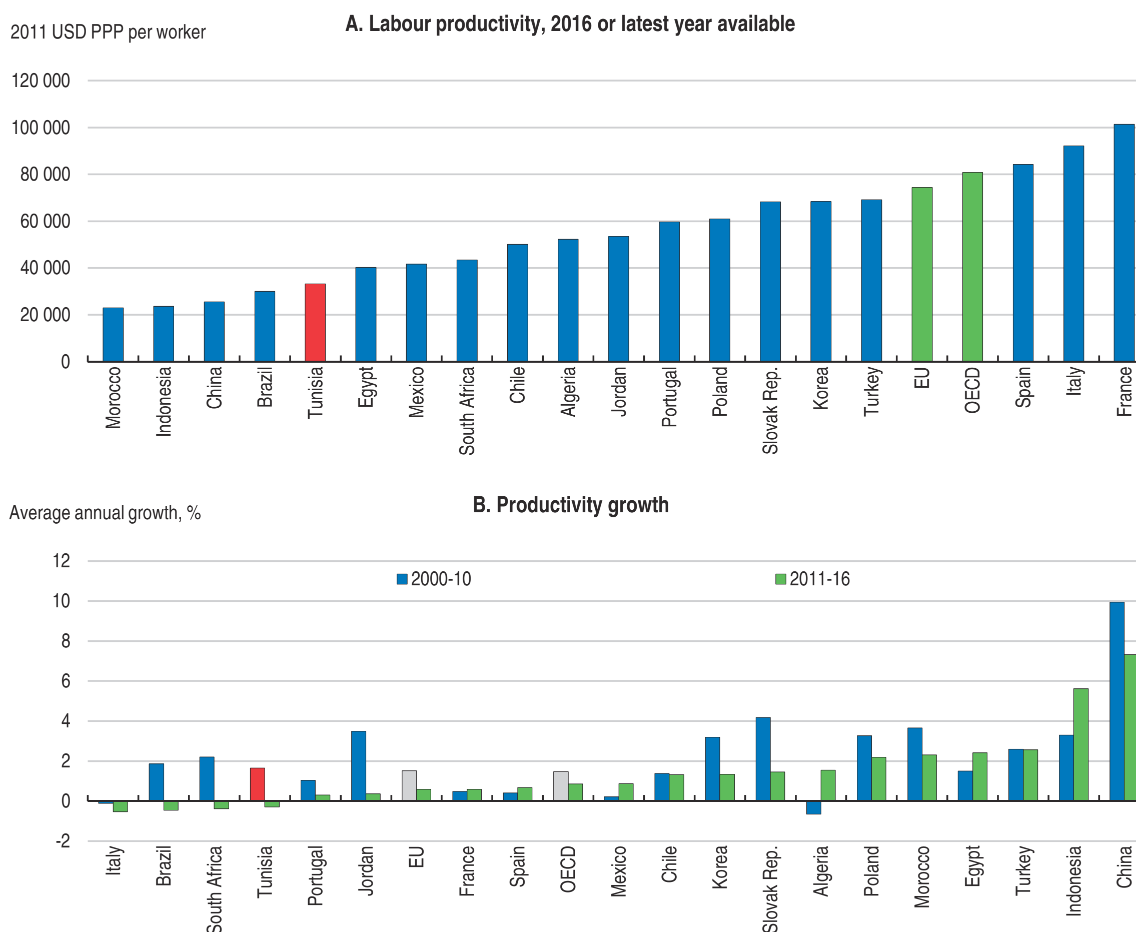
Because of its geographic position, it is a privileged point of entry for European countries into the countries of the Maghreb and sub-Saharan Africa. It is also a strategic base for the reconstruction of Libya. Foreign companies are attracted by competitive production costs and a relatively well-trained workforce (AHK, 2017).

FDI has been largely focussed on natural resource prospecting and exploitation (Samoud, 2017), in particular oil and phosphates (50% of total FDI over the years 1991-2015). The relative weight of the energy sector has declined recently, however, as it has lost ground to services, with strong contributions from finance and telecoms, and the manufacturing sector. Foreign investors based in Tunisia have often increased their FDI production capacity, with data from the Foreign Investment Promotion Agency (FIPA) indicating that in 2016, increased capacity represented over 90% of FDI inflows. Efforts are nevertheless needed to attract new investors, especially given that higher labour costs in China and some Eastern European countries are increasing Tunisia's appeal.

Productivity is respectable, but gains are shrinking

The Tunisian economy exhibits a fairly high level of labour productivity, in comparison to other emerging economies (Figure 1.6). This reflects the fact that Tunisia adopted

Figure 1.6. **Productivity, investment and potential growth**



Source: IMF World Economic Outlook database; World Bank, World Development Indicators (WDI); and *OECD Economic Outlook 102 Database.*

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policies favourable to improving productivity earlier than did many emerging countries. Those policies included: i) universal education, including for women; ii) development of high-quality infrastructure; iii) openness to external trade, including the signature of a free-trade agreement with the European Union in 1995. Nevertheless, these productivity gains have been declining in tandem with the falling investment rate.

The reallocation of resources between sectors has until recently played only a marginal role in productivity gains, despite some fairly important productivity gaps (Figure 1.7.A). The shift in Tunisian employment away from agriculture towards trade, construction and administration has been relatively slow and incomplete (see also Larbi and Marrakchi, 2016; Marouani and Mouelhi, 2016). These sectors are also characterised by modest productivity. Nevertheless, other sectors stand out: job creation in agri-food and the chemicals industry

Figure 1.7. **Productivity: sharp differences between sectors but poor reallocation of resources**

A. Apparent labour productivity by sector, 2016

% of average productivity

Social and cultural services
Construction and public works
Textile, clothing and footwear
Agriculture and fisheries
Commerce
Other manufacturing industries
Education, health and administrative services
Hotel and catering services
Engineering and electrical industries
Agri-food industries
Chemical industries
Construction materials, ceramics and glass
Repair services, real estate and other services to institutions
Transport and telecommunication
Banks and insurances
Mining and energy

% of total employment

B. Breakdown of productivity gains[1]: within sectors versus reallocation between sectors[2]

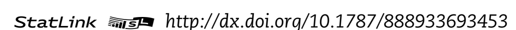
Annual productivity growth, %

Reallocation between sectors
Within sectors

2008-11
2012-16

1. Productivity gains reflect, on one hand, changes in total factor productivity internal to each sector – for a given quantity of inputs, Tunisian firms produce the same products more efficiently – and on the other hand, a reallocation of resources from less productive sectors to more productive sectors.
2. Based on INS data for 16 sectors.

Source: INS; and OECD calculations.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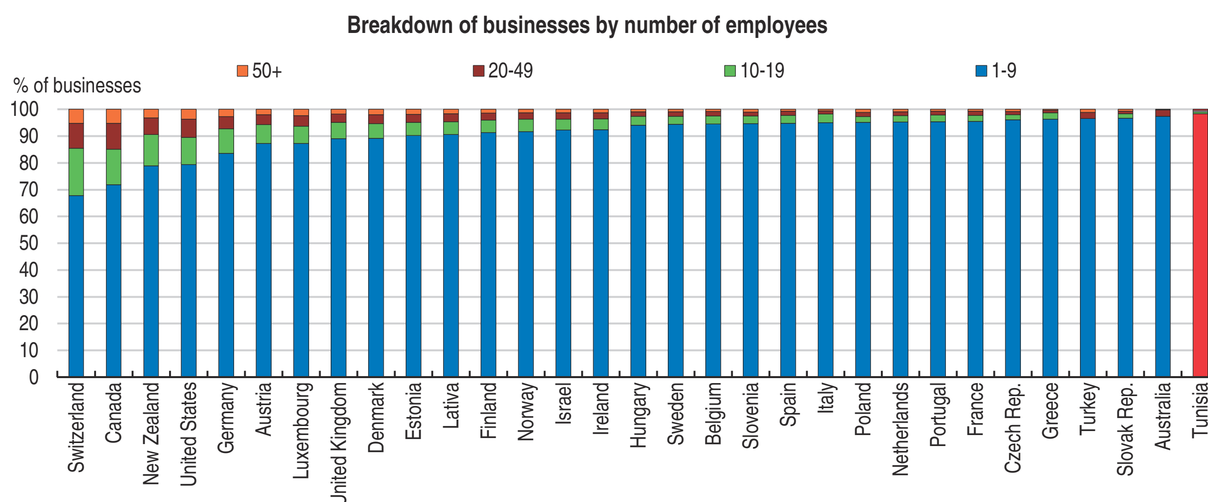
has been strong. The electromechanical industries, and more recently the electronic industries, have been particularly dynamic. They have developed in product niches of medium to high value-added. Their success can often be attributed to large groups geared essentially to the European market, which is demanding in terms of quality, innovation and competitiveness. These enterprises generally operate under the "offshore" regime, where they benefit from streamlined customs and administrative procedures (see below).

The increase in total factor productivity has been driven by productivity gains internal to each sector (Figure 1.7.B). Performances across sectors are however uneven. Productivity gains have been particularly strong in the transport and communications sectors, as well as in banking and insurance services. On the other hand, they are weak in the textile sector. Over the most recent period, these gains have declined, reflecting a very slow structural transformation of the Tunisian economy.

Obstacles to the entry and exit of firms hold back the reallocation of resources, both between sectors and among firms in the same sector. The growth of firms is generally weak (World Bank, 2014a). The inventory of enterprises shows that 98.3% of private firms employed fewer than 10 workers in 2015, a proportion that has risen steadily since the end of the 1990s, and is now well above the level prevailing in most OECD countries (Figure 1.8). Once they are created, Tunisian firms tend to stay small, faced as they are with major constraints on market access, restrictive regulations, heavy taxation and problems in accessing financing. Others remain in the informal sector for similar reasons.

Figure 1.8. **Tunisian businesses tend to remain small**



Source: OECD Structural and Demographic Business Statistics (SDBS); and INS.

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Improving the business climate in order to boost productivity and returns on investment

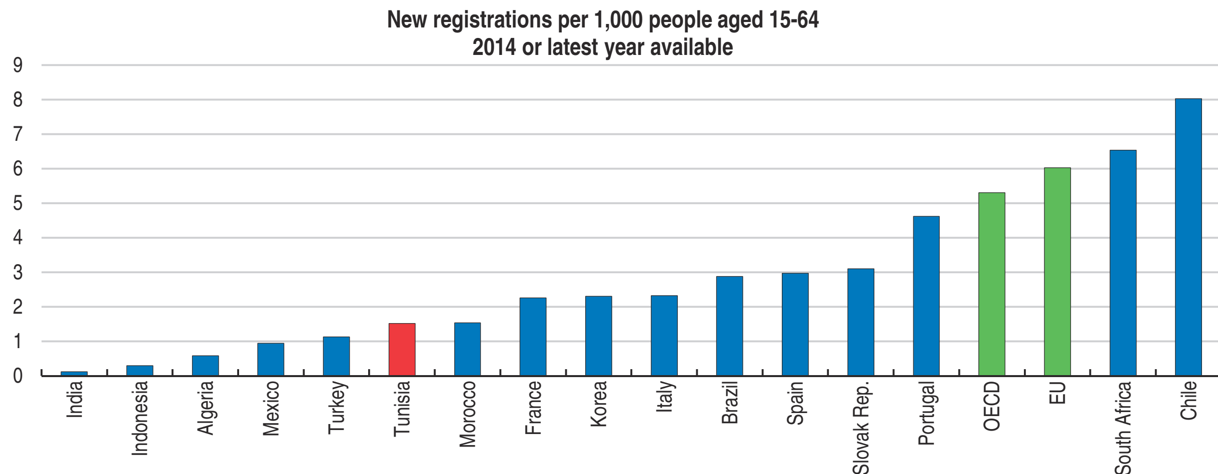
The 2016-20 Plan calls for boosting the investment rate by more than three percentage points. The previous analysis points to the conclusion that the main challenge here is to revive investment by firms so as to promote their productivity.

Barriers to business activity: progress is needed on several fronts

The business creation rate has risen since the year 2000. It now exceeds the rate recorded in other emerging countries, but it remains well below the average for OECD

countries (Figure 1.9). Moreover, growth among Tunisian firms is weak, yet it is the younger and larger firms that create the most jobs (World Bank, 2014a). With some rare exceptions, new enterprises struggle along with one or two employees for years, whereas the big firms were created 20 or 30 years ago – a situation that testifies to the lack of dynamism among small and medium-sized firms.

Figure 1.9. **The rate of business creation remains low**



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

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Surveys of business leaders show that cumbersome administrative procedures and lack of transparency in the enforcement of regulations are seen as major obstacles. The survey by the World Economic Forum reveals that firms considered bureaucratic inefficiency as the most important constraint on their development (Table 1.3), even before the change in political regime. In addition, Tunisia's position in this international ranking has deteriorated. Other business climate indicators, in particular that of the World Bank ("Ease of Doing Business"), point to a similar finding: the distance from the standard set by "good practice" has grown, especially in international trade and the protection of minority investors. Tunisia fell from 40th position in this ranking in 2010 to 77th in 2017.

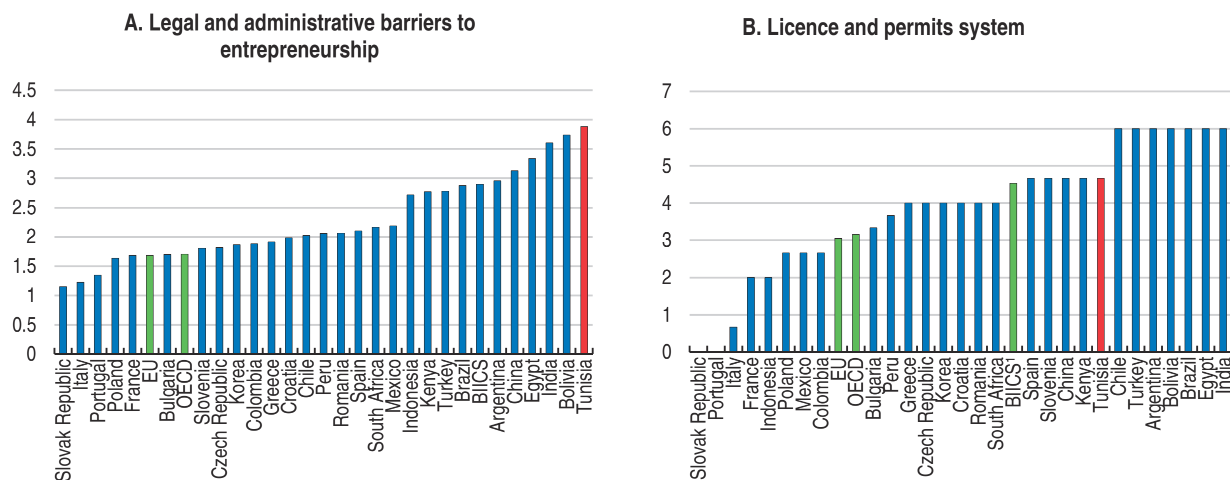
Table 1.3. **Business climate: the most problematic factors according to business leaders**

World ranking of Tunisia	2009/10 40 (out of 133)	2011/12 40 (out of 142)	2016/17 95 (out of 138)
Most problematic factors for doing business (of 16 possible scores, 1 = most problematic factor)			
• Access to financing	2	2	5
• Tax rates	8	12	6
• Tax regulations	9	10	9
• Inefficient government bureaucracy	1	1	1
• Restrictive labour regulations	3	5	4
• Inadequately educated workforce	6	9	13
• Foreign currency regulations	4	11	7
• Inadequate supply of infrastructure	7	6	10
• Corruption	11	7	3
• Political instability	12	4	2
• Government instability	13	3	12

Source: Global Competitiveness Report (Schwab and Sala-i-Martin, 2017).

This international benchmarking suggests that there is considerable room to promote entrepreneurship. Tunisia's performance, as measured by the OECD product market regulation indicators, is mediocre (Figure 1.10). It shows that regulatory procedures for creating businesses, and in particular the authorisation systems, are cumbersome and the administrative burdens imposed on individual firms are particularly high.

Figure 1.10. **Barriers to entrepreneurship remain high**



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

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

Source: *OECD-World Bank database on product market regulation.*

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Regulations need to be simplified, especially as the complexity of the regulatory framework and the lack of transparency in the preparation and enforcement of regulations encourage corruption (OECD, 2013) and thereby undermine the legitimacy of government. In 2012 the authorities had already recognised the need to simplify regulations in order to promote economic activity. The "regulatory guillotine" announced in 2012 was supposed to produce an inventory of all administrative and regulatory procedures involved in conducting an economic activity, and to eliminate those that were obsolete or redundant. Some 500 procedures were deemed inappropriate in 2014. Unfortunately, the reform was never completed, and these procedures are still in effect. It is imperative to put the process back on track.

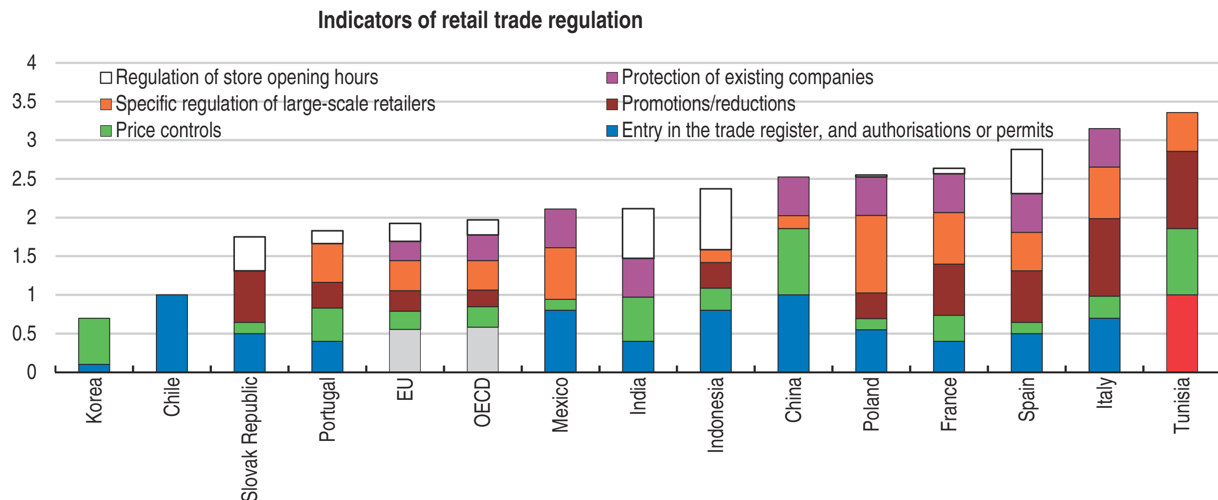
Support services for entrepreneurs throughout a business lifecycle are ineffective. There exists a great number of structures offering guidance and assistance but few entrepreneurs know about them. A recent survey showed that almost half of entrepreneurs knew little or nothing about the support structures and financing services available at the time they were setting up their business (APII, 2017). The number of new businesses fell sharply between 2010 and 2015, and the number of projects filed but not realised is fairly high, pointing to the need for a new strategy. This could be based on the promotion of clusters and value chains, the creation of industrial zones with partnerships between businesses, technology hubs and universities, including on a regional level.

Price controls, restrictions on market access and competition for certain services

Entry restrictions reduce incentives to modernise existing businesses and they hold back investment. The distribution sector is a case in point. It is heavily protected by

significant restrictions on foreign direct investment and by a restrictive set of regulations on prices and authorisations (Figure 1.11).

Figure 1.11. **Retail trade regulations are restrictive**



Note: Data for Tunisia refer to 2016. Data for other countries refer to 2013.
Source: *OECD Database on product market regulation.*

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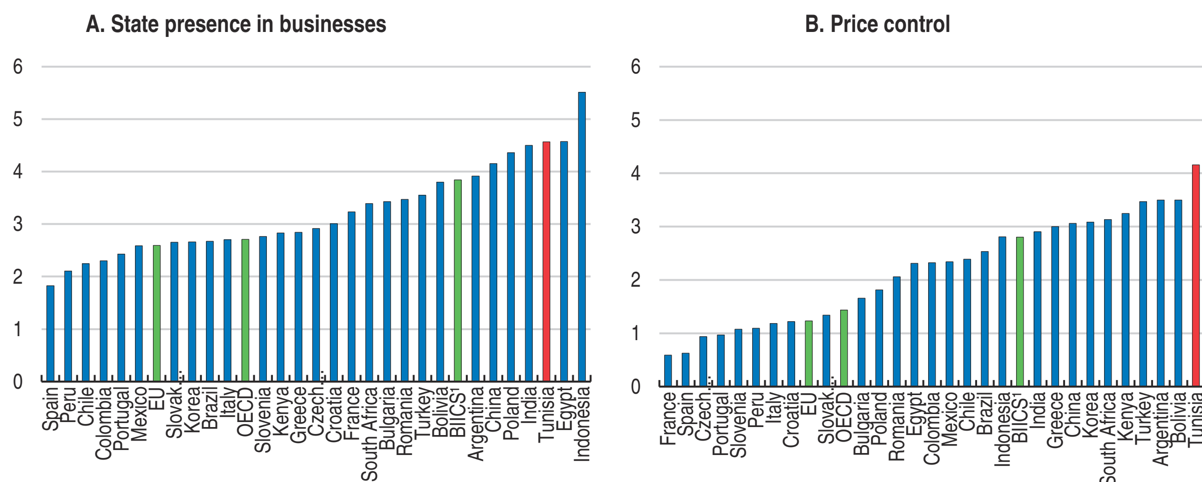
Network infrastructure is frequently managed by firms that face little competition. The government is still the dominant shareholder in the companies responsible for many so-called network services – for example, electricity, water, gas, railways, land transportation and telecoms. Only Egypt and Indonesia have a greater direct government involvement in these businesses (Figure 1.12). In the water, sanitation, electricity, air and rail transportation sectors, moreover, and to a lesser extent in telecommunications, the number of operators is limited by law, and prices are approved by the government. Past experience in some countries, including France, suggests that easing barriers to entry, especially in telecommunications, leads to lower prices for the end user.

The case of air transportation is a good illustration of market access restrictions. The signature of the “open skies” agreement with the European Union, which was to allow all airline companies to serve all destinations, has been pushed back since 2012. That agreement applies to certain destinations, but Tunis-Carthage airport (the country’s largest) will remain closed to new operators for at least another five years, in order to give the public operator, Tunisair, a chance to adapt. In a reflection of the poor quality of air transport infrastructure, however, Tunisia has seen its attractiveness for travellers and tourists diminish, according to the World Economic Forum’s indicator (WEF, 2017).

The prices of many goods and services are set by the government: this is true for sugar, milk, water, electricity and gas. In many cases, prices are not revised on an annual basis, and when they are raised the increase is often kept lower than the general inflation rate, in order to contain inflationary pressures and preserve households’ purchasing power. For investors, price controls often mean lower profit margins, and moreover, on the cost side, wage adjustments do not reflect productivity trends, while public operators have been ordered to create jobs to bring unemployment down. Lastly, price controls, by reducing the profit margin, tend to discourage investment (Zribi et al., 2016).

Figure 1.12. **State control of businesses: PMR outcomes**



1. Data represent simple averages for the following countries: Brazil, India, Indonesia, China and South Africa.
Note: Data for Tunisia refer to 2016. Data for other countries refer to 2013.
Source: *OECD-World Bank database on product market regulation.*

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International trade facilitation: Tunisia's position has deteriorated

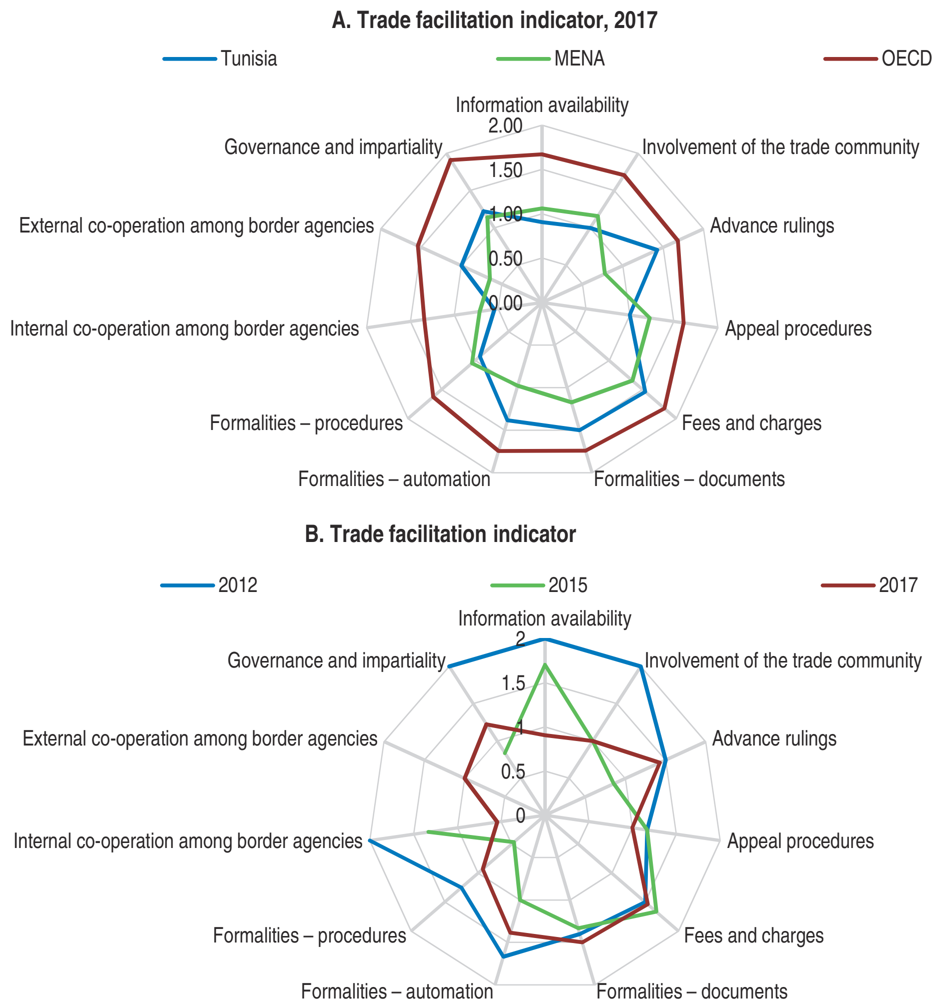
In global value chains, goods cross borders many times. The predictability and efficiency of border procedures is therefore especially important in maintaining competitiveness and conquering new export markets. The OECD trade facilitation indicator reflects the broad terms of the WTO agreement that was concluded four years ago and came into force in February 2017. That agreement deals with regulations and procedures, and not with infrastructure. The indicators cover customs and other agencies at the border, and apply to the general regime, i.e. to businesses under the "onshore" regime in the case of Tunisia although Tunisia has yet to ratify the agreement.

Although Tunisia made some significant progress in simplifying and automating border procedures in the early years of this century, the pace of reforms has slowed in recent years. Tunisia's position has deteriorated, and the gap with OECD countries has widened (Figure 1.13). As a result, businesses face problems in meeting the delivery deadlines demanded in their production chains. Businesses importing into Tunisia which fall outside the offshore sector struggle with the many different customs duties, often accompanied by checks on the kinds of goods being imported and abundant red tape, all of which generates costs and undermines the competitiveness of onshore businesses. If foreign investors are not to turn to nearby competing countries and if onshore businesses are to be able to compete on the export market, Tunisia will have to undertake another reform make improvements to facilitate trade. In particular, it will have to rationalise border controls and organise "one-stop windows" for the submission of all the required documents, while improving coordination among the various national agencies present at the borders.

The offshore sector has been more dynamic and its share in paid employment is rising

The performance of export-only businesses, known as the "offshore" sector, suggests that regulatory reform can promote investment as well as creating value-added and quality jobs. "Onshore" businesses suffer from the proliferation of regulations and they encounter difficulties of access to logistical services, especially ports and customs. Moreover,

Figure 1.13. **Trade facilitation: competitiveness gains to realise**



Note: The trade facilitation indicators measure the relative economic and commercial impact on trade flows and costs of facilitation measures currently in place within the framework of the World Trade Organisation (WTO). The indicators take values from 0 to 2; where 2 represents the best performance that can be achieved.
Source: *OECD Trade Facilitation Indicator*.

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restrictions on competition are such that few onshore businesses ("insiders") have an incentive to diversify or to improve their competitiveness. On the other hand, Tunisia-based offshore firms (Box 1.1), which are exposed to intense international competition, are driven to make continuous efforts at investment, innovation and training. These firms also enjoy privileged and simplified arrangements concerning, for example, customs procedures and access to port facilities. It is interesting to note that foreign firms under the offshore regime report much less in the way of bureaucratic hassles than do their counterparts in the onshore regime (7% versus 80% for firms with German participation, according to AHK, 2017).

The offshore sector is much more dynamic than the onshore sector. The number of firms in the offshore sector grew by more than 13 times between 1996 and 2016, while the number of firms in the onshore sector less than doubled. Offshore companies have also created more in the way of formal paid jobs (Figure 1.14). In 2015, offshore firms accounted

Box 1.1. Export-only businesses and the "offshore" regime

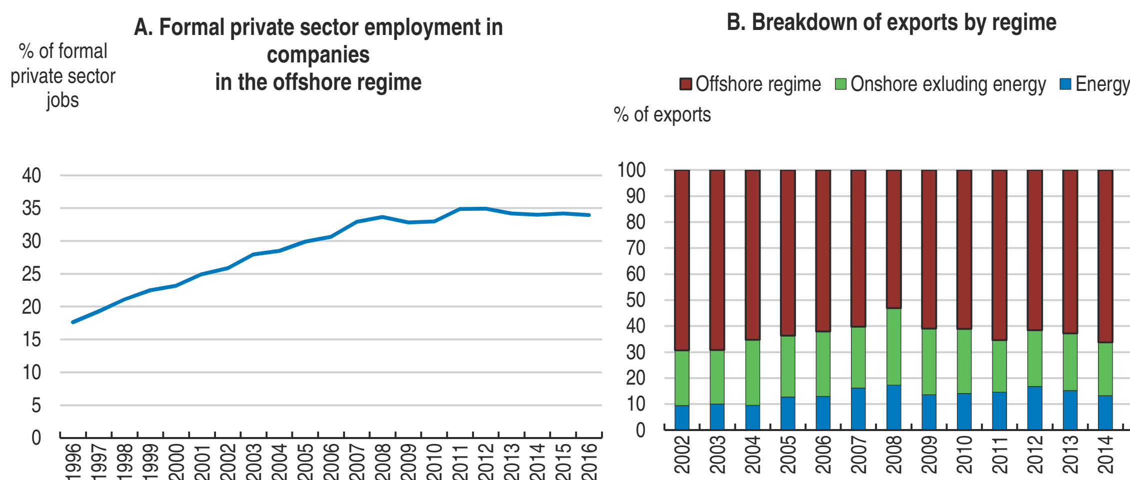
Definitions of the offshore sector. There are two definitions of the offshore regime. For the INS, these businesses are those that are wholly engaged in exporting, whether they are Tunisian or foreign. The Tunisian central bank adds another criterion: foreign ownership of at least 66% of the share capital of an export-only company. Such businesses are considered to be non-domiciled if their capital is held by non-resident Tunisians or foreigners through the import of convertible currencies equal to at least 66% of the capital.

Advantages granted to offshore businesses. Although offshore businesses are still subject to the same labour regulations as onshore businesses, they enjoy several advantages:

- They are exempt from import duties on the inputs incorporated into re-exported products, and they have no dealings with the customs administration if they are exclusively devoted to export.
- They enjoy privileged access to port services.
- They are subject to a reduced rate (10% instead of 25%) of corporate taxation. They have little interaction with the tax administration during the entire period of tax exemption, and some of them say that this represents a more important advantage than the tax reduction itself.
- When non-domiciled parties own 66% or more of the capital of a firm devoted exclusively to export, and that capital is financed through the import of foreign currency, the said firm is considered to be non-domiciled "for foreign exchange purposes" and is therefore not subject to foreign exchange regulations.

Since February 2017, firms in the offshore regime can sell on the Tunisian market to the extent of 30% of their turnover, with prior payment of customs duties.

Figure 1.14. **Contribution of offshore businesses to exports and the creation of formal employment**



Source: INS.

StatLink http://dx.doi.org/10.1787/888933693586

for more than 34% of formal paid employment, compared to 21% in 1998, and they represented 78% of exports excluding energy. As to the onshore firms, more than 60% of their exports consist of agricultural, energy, mining and phosphate products.

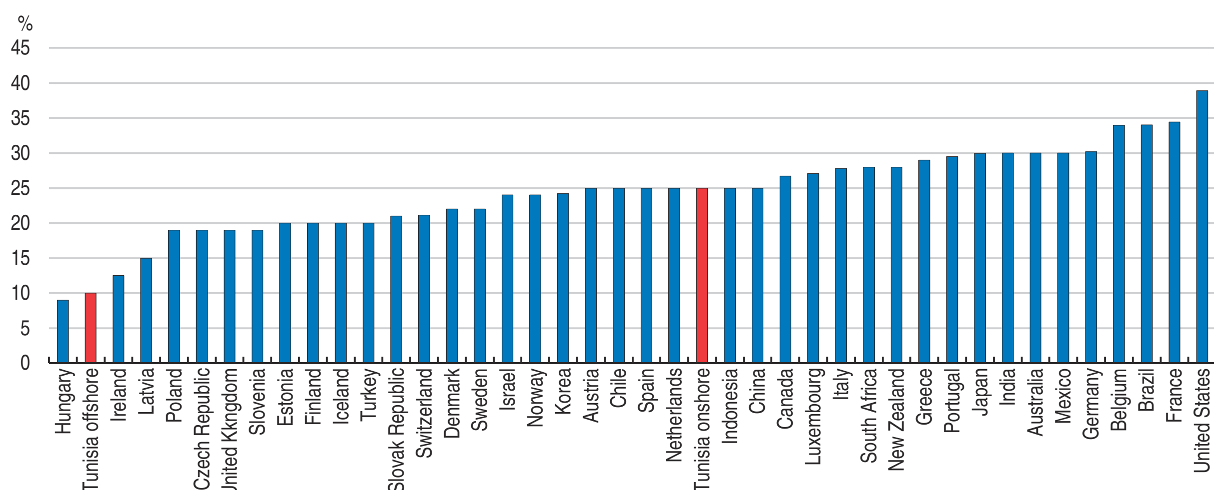
Firms in the two regimes trade little with each other. When they sell their output in Tunisia, export-only firms must therefore pay taxes and customs duties, and thereby enter into a relationship with the government. They may also supply themselves on the local market, in which instance they are exempt from paying VAT. Few do so in practice. Similarly, an onshore business selling products to an offshore business should be able to claim back the VAT paid on its production inputs. Refunds are made once a year, which can cause cashflow problems for some businesses, especially smaller ones. Requesting a VAT refund is also often accompanied by accounting and tax inspections that discourage subcontracting by onshore businesses. Taxation and administrative and customs procedures pose a barrier to the development of subcontracting or outsourcing relationships between the two sectors, and more generally tend to preclude spillover effects from the offshore sector into the Tunisian economy. Moreover, technology transfers, which are often associated with exposure to trade and foreign investment, are inhibited (Dhaoui and Samoud, 2016).

The strong performance of the offshore firms suggests that removing entry barriers and streamlining administrative procedures could revive investment and job creation in the private sector. To take full advantage of the offshore regime's potential to stimulate the rest of the economy, the government should facilitate closer relations between these two sectors and encourage outsourcing, by simplifying customs and tax procedures between them.

Taxation: remedying the lack of transparency and predictability

Several welcome reforms have been undertaken since the *Assises de la fiscalité* (taxation consultations) of 2014. VAT has been simplified and the number of rates and exemptions cut. Eligibility conditions for the flat rate regime have been rationalised, improving the system's fairness. Tax distortions between the offshore and onshore regimes have been reduced: firms under the offshore regime are now subject to a 10% profits tax since 2014 (they were previously exempt), and the tax rate on firms of the onshore regime has been cut from 30% to 25%. The statutory profits tax rate has thus been brought closer to the average for OECD and MENA countries (Figure 1.15).

Figure 1.15. **Statutory tax rate on corporations, 2017**



Source: OECD Revenue Statistics; Deloitte; and Tunisian Ministry of Finance.

StatLink http://dx.doi.org/10.1787/888933693605

The tax administration has also been modernised. To improve relations with taxpayers, online facilities have been introduced for calculating taxes owing, filing electronic tax returns, and paying the tax. Tax controls have been reinforced in an effort to combat tax evasion, but they are still insufficient. As a result, tax collection rates remain low. A recent study (Haddar and Bouzaiene, 2017) reveals that only a quarter of companies declare profits and pay taxes: 46% do not file declarations, and 30% claim losses or report zero profit.

The lack of "predictability" remains a major problem for investors. The heads of offshore companies say that they are less bothered by the new fiscal burden itself (with the corporate tax rate rising to 10%) than by the relationships with the tax administration generated by these new tax obligations in terms of documentation, time and transaction costs. Moreover, the lack of stability in the tax system, given the many measures introduced in the preceding budget laws, tends to delay or discourage investment projects. More than 530 tax provisions appeared in the budget laws between 2011 and 2016 (Haddar and Bouzaiene, 2017). Thus, the one-off contribution of 7.5% of profits for businesses subject to the corporations tax, introduced in 2017, will be replaced by other taxes in 2018 – including the social solidarity contribution levied on profits ranging from at a rate of 1% to 5% depending on the company's size and sector of activity – earmarked for the social security funds. As well, the prospect of a further adjustment in the corporate tax rate, to diminish the duality between the onshore and offshore regimes, creates a climate of fiscal uncertainty that is harmful to investment projects.

To promote investment, the tax system will have to be made more predictable. This will require implementing the programme of reforms agreed at the *Assises de la fiscalité* and narrowing further the field of application of the flat rate regime – the draft 2018 budget law goes in this direction. The performance of the tax administration should also be improved, particularly in the areas of enforcement and collection. The creation of a large businesses unit would help to remedy the lack of coordination between the Taxation Division and the Tax Inspection Division.

New investment law: fewer procedures, more transparency, better-targeted incentives

The new law on investment (Box 1.2), which has been implemented gradually since April 2017, stresses the principle of freedom of investment and market access. It also seeks to make administrative rules and procedures more transparent and predictable. This is a simplified law, containing 36 articles in contrast to the preceding 75, and three application decrees, compared to 33 for the old code. The prior authorisations that applied to all sectors have been eliminated.

Sector-specific authorisations persist, but their transparency has been improved and their numbers should be gradually reduced. In 2017, there were 360 open sectors, 138 135 activities subject to specifications and 162 154 activities subject to authorisation. The list of sectors requiring authorisation (negative list) was to be published during the autumn of 2017 but had yet to be released as of mid-December the beginning of 2018. A management-by-objective unit has also been established to negotiate the elimination of these authorisations with the line ministries. The government's objective is to come up with a shortened negative list within three years by 2020. For activities that remain subject to authorisation, procedures for granting approval will be streamlined and made more predictable. As well, for foreign investors, the law abolishes the High Commission on Investment, whose prior approval was necessary to acquire securities that convey voting rights when the foreign shareholding interest exceeds 50% of the capital, applicable across all to certain sectors.

Box 1.2. **The new investment law**

The previous Investment Code contained a number of tax and financial incentives that were primarily of benefit to a small number of firms, often dedicated to export. Only 7.5% of tax incentives and 10.2% of financial incentives were disbursed in the name of regional development. The system was not only costly – 2.5% of GDP for customs and tax incentives alone, and 10% of tax revenues – but was also complex and non-transparent, and in the end it was not very effective in promoting investment and creating jobs (Zribi et al., 2016).

The new investment law, which was adopted in 2016 and came into force in April 2017, calls for:

- ***Streamlining the authorisations system.*** The positive list that specified the authorised sectors has been replaced by a negative list of activities that require prior authorisation. For activities that remain subject to authorisation, the procedures for granting approval will be simplified by the spring of 2020. The deadline for issuing approval will be set by law, with the obligation to substantiate refusal. Failure to respond within the deadlines will be deemed tacit approval, validated by the Tunisian investment authority.
- ***Relaxing certain restrictions on foreign investors.*** The maximum number of foreign managers that a firm may hire (four under the previous legislation) is replaced by a percentage that changes over time: 30% of foreign managers during the first three years, and 10% as of the fourth year, with a minimum of four foreign managers allowed in all cases. Beyond the stipulated rates or limits, the firm must obtain authorisation from the government. Foreign investors now have the right to acquire non-farm real estate and Tunisian securities that convey voting rights in firms installed in Tunisia. The intellectual property rights and assets of foreign investors enjoy the same legal guarantees as those of Tunisian investors.
- ***Enhancing incentives to promote investment in disadvantaged zones and in certain activities.*** Investments in disadvantaged zones are exempt from corporate taxation during the first 5 to 10 years. Investments in the agriculture and fisheries sector, activities involving the processing of agricultural products, and investments "of national interest" (more than 50 million dinars or 500 jobs created over three years) enjoy the same advantages. For the "priority" sectors (20 businesses defined by decree, including information and communication technologies, textiles and clothing, and the electronic industries) and/or disadvantaged regions, the new law proposes to pay a bonus (from 15% to 30% of the investment amount, with a ceiling) and to have the government cover employers' social contributions and infrastructure expenses. The sector and regional development bonuses are cumulative (up to a ceiling). There are also cross-sector bonuses for investment in training, new technologies, research and development, sustainable development, and the adoption of clean technologies.
- ***Improving the framework for settling disputes between the State and investors.*** The law confirms the guarantees of investors' property rights. For foreign investors, it recommends conciliation in the event of a dispute, but also provides for international arbitration.

The **institutional framework** is being reorganised around three structures:

- The High Council on Investment (*Conseil supérieur de l'investissement*) – chaired by the Prime Minister and comprising ministers and the Governor of the Central Bank of Tunisia – approves investment policies and strategies.
- The Tunisian Investment Authority (*Instance Tunisienne de l'investissement*), created in 2017, is responsible for approving processing investment projects of more than 15 million dinars as of 2018. Its main objectives are to streamline procedures, respond to applications by the official deadline and grant financial advantages. The Authority represents a single contact point for investors. (Below that the 15 million dinar threshold, financial advantages are granted by the sectoral agencies and their regional representativesapprovals will be granted by the Industry and Innovation Promotion Agency, APII). The main objectives of the Authority are to simplify procedures and to respect response times. It offers a single point of contact for investors.
- The Tunisian Investment Fund *(Fonds tunisien de l'investissement)* is responsible for paying the sector-specific and regional incentives called for in the new law, and will take shareholding interests in venture capital funds.

The new law reaffirms the principle of investment incentives, but the targeting is different. Reflecting Tunisia's priorities, and in line with the National Development Plan 2016-2020, the financial and tax incentives will now benefit the most disadvantaged regions and certain key sectors, particularly those with high value added and the capacity to create jobs for young graduates. The probable cost of these incentives is not available. Experience in other countries suggests that sector-specific or regional incentives to investment may sometimes yield weak returns – the cases of India (OECD, 2017a; Rao et al., 2016) is and France are instructive here (OECD, 2017a; Rao et al., 2016). In Tunisia, a study by IACE (2016) suggests that the impact of investment incentives contained in the new law will diminish. If that impact is to remain positive, a better business climate will be needed. There is a plan for the Investment Authority to assess the return on these investment incentives and check the system's administration. It would also be timely to assess the impact of these provisions on investment, job creation and regional development, regularly and to introduce "sunset clauses" adapt or abolish them if they are found to be ineffective in the light of their cost.

The institutional framework for implementing the new investment law is still complex. The law introduces a new institutional system, with the Tunisian Investment Authority (*Instance tunisienne de l'investissement*) acting alongside the pre-existing bodies that encourage investment: these include the Agency for the Promotion of Industry and Innovation (APII), the Foreign Investment Promotion Agency (FIPA), the sector agencies (such as the ONTT for tourism, the Agency for the Promotion of Agricultural Investment (APIA) and the CEPEX for exporters) and the regional development offices. The large number of these structures could well impede coordination of efforts to promote investment (OECD, 2015). Framework conventions have been signed between the Investment Authority and other actors to improve the system's governance, but a simplification of the institutional framework would nevertheless be welcome. Since the Tunisian Investment Authority is, legally, the only contact point for investors, it would seem that a skills transfer is will eventually be needed to create a genuine one-stop-shop.

Restrictions on foreign investment are declining but remain high in certain sectors

The new investment law removes certain restrictions on foreign investors. Tunisia has joined the OECD Declaration on International Investment and is committed to honouring the obligations this implies, including the notification of exceptions to the national regime and the promotion of the Guidelines for Multinational Enterprises in order to encourage responsible business conduct. The FDI Regulatory Restrictiveness Index, which is based on the notification of exceptions to the national regime, is falling but remains high (Figure 1.16). Prior authorisations for sectors deemed strategic make Tunisia less attractive to investors. The services sector – retail and wholesale trade, consulting services (including engineering) and certain financial services – is particularly protected, and this results in a relatively low value-added content of local services in exports of manufactured goods. The construction sector is also protected because Tunisia is concerned about competition from neighbouring countries and an inflow of low-paid foreign workers. As well, the restriction on the number of foreign managers has been relaxed by the new law, but it could be relaxed further in order to improve Tunisia's attractiveness and reinforce the transfer of skills.

If Tunisia is to become more attractive for foreign investors it will have to pursue efforts at deregulation and will also have to simplify administrative procedures. The adoption of measures announced in late 2007 by the Tunisian central bank – concerning the computerisation of the investment file allowing non-domiciled investors to self-assess

Figure 1.16. **FDI restrictions have declined but remain high in certain sectors**

A. OECD FDI regulatory restrictiveness index for 2016

More restrictions
Fewer restrictions
Other restrictions
Restrictions on foreign workers
Screening or approval mechanisms
Foreign equity restrictions

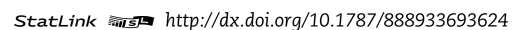
B. OECD FDI regulatory restrictiveness index for 2016[3]

OECD average
Tunisia
Fewer restrictions
More restrictions

1. Data for 2017 are based on preliminary assessments, considering the elimination of horizontal authorisations.
2. Data for 2017 are based on preliminary assessments, considering the elimination of horizontal and sector-specific authorisations.
3. For Tunisia, the data refer to 2017 and are based on preliminary assessments, considering the elimination of horizontal authorisations.

Note: The FDI Index measures statutory restrictions in 22 economic sectors. It considers four main types of restriction: 1) foreign equity restrictions; 2) screening or approval mechanisms; 3) restrictions on key foreign personnel; 4) other operational restrictions, including land ownership, capital repatriation and the opening of branches. Restrictions are scored on a scale from 0 to 1, where 0 corresponds to a sector that is totally open and 1 to a sector that is closed. The aggregate restrictiveness index is an average of the sector scores. The discriminatory nature of measures, when applied exclusively to foreign investors, is a central criterion of evaluation. The index for Tunisia does not include restrictions on the employment of foreign managers because they do not specifically concern executives, such as the CEO, COO or CFO.

Source: OECD Foreign direct investment regulatory restrictiveness index.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their tax returns and draw up their investment file for validation by the domiciliation intermediary approved for their investment case file, and the option to subscribe capital increases through the conversion of foreign currency advances in current accounts granted by non-domiciled parties – is a step in the right direction. It will also be vital to improve border services (especially customs) and logistical services (see below).

Improving infrastructure

The five-year plan 2016-2020 calls for implementing some large-scale ("structuring") infrastructure projects, with particular emphasis on the creation of a deep-water port and the development of the highways network, railway lines, regional roads, power generating stations, and water desalination plants.

The main objective of these large-scale projects is to improve people's living conditions (especially those in the regions of the interior), to enhance the economy's competitiveness by reducing goods transport costs and times, and opening up isolated regions (Chapter 2). Logistics costs – linked to transport, maintenance and warehousing of merchandise – are estimated to represent 20% of GDP (OECD, 2017b), a level that is significantly higher than those of the emerging countries (15%) and developed countries (7%). The new law on expropriation for public utility projects, which provides more realistic compensation to expropriated owners and simplifies expropriation procedures, should serve to speed implementation of these projects.

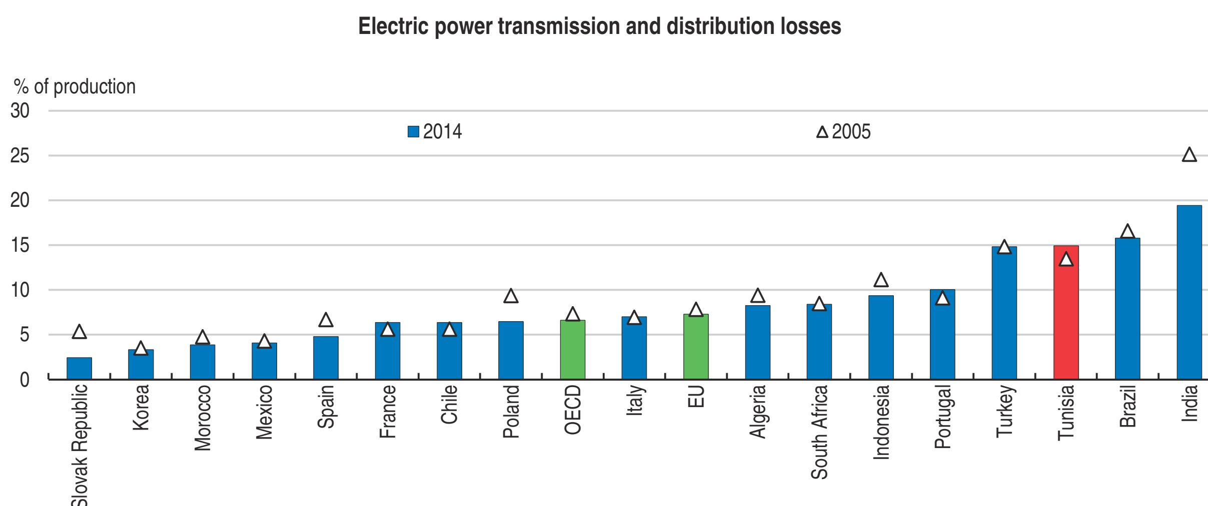
Rationalising the choice of public investments

Better maintenance and operation of existing infrastructure

If it is to make a swift improvement in infrastructure performance in certain areas, Tunisia will have to give priority to upgrading existing facilities. The lack of maintenance and efficiency in the management of infrastructure and related services often leads to their rapid deterioration and a poor quality of service, despite fairly high installed capacity and coverage. Losses from the electricity network are a striking example: they have risen sharply, and are high in comparison to OECD countries and other emerging countries (Figure 1.17). Comparable losses can be seen in the drinking water sector (around 15%) and in water used for irrigation (28%).

Figure 1.17. **Losses in the electric power network**

Electric power transmission and distribution losses



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

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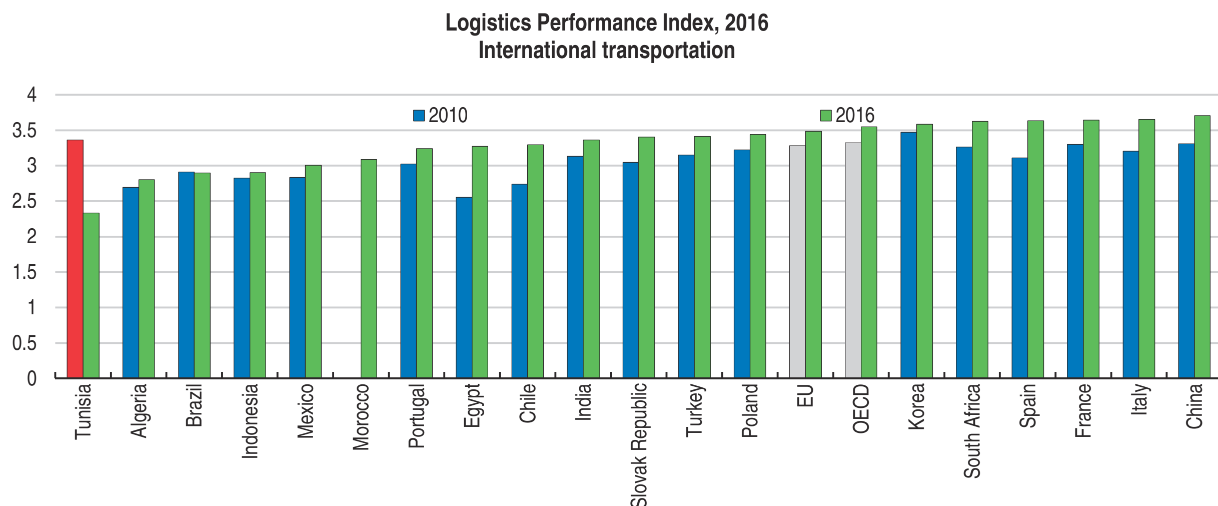
The quality of port infrastructure has deteriorated sharply according to Tunisia's ranking by the World Economic Forum with respect to the quality of port infrastructure has deteriorated sharply, dropping which has fallen from 38th position in 2008-09 (out of

134 countries assessed) to 100th position in 2016-17 (out of 137 countries). Entrepreneurs complain particularly about the slowness of loading and unloading operations in the port of Radès, Tunisia's main port. Container handling services there are inefficient – on average, seven containers per hour in 2016 versus more than 20 in other European ports – and the average dwell time for merchandise is estimated at 12 days, much higher than that recorded in European ports (OECD, 2015a). Moreover, ships wait at anchor for 10 days on average before they can enter the port. The shortcomings of the Radès port entail a high cost to the Tunisian economy. Blame is also levelled at the customs services, where clearance times are often longer than those of comparable countries, a point confirmed by World Bank surveys and the OECD's trade facilitation indicator (see the chapter on the Global Economic Situation. Overall, Tunisia has been severely downgraded in the World Bank's rating of logistics performance (Figure 1.18).

Figure 1.18. **Room for improvement in logistics performance**



Note: The overall score on the Logistics Performance Index reflects perceptions of a country's logistics based on the efficiency of the customs clearance process, the quality of trade and transport-related infrastructure, the ease of arranging competitively priced shipments, the quality of infrastructure services, the ability to track and trace consignments, and the frequency with which shipments reach destination within the scheduled delivery time. The index ranges from 1 to 5, with the highest score representing the best performance.
Source: World Bank Logistics Performance Index database.

StatLink http://dx.doi.org/10.1787/888933693662

Selecting future projects more carefully

Future investments will have to be selected on the basis of their expected economic and social returns. This will require enhanced capacities for planning, evaluation and selection of investments in the main ministries in charge of managing the public finances and infrastructure (specifically the Ministries of Equipment, Energy, Agriculture and Investment). The creation in 2017 of the National Committee for the Approval of Public Projects (*Comité national d'approbation des projets publics* – CNAPP) was designed to lead to improved prioritisation and better feasibility and impact studies before projects are added to the budget. This is a horizontal structure, that embraces the technical and financial departments of the relevant Ministries and falls within the jurisdiction of the Ministry for Development, Investment and International Co-operation.

Improving the performance of the Radès port is essential in the short term in order to shorten dwell times for merchandise in the port and to improve the competitiveness of the

Tunisian economy and attract investors. This will require boosting the capacity devoted to containers and speeding their handling pace. Construction of a new container terminal at Radès could be considered, and the feasibility of using a public-private partnership for making sustainable improvements to the port's performance could be evaluated. The construction of heavy and costly infrastructure for a deep-water port (Enfidha) must be considered a longer-term project.

Establishing a pricing structure favourable to sound management of infrastructure

The prices of many public infrastructure services are deliberately kept low in order to guarantee access to all Tunisians. Keeping prices low, however, encourages waste and reduces incentives for businesses to maintain their infrastructure property. Enterprises in charge of infrastructure management, often public, are moreover faced with high production costs. In fact, public enterprises have often been obliged to create jobs in order to prevent unemployment and poverty from rising too sharply. Thus, employment in most public enterprises has jumped since 2010 (sometimes more than 50%), and wages have gone up by more than 45%. By way of example, the company responsible for managing the superhighways network doubled its staffing complement in 2011, and its payroll increased by a factor of more than three between 2010 and 2016.

The operating deficits of public enterprises have deepened since 2011. The National Water Company of Tunisia (SONEDE) is a case in point. With sharply rising costs combined with water rates and charges that have remained low, its profitability has collapsed, and has been negative since the beginning of the century (OECD, 2014). As well, the STAM, the public enterprise responsible for freight handling and stevedoring services at the main port (Radès), is overstaffed and its productivity fell from 15 to 7 containers per hour between 2010 and 2015. At the same time, its rates have been kept low in order to make Tunisia's ports more attractive, and they offer no margin for upgrading or even maintaining existing infrastructure and equipment (OECD, 2015a).

The pricing policy for public services needs to be redefined on a cost recovery basis, in order to avoid the chronic public enterprise deficits that burden the government budget and affect the financial sector. This would make it possible to boost incentives for the proper management of existing infrastructure and to promote investment in the sectors concerned, as well as preventing wastage and protecting the environment (Box 1.3).

Box 1.3. **Enhancing water security in Tunisia**

Water supply is a critical issue in all countries of the MENA region, although Tunisia is perhaps better placed than the majority of other countries. In Tunisia, unsustainable liftings of underground and surface water represent a fifth of total liftings, and economic losses due to shortcomings in sanitation and water supply services amount to 1% of GDP (World Bank, 2017). The use of underground water is lowering the water table and is increasing water supply costs and pollution risks, especially in coastal areas that are exposed to infiltration by seawater.

The rising risk of hydric stress has been recognised now for several years (ITES, 2009 and 2011). To increase supply and adjust demand, it has been proposed that dams should be improved and water-intensive crops and industries avoided. Until recently, raising the price of water was not seen as a politically viable option. Resource depletion and water cuts, however, seem inevitable if consumption does not adapt.

Box 1.3. **Enhancing water security in Tunisia** *(cont.)*

To protect the environment without affecting the disadvantaged population, the government could gradually increase the price of water while guaranteeing a certain level of consumption at lower cost for all Tunisians – in other words, it could adopt a "social price" for water – similar to the approach recently taken for electricity.

Facilitating private sector participation in the financing and management of infrastructure

The private sector should be encouraged to participate, either directly or in the form of public-private partnerships (PPP), in order to improve economic and social infrastructure without exacerbating the pressure on the public finances. In some areas, the private sector can play a complementary role to public investment. Indeed, in certain cases it has been shown to be more effective. Thus, the performance at Tunisian ports where the private sector is involved in freight handling (Sfax and Sousse) is better than that in ports where the State-owned enterprise is the sole operator.

Increasing private sector participation in the financing and management of infrastructure will require constructing an evaluation framework, stipulating criteria for choosing between PPP and conventional modes of financing and operation, and introducing an appropriate legal environment. The new law on PPPs, adopted in 2015 with application decrees published in 2016, constitutes an important step in implementing the legislative and institutional framework for PPPs (OECD, 2016). The government has announced that it intends to launch a PPP programme worth a total of 5.2 billion dinars (around 5.4% of 2017 GDP) between 2018 and 2020, to be focused on sanitation, waste management, water desalinisation and renewable energies. The list had not been published in January 2018, however. Experience in other countries suggests that it would be well advisable to assess the relevance of this law as well as its impact in terms of projects implemented or aborted impact and budgetary risks of PPP projects over the medium and long term.

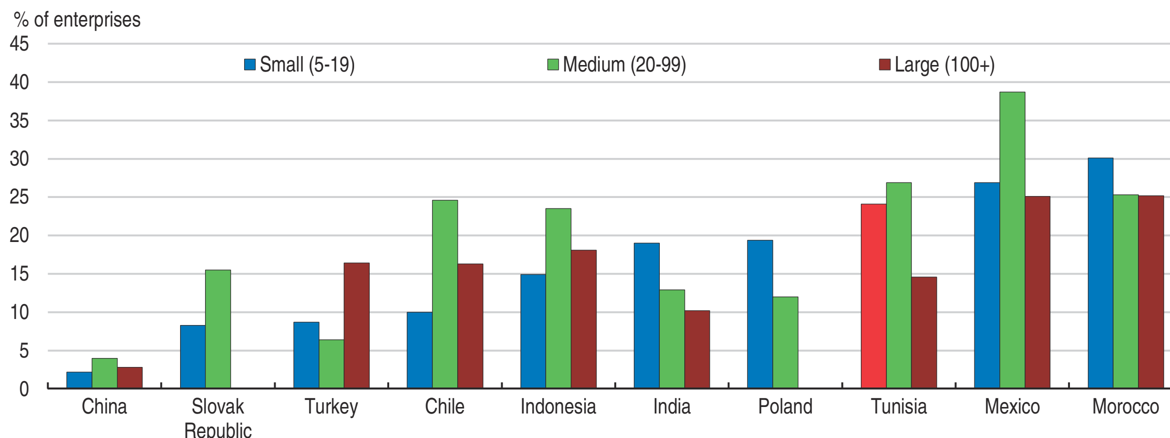
Other measures will be needed to encourage the private sector to contribute to infrastructure. For example, the government objective of raising the share of renewable energy from 12% to 30% of power production in 2030 is ambitious but achievable with private sector participation. Yet increasing private sector investment in the renewable energy sector will require simplifying approval procedures for PPP projects and contracts, introducing greater freedom for choosing the capacity to be installed, adopting an appropriate pricing structure, and having access to proven expertise in preparing, negotiating and managing PPP projects

Removing constraints on the financing of investment

Access to financing is one of the main obstacles identified by Tunisian businesses, according to the World Economic Forum (WEF, 2017). The last business survey by the World Bank (2014) showed that more than a third of Tunisian firms perceive access to financing as a major or a very severe obstacle. It is the mid-sized enterprises (between 20 and 100 employees) that are most likely to complain of this difficulty (World Bank, 2014b).

Self-financing plays an important role for small and medium-sized enterprises. It is often shown however to be ineffective for sustaining their long-term development (ITCEQ, 2012) and it puts them at a disadvantage vis-à-vis offshore firms (which are for the most

Figure 1.19. **Financing constraints by size of enterprises**



Source: World Bank Enterprise Survey.

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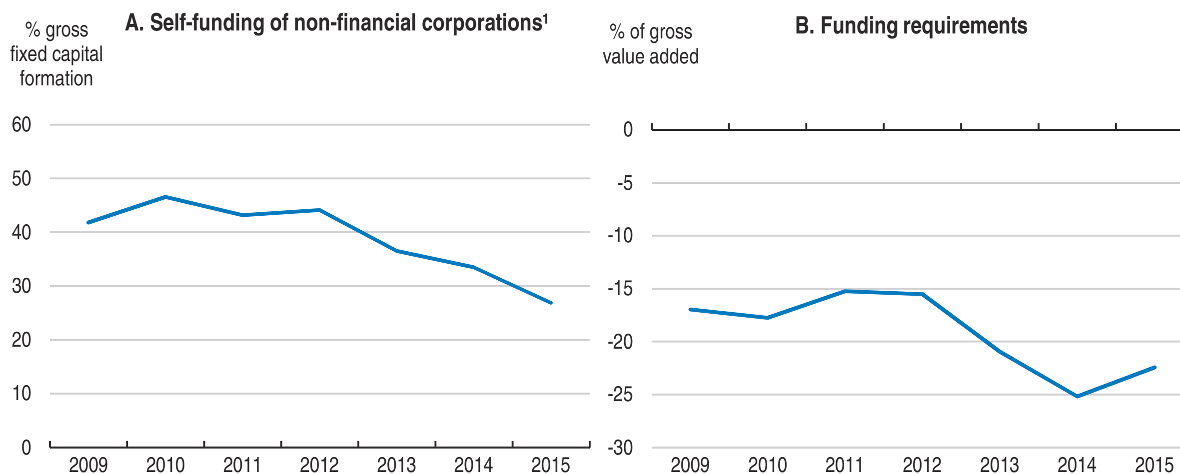
part financed by their group) and to a lesser extent public enterprises (which enjoy a State guarantee). The capacity of firms to finance themselves has however been compromised by shrinking profit margins, rising wages, and higher social contributions (Figure 1.20.A). Under these conditions, firms have seen their financing needs rise sharply (Figure 1.20.B), and they are turning increasingly to the banks.

Figure 1.20. **Self-financing plays an important but declining role**



1. The self-financing rate is defined as the ratio of a company's gross savings to gross fixed capital formation.

Source: National Accounts, National Statistics Institute (2016).

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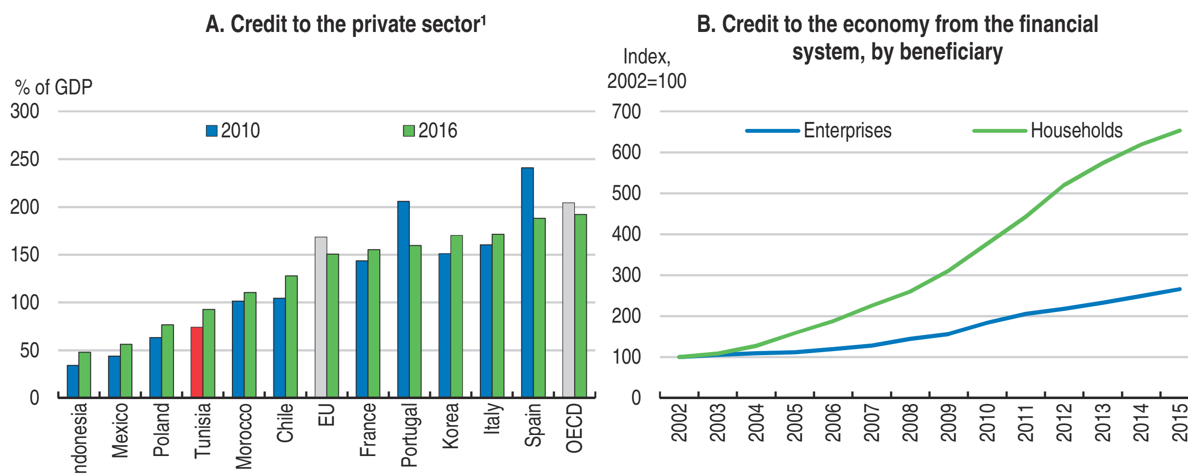
Resolving the shortcomings in banking intermediation

The banks account for more than 90% of intermediated financing, while insurance companies and micro-credit institutions still play only a marginal role. The number of banks (24) is relatively high, given the size of the country. They are often small, and their profitability is weak. Moreover, they have trouble in channelling resources to private firms.

Although it has increased, the share of bank credit in GDP is still low, and lending to households has been rising faster than that to businesses (Figure 1.21).

Figure 1.21. **Bank lending remains weak and the recent increase has gone mainly to households**



1. The lending rate is equal to domestic credit granted by the financial system as a percentage of GDP.
Source: Central Bank of Tunisia; World Bank, World Development Indicators (WDI).

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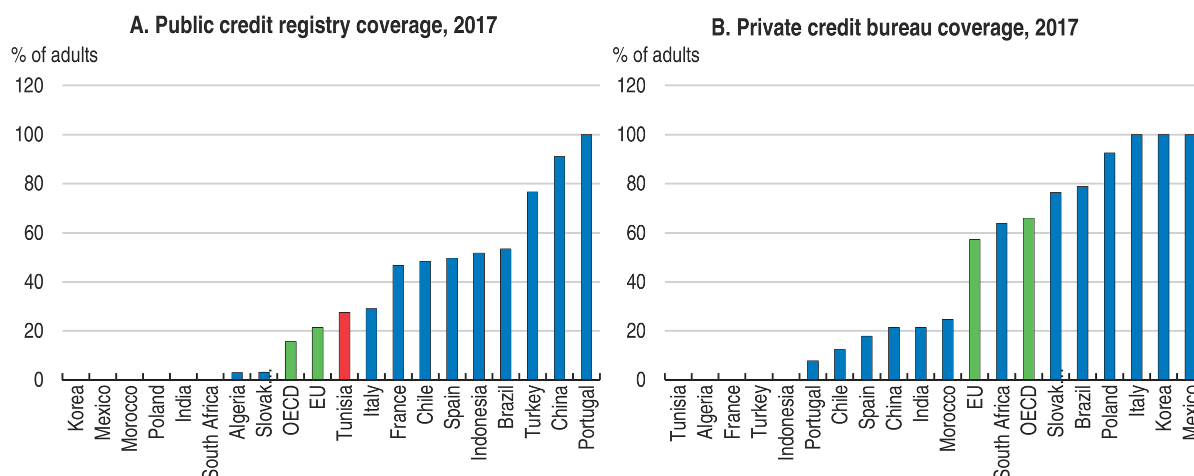
The inadequacy of risk assessment and management tools makes the banks extremely cautious. There is little information systems available about borrowers' creditworthiness, owing largely to a lack of private credit bureaux are underdeveloped (Figure 1.22); a bill to allow the creation of such bureaux was tabled at the Assembly of the Representatives of the People in February 2017. This limits limiting the banks' possibility to remedy the asymmetry of information. A study conducted by the ITCEQ in 2017 shows that 84% of banks recognise this problem as the main reason behind their excessive reliance on collateral. Some banks, moreover, especially the smallest, do not have sufficient expertise to evaluate the risks associated with investment projects (World Bank, 2014a).

Figure 1.22. **Credit information systems are rudimentary**



Source: World Bank, Doing Business 2017.

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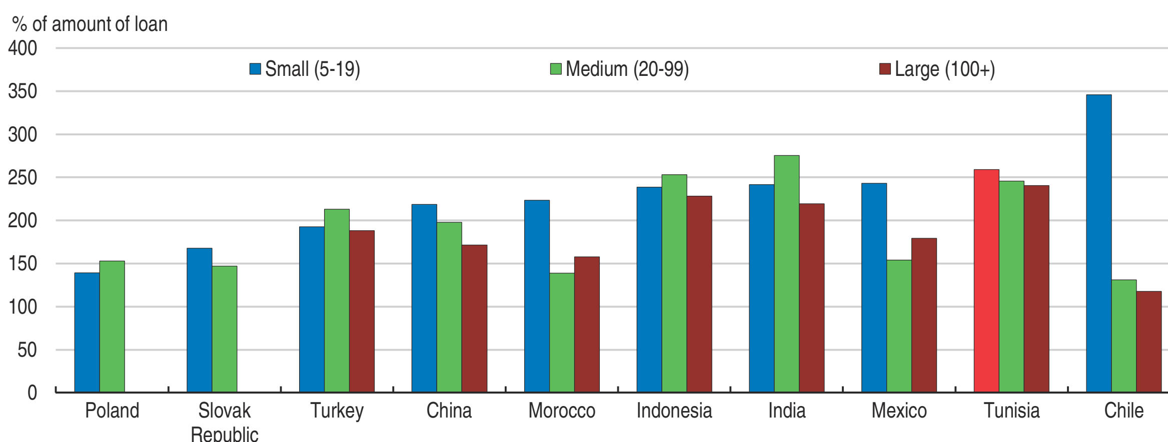
A new bankruptcy law has been adopted but not yet applied. Thus, many unprofitable firms continue to operate without restructuring or repaying their debts. Between 1995 and 2015, 2 767 firms were involved in bankruptcy proceedings; 1 084 reached an amicable settlement, and 1 437 were subjected to judicial settlement. Among the latter, more than 600 firms are still operating (according to figures from the General Directorate of assistance to businesses in the Ministry of Industry), or nearly 1% of all private firms entered in the national business registry. By immobilising loanable funds in these enterprises, the inefficiency of bankruptcy procedures reduces financing for innovative companies (Adalet McGowan et al., 2017). For the banks, this also translates into significant volumes of bad loans. To cover themselves, the banks demand excessive collateral, thereby excluding firms that are otherwise viable but cannot post sufficient guarantees.

Figure 1.23. **Banks ask for significant collateral**

Average value of collateral demanded for a loan



Source: World Bank Enterprise Survey.

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The capping of interest rates impedes risk pricing. The difficulty in modulating interest rates as the maturity of loans increases encourages the banks to favour short-term lending, which is ill-suited to the financing of investment. They also tend to favour borrowers who can limit their risk by offering high levels of collateral, to the detriment of start-ups and innovative enterprises.

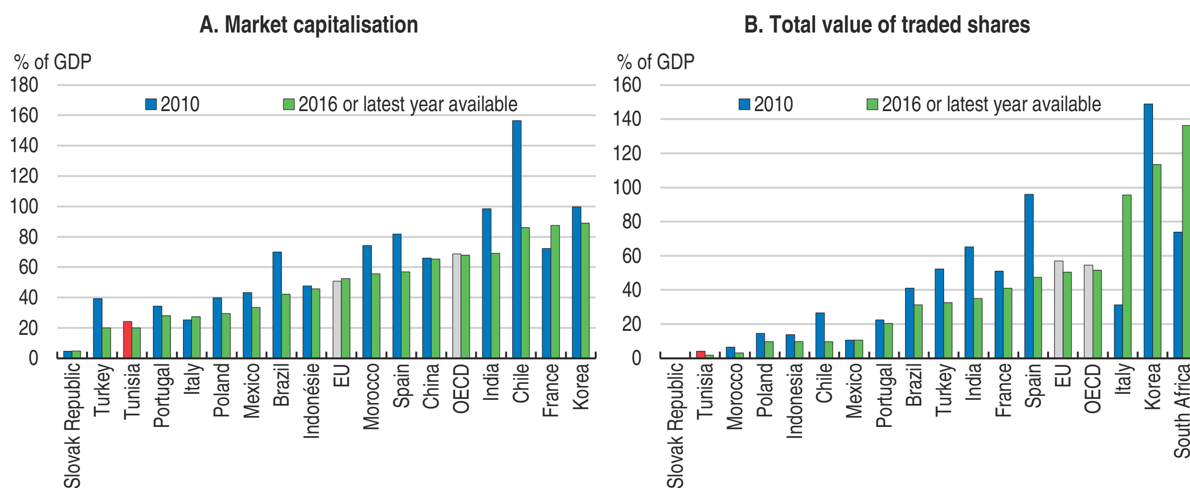
The reforms undertaken should be implemented promptly in order to improve bank financing for enterprises. Application of the new Bankruptcy Law ("law on collective procedures"), adopted by Parliament in 2016, would serve to modernise, simplify and speed the process of amicable settlement or judicial restructuring of viable firms, and the liquidation of those that are insolvent. It would increase loan recovery rates, which are still fairly low. A better distinction between corporate and personal bankruptcy would overcome business people's reluctance to declare suspension of payments at an earlier stage. Moreover, a draft law on credit bureaus has been submitted to parliament. It is important that the final version of that law should make it possible to collect and communicate positive information (amount of loans outstanding, repayment plans etc.) as well as negative information (late payments, number of payment defaults, etc.).

It would be advisable to consolidate the provisions for the financing of small enterprises. Today, there are already three public entities – the BFPME for loans of 100 000 to 5 million dinars, the DTS for loans of less than 100 000 dinars, and the guarantee fund, SOTUGAR. To avoid the duplication of structures, the plan to create the Bank of the Regions, which is supposed to improve access to financing for small enterprises in the hinterland, should be reconsidered in light of the fragmentation of the banking sector, and the institutions already existing in this niche.

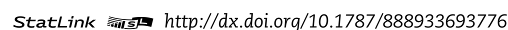
Revitalising the financial market

The Tunisian financial market contributes little to the financing of the economy. Despite the adoption of the Mutual Funds code ("code of collective investment agencies"), the dematerialisation of securities and the introduction of stock savings accounts at the beginning of this century, stock market capitalisation remains low, the market is illiquid, and its instruments are relatively unsophisticated (Figure 1.24). The number of companies listed (81 in 2017) is still modest. It is dominated by the banking sector, which accounts for more than 50% of market capitalisation (BVMY, 2017). The public nature of some large enterprises in the real sectors of the economy, and the family-dominated dimension of Tunisian capitalism, have much to do with this situation. The alternative market was created in 2007 to ease the move of small and medium-sized enterprises (SMEs) into the main market. Its success to date has been limited: fewer than a dozen companies are quoted, and only one has been transferred to the main market.

Figure 1.24. **Stock market performance**



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



Restrictions on foreign participation in the capital of listed companies practising activities subject to regulations that restrict foreign ownership make the Tunis market relatively unattractive to foreign portfolio investors. In 2016, foreign investments represented 24.5% of stock market capitalisation (BVMT, 2017) compared to 32.9% for the Casablanca Stock Exchange and 49.6% for that of Amman (Moroccan Capital Markets Authority AMMC/ Amman Stock Exchange ASE, 2017). The investment law will reduce administrative and regulatory restrictions that burden foreign investors. This measure is consistent with the OECD Declaration on International Investment and Multinational Enterprises, to which

Tunisia adhered in May 2012 (OECD, 2012). It will help put foreign savings to better use and to achieve the goal of doubling the stock market capitalisation held by foreigners by 2020. Moreover, further efforts at openness and cooperation with international markets (following the NASDAQ example) will help to make the market more dynamic and attractive for foreign investors.

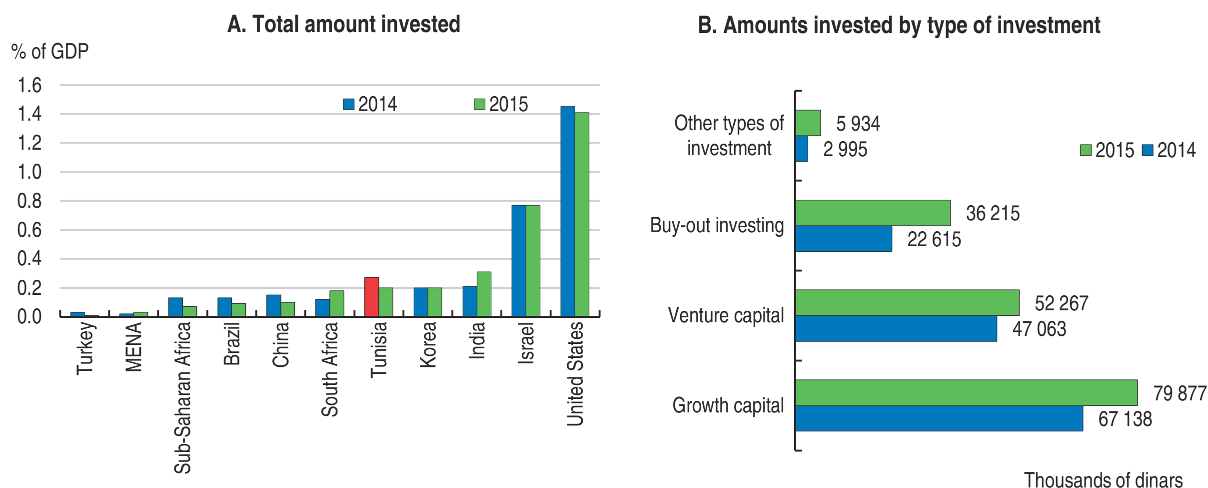
Expanding the supply of securities would seem crucial for development of the financial market. Stock market flotations of certain confiscated enterprises and public enterprises in key industrial sectors could be a first step in this direction, in anticipation of longer-term options for expanding the base of potential candidates.

The bond market is heavily dominated by government issuances, which account for 80% of the market. The volume of this market amounts to 16% of GDP, well below that of most other emerging countries. Corporate bonds are issued primarily by the banks and leasing companies, whereas non-financial companies are virtually absent from the market. The lengthy issuance process constitutes an obstacle to development of the bond market. The establishment of a yield curve for sovereign bonds, which should be published as of January 2018, will offer a benchmark value for the corporate bond market and should encourage long-term investment.

Developing investment capital

Investment capital or private equity can meet the medium and long-term need for financing and can leverage SMEs' own funds in support of their balanced growth. Although the degree of penetration of investment capital in Tunisia is well above the average for the MENA region, it is still low (Figure 1.25). According to the Tunisian Association of Capital Investors (ATIC), there are currently 32 venture capital companies (Sociétés d'Investissement à Capital Risque, SICARs), half of which are owned by the banks, and 8 venture capital mutual funds (Fonds Commun de Placement à Risque, FCPR). In 2015, the volume of investment stood at 174 million dinars, providing financing to 170 enterprises (Deloitte, 2016). Investment in SMEs occupies only a secondary position, with 12 investment operations, and a quarter of the total volume of investment. The industrial sector has received more than

Figure 1.25. **Investment capital is scarce and supports few new enterprises**



Source: EVCA-AVCA-MENA Private Equity Association-AMIC (2015); Statistical reports on investment capital activity in Tunisia, Deloitte (2016).

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80% of investments, with more than three-quarters of these investments are concentrated in the coastal regions. Private equity is the most widespread type of investment in Tunisia, with 46% of the total. This shows a preference on the part of investors for financing high-potential enterprises that have already reached maturity, rather than new start-ups or those in the process of creation.

Disinvestment has risen nearly 55% over its level in 2014, and exits from the stock market have represented nearly 20% of the total volume of disinvestment (Deloitte, 2016). This proves the importance of capital investors for the development of the stock market. By playing a role in the development of companies' governance and financial management structures, these investors can help create a group of entrepreneurs and managers with the capacities and the mentality needed to run companies quoted on the market.

To speed the development of investment capital, it would be advisable to lift regulatory constraints, especially the proliferation of laws and regulations, and to simplify procedures for constituting and winding up SICARs. The reforms planned by the authorities, especially the new code on mutual funds, go in the right direction. By combining and simplifying the various texts governing capital investment activity, the new code seeks to encourage this activity and expand its field of action. By creating new categories of funds such as specialised investment funds, co-investment funds, umbrella funds, and offshore funds, the authorities are hoping to mobilise savings, including foreign savings, to revitalise investment in the country and diversify its sources.

Box 1.4. **Summary of recommendations for reviving investment**

Main recommendations

- Speed up the process for reducing the number of permissions to operate, and administrative authorisations, licences and permits.
- Further reduce restrictions on the presence of foreign executives.
- Simplify administrative and customs procedures for goods entering and exiting the country.
- Improve the management of port infrastructures, potentially through public-private partnerships.
- Improve the governance of public enterprises, by better enforcing performance contracts and with a level playing field for public and private companies.
- Allow banks to set risk premiums by reconsidering the ceiling on lending rates.
- Speed up the adoption and application of the new code for collective investment funds.

Other recommendations

Improve the efficiency of public measures in favour of housing

- Speed procedures for preparing and applying urban development and subdivision plans at the local level.
- Strengthen the management capacity of local governments for organising urban development on their territory.
- Eliminate obstacles to the proper functioning of the real estate market in order to expand the supply of serviced lots by putting in place a capacity to mobilise and constitute land reserves.

Box 1.4. **Summary of recommendations for reviving investment** *(cont.)*

Improve the business climate

- Evaluate systematically the fiscal cost and the impact on investment, job creation and regional inequalities of financial and tax incentives contained in the new law and amend or eliminate provisions that produce a low economic return and unsatisfactory social impacts.
- Evaluate the performance of the institutional framework for applying the investment law, on the basis of periodic surveys of existing and potential foreign investors, and simplify that framework if necessary.
- Reconsider price controls and other restraints on competition.
- Make the tax system more predictable by applying the tax reform programme approved by preceding governments, giving sufficient advance notice of changes to tax rules and avoiding unanticipated and retroactive adjustments.
- Improve the performance of the tax administration by strengthening coordination between the Taxation Division and the Tax Control Division.

Improve the quality of infrastructure

- Give priority to upgrading and maintaining existing infrastructure and equipment.
- Improve performance at the main port, Radès, by stepping up the pace of cargo passage, constructing a new container terminal, and turning management of that terminal over to the most efficient operator.
- Select future public investments on the basis of their economic and social performance in a single framework that is consistent with the National Development Plan.
- Redefine the pricing policy for public infrastructure in order to ensure cost recovery.
- Simplify procedures for the approval of renewable energy projects.
- Facilitate private sector participation, directly or through PPPs, in the development and management of infrastructure, specifying the criteria for choosing between PPP and the traditional mode of financing and management.

Remove restrictions on investment financing

- Ensure prompt application of the bankruptcy law (*Loi sur les procédures collectives*).
- Speed the adoption of the law governing credit bureaus.
- Expand the range of financial instruments available to promote the development of investment capital.

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