Republic of Tunisia
Development Policy Review
Making Deeper Trade Integration Work for Growth And Jobs

October 2004

Social and Economic Development Group
Middle East and North Africa Region
FISCAL YEAR 2004
July 1 – June 30

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Helpful comments were also received by Hamid Alavi, Najib Benhassen, Elisabetta Capamaroli, Naderch Chamou, Xavier Ferrer, Cecile Ferran, Fared Housan, and Carmen Niederhauser.

Valuable support from the counterpart team in the Ministry of Development and International Cooperation in Tunisia is gratefully acknowledged. The team also benefited from discussions with the Central Bank of Tunisia, the Direction du Trésor and Direction du Budget of the Ministry of Finance, the Securities Commission, and other administrations and market participants.
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Executive Summary

Thanks to a steady pace of structural reforms and sound macroeconomic management, Tunisia experienced fast and sustained growth. GDP grew by 5.2 per cent during the Ninth Development Plan (1997-2001), outpacing MENA and middle-income countries’ average. In 2002 growth slowed to 1.7 percent, due to a drop in tourism and manufactured exports and severe drought for a third year in a row, but non-agricultural GDP was resilient, growing by 3.5 percent. Thanks to a strong agricultural recovery, GDP grew by 5.6 percent in 2003.

Forward-looking policies helped preserve external and internal balances, but challenges remain in the context of a volatile external environment. In 2000-2003 inflation fell to 2.4 percent on average, while the external current account deficit was maintained at 3.8 percent of GDP despite a difficult external environment. Fiscal consolidation has progressed, but a primary budget deficit still persists, preventing a rapid reduction of public debt, which hovers at around 60 percent of GDP. Tunisia has improved its access to international financial markets, but foreign debt remains high compared to countries with a similar sovereign rating, especially in view of Tunisia’s high exposure to external shocks.

High and pro-poor growth contributed to a sharp reduction in poverty in the second half of the 1990s. The core poor made up only 4 percent of the population in 2000, down from about 8 percent in 1995, with a similar reduction in the share of poor and economically vulnerable. 74 percent of the poor live in rural areas. Tunisia has also made important headway on non-monetary aspects of poverty. However, a fairly high proportion of people remain clustered above, but close to, the poverty lines, so that Tunisia’s strong anti-poverty outcomes remain vulnerable to economic volatility.

But despite strong growth, unemployment remains high, at around 15 percent, partly reflecting demographic pressures, and partly the decrease in the employment intensity of growth. Nonagricultural employment grew by 2.6 percent in 1994-2001, down from a healthy 4.4 percent in 1989-94, and agricultural employment grew more slowly. The lower employment intensity of growth reflects faster labor productivity growth, which supports competitiveness and real incomes growth, but also the impact of distortions in the labor market, especially rigid employment termination procedures.

Reducing unemployment would call for a significant acceleration of growth, spurred by much higher private investment. Tunisia cannot afford to increase employment at the expense of productivity growth, because improving competitiveness is a prerequisite to meet the challenge of intense global competition. And in the years ahead, the need to maintain a sound fiscal framework will limit the potential for job creation in the public sector, and for higher public investment to stimulate growth. Bolstering private investment and the creation of small and medium enterprises is thus the key for stepped up job creation. On current trends in labor force growth and participation rate, reducing unemployment by about 3 percentage points in 5 years would call for growth of about 6.5 percent per year. All else equal, this would require a much stronger private investment effort, an increase of about 7 percentage points of GDP.

But compared to other high-growth countries, Tunisia suffers from a structural private investment gap. Tunisia’s growth has relied more on public investment, and less on private investment and human capital accumulation. Despite solid macroeconomic fundamentals, private investment remains compressed below potential, at around 14 percent of GDP. One reason is the limited openness of services markets and network industries, in particular ICT and transport, to private investment. Still another reason is heightened business uncertainty, reflecting the surrounding risks in Tunisia’s changing economic environment—stiffer competition in the free-trade zone with the EU; removal of MFA quotas; and structural weaknesses in tourism. These factors do not perhaps explain the large private investment gap in Tunisia.
Indeed, weaknesses in economic governance, in particular regarding the predictability and transparency of the regulatory framework, and market contestability, may be an important constraint to private investment. Strong government interference in the economy and the strategy of providing generous privileges for exporting and investing in selected economic activities has supported Tunisia's development in a context of limited trade integration. But existing incentives systems run the risk of locking the country's specializations into threatened activities, which may leave Tunisia ill-positioned in the face of stiffer international competition. Regulatory uncertainty, limited market contestability, and high discretionary intervention undermine the investment climate and run the risk of discouraging risk-taking by less connected entrepreneurs. Reflecting business uncertainties, private investment has been losing momentum since the mid-1990s, with little help from the generous incentive system in place. A more open dialogue with the private sector and a deeper understanding of factors affecting the investment climate in Tunisia would help appropriately target the policy initiatives aimed at stimulating private investment.

Tunisia faces a turning point where, unless coordinated efforts to improve the quality of economic governance and stimulate private investment are placed at the core of the reform agenda, the deeper engagement with the world may not fulfill its development promise. Deeper integration into global markets has the potential to stimulate growth, but will raise important challenges, due to surrounding risks and the weakness of private investment. Over the medium term, real GDP could keep growing within a baseline range of 4.5-5.5 percent per year, at about the same pace as during the Ninth Development Plan (1997-2001). But this growth would not be sufficient to reduce unemployment, which would even increase with no further employment growth in the public sector and in agriculture. Public debt would be sustainable, but would fail to decline significantly in proportion to GDP, while the debt ratio would increase in case of shocks.

Companion policies will be needed to make Tunisia's deeper trade integration work for growth and jobs. Strengthening policies in some key areas would help meet Tunisia's development challenge.

- **Strengthening the investment climate, by improving economic governance:** lowering transactions costs, enhancing transparency and predictability of the regulatory framework, and strengthening market contestability are main issues in the reform agenda.

- **Improving the functioning of the labor market**, by reducing protection within the firm, increasing protection of vulnerable workers outside the firm, and enhancing the efficiency of labor market policies.

- **Strengthening the soundness of the banking system and fostering the development of securities markets**, to improve the diversification of sources of finance, ensure good access to finance for private investment, and ensure the resilience of the economy to financial risks.

- **Securing a robust medium-term fiscal framework**, by stepping up fiscal consolidation, through better fiscal revenue mobilization and increased public expenditure efficiency—to reduce medium-term pressures on the budget and improve the capacity to deal with a potentially hostile external environment.

- **Enhancing the efficiency of education policies**, by improving the quality and links of the education system with the labor market, while promoting an education and training system that facilitate the emergence of the knowledge-based economy.

- **Strengthening the effectiveness and sustainability of social sector policies**, by improving the quality and containing the costs of health care services; strengthening the cost-effectiveness of social protection; and securing the sustainability of the pension system.
Lowering transactions costs for business entry, operation, and exit. Business registration is fast and efficient, and small commercial contracts are rapidly enforced. However, the minimum capital requirement is still high, and delays in securing finance, land and construction permits still persist. Closing a business is difficult due to lengthy bankruptcy process and insufficient protection of creditors' rights in the insolvency process. Despite substantial progress on trade facilitation reforms, procedural complexities and inconsistencies in customs clearance procedures remain, substantially burdening the on-shore enterprises.

Enhancing transparency and predictability of the regulatory framework. The investment incentive regime grants very generous tax advantages, especially to exporting firms. However, the impact of the current incentive regime on job creation and private investment has been rather limited. And it has entailed sizeable fiscal costs and administrative complexity. Balancing taxation in favor of on-shore firms would provide incentives for investment and job creation. Restrictions still apply on majority capital ownership by foreign investors in key services sectors, while the process of prior approvals is lengthy, uncertain, and lacks transparency, and does not contribute to strengthening the investment climate.

Enhancing market contestability: by reducing barriers to entry in key infrastructure services—The scope for increased competition is greatest in ICT and transport services. Tunisia still lags behind in key ICT sector development indicators and international communications holds high costs. Competition in the water, sanitation and electricity sectors could also be tested, within a regulatory system allowing to benchmark the performance of the public operator against a private operator. Estimations suggest that making more room for private sector investment in services would increase GDP by roughly 5 percent.

—and by strengthening competition policy. Tunisia has made considerable progress on the legal front of competition policy. But anticompetitive practices remain, while the Competition Council is weak and lacks resources. Strengthening the role of the Competition Council and ensuring coordination of the regulatory functions across sectors remains a key challenge. The regulatory fragmentation and the lack of separation between the incumbent operator and most of the agencies in the telecommunications sector should also be tackled, because they may impede a more dynamic development of the sector.

Furthering Tunisia’s international trade integration. High MFN tariff differentials to preferential tariffs on EU imports may be at the origin of trade diversion, denying the Tunisian producers and consumers the benefit of less expensive imports from outside the free-trade zone with the EU. Targeting tariff reductions that bring Tunisia’s MFN tariffs as close as possible to the EU’s external tariffs for industrial products would help Tunisia reap the full benefits of trade liberalization.

Enhancing the flexibility of the labor market. Although the use of temporary help agency workers is still not allowed, labor regulation reforms have introduced flexibility in hiring. Employment termination, however, remains rigid and too protective. Thus, Tunisian private enterprises find it difficult to restructure, and small firms often find solutions outside the legal framework. Tunisia would benefit from more effective protection outside the firm, through well-designed social safety nets, and lower employment protection within the firm.

The Tunisian banking sector has better room for dynamic growth, thanks to gradually reduced government ownership, but suffers from high non performing loans. Commercial banks have become increasingly exposed to sectors vulnerable to a cyclical downturn, and despite satisfactory profitability and capital adequacy ratios, non performing loans remain large, at 22 percent of their total assets in 2002. The level of provisioning of NPLs remains low, at 44 percent in 2002, owing to heavy reliance on real estate collateral—even though the liquidity of real estate collateral is limited.
Strengthening the banks’ balance sheets on a sustained basis would stem financial risks, and hold major benefits for the international image of Tunisian finance. Large, under provisioned NPLs increase the cost of bank intermediation, and deprive Tunisia from an even better access to international capital markets. Real estate guarantees also pose financial risks to the banking system because they are illiquid and possibly overpriced—in view of the questionable viability of some loss-making borrowers, especially in the tourism sector. To effectively strengthen the banking system, banks should be encouraged to increase provisioning, especially of old delinquent loans. This would also create appropriate incentives for the banks to recover the collateral.

Despite modernization and adequate regulatory framework, issuance in the primary market for government securities remains limited, while the secondary market remains fairly inactive. Dependable and easy access of banks to liquidity, provided by the Central bank at a predictable rate, hinder the development of an active interbank market, a prerequisite for the development of a bond market. Better transparency and predictability of Treasury issuance would strengthen investor confidence, and help reduce the cost of borrowing in the medium term. Improving the transparency of the “parallel” secondary market for intra-group transactions, would promote the development of the secondary market. Partial opening of domestic debt issuance to foreign investors could also be envisaged, but would call for careful planning to secure the liquidity of the secondary domestic debt market.

Revitalizing private securities markets would call for simultaneous action on various fronts. Reducing the high cost of transparency faced by listed companies—by strictly enforcing the disclosure requirements of unlisted companies that obtain large amounts of bank finance—would lower the reluctance of many private groups to list on the stock exchange. The supply of suitable securities could be increased by a more ambitious privatization program. Reinforcing mandatory corporate financial disclosure and auditing procedures would strengthen investor confidence. Differentiating the tax treatment of savings in favor of investments with longer holding periods would help address the shortage of long-term savings. Appropriate income tax and social security charge treatment of group life insurance contracts; development of distribution of life insurance by the banking sector; and promoting a capitalization pillar for retirement benefits, would provide support to long-term contractual savings.

Improve SME’s access to finance. In recent years, the range of financial facilities available to SMEs has broadened, but the practice of over-collateralization remains and the cost of SME finance is still high by international standards. Improving financial information on the quality of borrowers, by reforming the design of the public credit registry, and promoting appropriately regulated private credit registries, would help ease over-collateralization. Strengthening the protection of creditors’ rights in bankruptcy would contribute to improving SMEs access to credit.

Efforts for reforming the tax system should focus on enhancing revenue mobilization, redistributing the tax burden, and improving tax neutrality. Overall, the Tunisian tax burden is not very high by international comparison, but its distribution appears to be uneven, both between labor and capital income and across taxpayers. Serious non neutralities exist in the taxation of corporate income and in indirect taxation that undermine the fairness of the tax system; narrow the tax bases; create complexities that increase the cost of tax administration; weaken incentives for tax compliance. Reducing the number of tax exemptions and preferential tax regimes—especially for off-shore businesses and the VAT—and reforming the “forfaitaire” system for the self employed and small businesses would broaden the tax bases and improve the fairness and efficiency of the tax system.

Policy priorities were generally matched in the budget, but the strategy of public expenditures allocations could be further improved, while large non discretionary spending limits budget flexibility. Budget allocation decisions will become more complex in the future, reflecting the need for greater budget flexibility and pressures on social spending. Main issues that will require attention include:
• Spending on wages and salaries is high and steadily rising, hindering the flexibility of the budget;
• Spending on non-wage goods and services is low, suggesting distorted proportions between spending on wages vs. equipment;
• Social transfers are lower than in countries at similar level of development, but they are set to increase in the years ahead due to an ageing population and greater social risks posed by deeper international integration;
• Capital spending is high and rising, warranting efficiency concerns.

Tunisia is well positioned to make further progress in the reform of budgetary processes. Public spending systems, control of public funds, and the accountability arrangements for their use, are already quite strong, boding well for maintaining global fiscal discipline. But implementation of performance-based budgeting reforms, envisioned by the Government, would call for a more supporting institutional environment, in terms of the quality of budget formulation and execution. Two, closely related directions of reform would help achieve these objectives:
• Greater comprehensiveness of the budget will provide a common platform to compare different policy commitments, including those existing beyond the budget;
• A rolling Medium-term Expenditure Framework would be a key underpinning of performance-based budgeting; would help strengthen the overall fiscal framework; and provide the necessary foundation for active public debt management.

The debt management practices are strong, but will benefit from greater centralization and functional focus. The debt management function is strong but fragmented, and does not support an integrated view of public debt portfolio, a necessary condition for active risk management. Options for reform include consolidation of the debt management function and more operational flexibility of debt management units, within a sustainable medium-term debt strategy, relying upon clearly defined quantitative benchmarks.

Facilitating the emergence of the knowledge-based economy would help create more and better jobs for Tunisia’s increasingly educated labor force. Tunisia appears relatively well positioned in the emergence of the knowledge-based economy among MENA countries, but it is in a less favorable position than direct competitors in other developing regions. Particularly problematic are the insufficient development of the ICT infrastructure, while in other key areas institutions and the regulatory framework have yet to be strengthened to support entrepreneurial capabilities. Stronger integration of Tunisian women in the economy would help foster the emergence of the knowledge-based economy, as women increasingly make up a large proportion of university degree holders, yet they are still disadvantaged when it comes to labor market opportunities.

Education is one of the principal pillars of Tunisia’s strategy for development, as it aims to build the kind of human capital necessary to compete in the global knowledge-based economy. Main challenges in the years ahead include:
• Improving quality and reducing selectivity, to ease geographical disparities, improve the distribution of resources, and promote good quality private secondary education. Greater participation of the civil society in education establishments would support improved quality and help build better links with the labor market.
• Improving internal efficiency, by reducing the number of non-teaching staff and personnel in primary and lower basic education, where student population is set to decline, and using the savings to increase spending on pedagogical inputs and expand staff in secondary school.
Defining the new roles of secondary and higher education, to diversify the post-basic education curriculum and strengthen links to pre-employment vocational training, while reinforcing short and technical tracks in higher education.

Diversifying specialties fields and increasing flexibilities, to adapt education to the needs of the market—by establishing structural links between education establishments and the labor market; improving flexibility in qualification of teachers; encouraging diversity in the orientation of girls in the secondary and higher education system.

Introducing partial cost recovery in higher education and promoting private sector involvement, to release scarce public resources that now subsidize the better-off and that could be reallocated to benefit the poor.

While the health sector shows superior performance, challenges remain to ensure sustainability and cost effectiveness of service delivery.

Improving financial risk protection. In spite of virtually universal coverage of the population, the private out-of-pocket health expenditures have approached 50 percent of all health expenditures, while the economic burden of health expenditures on the poor is substantial.

Containing costs. Health care costs have increased rapidly during the past decade. Due to the strong pressures created by an ageing population, systems reforms are needed to contain costs.

Implementing major organizational reforms. Organizational and provider payment reforms would encourage greater efficiency and improved quality of care. Regulation of private providers, the development of accreditation procedures, and the development of a capacity to regulate private health insurance markets, will be essential if the private sector is to perform in a socially desirable way in the future.

During the last two decades the government has developed a vast number of active labor market programs, but targeting could be improved. ALMP expenditures of about 1.5 percent of GDP are high by international comparison. Micro-credits and youth interventions represent the majority of total expenditures, but public work programs and labor market training for unemployed adults are limited. ALMPs would need to be streamlined and better targeted, while a comprehensive social protection scheme needs to be developed to protect those who will lose their jobs. Impediments for enterprises to undertake training for their workforce need to be addressed.

With rising proportion of old people in the population, both financial sustainability and coverage of the pension system would need to be improved. Parametric reforms within the existing framework are essential to improve the financial sustainability of the pension system, reduce fragmentation, and gradually increase coverage. To cope with the ageing pressures, more radical reforms would need to be considered: (i) alternative designs and transition mechanisms for the main pillars of the system; (ii) better governance of public pension funds and voluntary plans; (iii) eliminating constraints to the expansion of pension and long-term-savings products within life insurance companies; (iv) considering coverage expansion of current non-contributory schemes for the elderly poor (zero pillar).
### Tunisia—Development Policy Priorities and Key Reform Options

<table>
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<th>Policy priorities</th>
<th>Challenges and policy goals</th>
<th>Key policy options</th>
<th>in the short term (up to 18 months)</th>
<th>in the medium term</th>
</tr>
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</table>
| **Environment for private sector investment and competitiveness** | • Step up private investment  
• Promote the creation of SMEs  
• Promote faster job creation  
• Maintain fast productivity growth and improve competitiveness  
• Improve the quality and reduce the cost of backbone services  
• Promote high-skill sector growth | Improving economic governance by lowering transaction costs, enhancing transparency and predictability of the regulatory framework, and strengthening market contestability | • Accelerating opening up of infrastructure services to competition, especially in ICT services and transport  
• Reviewing minimum capital requirements for business entry  
• Improving efficiency and predictability of customs clearance rules and procedures  
• Ensuring nondiscriminatory treatment of investors in market access, by reducing restrictions to majority capital ownership by foreign investors and the cases where prior approvals are required  
• Strengthening the independence of the telecommunications regulator and reducing regulatory agency fragmentation in the ICT sector | • Implementing reform of the incentives system with the aim of leveling the playing field between off-shore and on-shore companies  
• Simplifying the regulatory framework for land and construction permits  
• Simplifying bankruptcy procedures and narrowing court powers by ensuring greater involvement of creditors and other stakeholders  
• Strengthening the autonomy of the Competition Council and ensuring the coordination of regulatory functions across sectors |

| **Labor market reform** | • Address bottlenecks to job creation  
• Improve flexibility and facilitate restructuring of domestic firms  
• Create adequate safety nets for those at risk of losing their jobs  
• Improve cost-effectiveness | • Eliminating current ban on temporary help agency work  
• Relaxing restrictions on the number of expatriate staff that can be hired by domestic companies  
• Streamlining active labor market policies to improve service delivery  
• Addressing impediments to in-service training, and step up implementation of vocational training reforms  
• Reviewing the costs and benefits of the vocational training tax | | • Accelerating the reduction of tariffs on imports outside of the EU  
• Completing domestic price adjustment and dismantling state import and trade monopolies in cereals, seed oils, petroleum products, tobacco, and alcohols | • Taking steps toward providing less employment protection within the firm and offering more effective protection outside the firm.  
• Better tailoring active labor market policies to the needs of workers at risk of losing their jobs  
• Encouraging development of private providers of training |
<table>
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<tr>
<th><strong>Financial sector reform</strong></th>
<th><strong>Management of the Public finance system</strong></th>
<th><strong>Introducing efficient social protection schemes (safety nets) outside of enterprises</strong></th>
</tr>
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| • Strengthen the soundness of the banking system  
• Diversify the sources of finance  
• Improve access to finance by SMIs  
• Promote the development of markets for domestic public debt  
• Revitalize private securities markets | • Improve the capacity of the budget to deal with volatility and external shocks  
• Accelerate reduction of public debt  
• Mobilize domestic savings for investment to preserve the external balance  
• Make room in the budget for future pressures on social spending | • Improving information on the quality of borrowers  
• Strengthening the protection of creditors’ rights in bankruptcy  
• Accelerating the privatization program of public utilities to increase the supply of suitable securities in the market  
• Overhauling regulation of venture capital companies (SICAR), and facilitate exit in partnership with foreign investors  
• Introducing well-target incentives in the tax treatment of savings in favor of investments with longer holding periods  
• Promoting adequate incentives for the development of life insurance  
• Taking appropriate steps to prepare for a well-regulated capitalization pillar for retirement benefits, in the context of a broader strategy for pension system reform |
| • Encouraging increased provisioning of non performing loans, to accelerate clean up of commercial banks’ balance sheets  
• Improving interest rate flexibility in the money market by adopting a monetary framework anchored on the control of base money  
• Improving the transparency of the secondary market for government securities  
• Taking early steps in the direction of strengthening corporate financial disclosure and auditing procedures  
• Strictly enforcing disclosure requirements for companies that obtain large amounts of bank finance | • Undertaking comprehensive examination of the tax system  
• Formulating a rolling medium-term expenditure framework and increasing the comprehensiveness of budgetary accounts  
• Initiating program and performance budgeting in a pilot ministry or agency  
• Restructuring debt management institutions to reduce their fragmentation | • Taking ambitious steps in fiscal consolidation by significantly increasing the primary budget surplus over the medium term  
• Reducing the number of tax exemptions and preferential tax regimes, and reforming the “forfaitaire” system for the self employed and small businesses  
• Identifying and measuring various tax expenditures and quasi-fiscal operations, and bringing them on budget  
• Containing the public wage bill as a percentage of GDP, creating an incentive structure in the civil service, and formulating public service reform  
• Expanding program and performance budgeting to all public institutions  
• Implementing a medium-term expenditure budgeting framework |

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Chapter 1. Development Outcomes and Medium-Term Prospects

1.1. Growth performance and development policy goals

*Strong growth has laid the groundwork for poverty reduction*

1. **Thanks to a steady pace of structural reforms and sound macroeconomic management, Tunisia experienced fast and sustained growth.** GDP grew on average by 4.3 percent in the decade since the initiation of structural adjustment in the mid 1980s, and growth accelerated to 5.2 per cent during the Ninth Development Plan (1997-2001). Growth outpaced MENA and middle-income countries’ average since 1987, even though it was slower than in other fast growing countries (Chile, Korea, Malaysia, Mauritius, Thailand—see Figure 1.1). GDP per capita increased by one third over the 1990s in real terms. The country’s sound economic management helped overcome several shocks, such as the Gulf war in the early 1990s, the 1997 East Asia crisis, and the droughts which regularly afflict Tunisia’s agriculture.

2. **Over the 1990s, growth was increasingly driven by domestic demand, and relied more on services.** Exports, mostly to the EU, continued to be an important driver of economic activity, reaching 47.5 percent of GDP in 2001-02, up from 42 percent in 1990-91. Growing export markets have supported investment, employment, real incomes, and thus growth of private consumption. But Tunisian exports are also intensive in imports of intermediate goods (especially exports of textiles and clothing), while imports of consumer goods are becoming more sensitive to domestic demand owing to trade liberalization. Thus, net foreign demand accounted for a smaller fraction of growth over the 1990s (Table 1.1). The contribution of net foreign demand turned even negative during 1997-2001 owing to the strong growth of imports. On the supply side, services have made up about two-thirds of GDP growth, reflecting the healthy importance of tourism—which accounts for about 30 percent of total export receipts. The contribution of agriculture was mute, because of its continuing vulnerability to droughts.

3. **Despite a slowdown since 2002, the Tunisian economy remained broadly resilient.** In 2002 growth slowed to 1.7 percent, from 4.9 percent in 2001, due to a drop in tourism and manufactured exports and severe drought for a third year in a row. Sluggish growth in the EU and the prolonged effect of September 11 on tourism and transport, have hampered export growth. But non-agricultural GDP was resilient, growing by 3.5 percent, supported by construction and other services, especially telecommunications. Thanks to favorable rainfall in the 2002/2003 season, agricultural production recovered strongly, by about 25 percent, in 2003. This has boosted GDP growth to about 5.6 percent.
Exports to the EU have also rebounded since the fall of 2002, through the first half of 2003. However, reflecting weak domestic demand, non agricultural GDP is grew at the same pace as in 2002, below the goals set in Tunisia’s Tenth Economic Development Plan (2002-2006).

4. But, despite strong growth, unemployment remains high, at around 15 percent, partly reflecting demographic pressures, and partly the decrease in the employment intensity of growth. Nonagricultural employment grew by 2.6 percent in 1994-2001, down from a healthy 4.4 percent in 1989-94, and agricultural employment grew more slowly. As further explained in chapter 2, the lower employment intensity of growth reflects faster labor productivity growth, which supports competitiveness and real incomes growth, but also the impact of distortions in the labor market. In addition, in recent years, job creation for skilled workers has slowed, so that unemployment of people with formal education has increased. Jobs for educated workers are mainly created in administration and public services, which have limited absorption capacity (see chapter 2).

5. High and pro-poor growth contributed to a sharp reduction in poverty in the second half of the 1990s. The core poor (those living below a lower poverty line, reflecting a minimum consumption expenditure level) made up only 4 percent of the population in 2000, equivalent to some 400,000 people, down from about 8 percent in 1990 and in 1995 (World Bank, 2003c). Similarly, the share of poor and economically vulnerable (those living below the upper poverty line), fell from 17 percent in 1995, to 10 percent in 2000 (Figure 1.2). The trends of falling poverty over the second half of the 1990s hold for both urban and rural areas and are visible in all administrative regions. Poverty reduction reflects strong per capita consumption growth of 3.4 percent between 1995 and 2000, up from just 0.7 percent in 1990-95. Moreover, in 1990-95, and contrary to the early 1990s, growth was pro-poor, as the consumption expenditures of the poorest decile grew above average.

6. Core poverty remains entrenched in rural areas but, economic vulnerability is important, especially in urban areas. The distribution of the core poor remained stable over time, with, in 2000, 74 percent living in rural areas, about the same as in 1990. The core poor made up 8.3 of rural population, a rate twice as high as the national average. Economic vulnerability remains, however, an important issue in urban areas, as 50 percent of the economically vulnerable lived in urban areas in 2000, up from 43 percent in 1990. Moreover, a fairly high proportion of people remain clustered above, but close to, the poverty lines. If poverty lines were set at twice the level for the lower poverty line, 40 percent of the rural population and 15 percent of people in Metropolitan areas would fell in extreme poverty. Tunisia’s high exposure to volatility (droughts) and external shocks (tourism, exports) may thus affect poverty outcomes in unpredictable ways.

7. Tunisia has also made important headway on non-monetary aspects of poverty. Health levels improved, as indicated by increasing life expectancy and falling infant, child and maternal mortality rates. Primary education became nearly universal and illiteracy is close to becoming eradicated among younger generations. Disparities still remain in female and male literacy rates, and urban and rural infrastructure. Overall, however, these achievements have put Tunisia ahead of countries at similar income levels. The strong progress on social indicators is an important factor behind the reduction in the poverty headcount index over the 1990s.
Forward-looking policies helped preserve external and internal balances

8. In 2000-2003 inflation fell to 2.4 percent on average, while the external current account deficit was maintained at 3.8 percent of GDP. Despite strong and accelerating GDP growth over the 1990s, prudent demand management helped bring inflation down, to levels below those seen in the five fast-growing comparators (Figure 1.3). At the same time, the number of administered prices has steadily decreased. Tunisia’s current account deficit—reflecting the sizeable trade deficit, at over 10 percent of GDP—was also kept under control, at around 3 percent of GDP for most of the late 1990s. However, due to domestic demand pressures, the current account deficit surpassed 4 percent of GDP in 2000 and 2001. In early 2002, the external shocks were further exacerbating the pressures on the current account. To prevent a potentially steep widening of the deficit, the authorities tightened fiscal and monetary policies, thus containing domestic demand pressures. With slowing domestic activity imports of equipment declined sharply, while imports of intermediate products fell as well, owing to sluggish exports. The current account deficit was thus reduced and foreign exchange reserves have stabilized at the equivalent of three months of imports since early 2003.

9. Fiscal consolidation has progressed, but a primary structural budget deficit still persists. A sizeable primary budget deficit of 2.1 percent of GDP in 1990-91 was turned into a 1.3 percent surplus by 1994, thanks to an important fiscal consolidation effort, and the primary budget deficit hovered around zero since then. But in 2000-2001 fiscal policy turned expansionary, despite strong domestic demand growth, and the primary budget deficit broadened to 0.7 percent of GDP. The fiscal stance was tightened in the 2002 and 2003 budgets, but the primary budget deficit still remains and prevents a rapid reduction of public debt. Overall, however, as suggested by the positive correlation between the estimated primary structural budget deficit and the output gap, fiscal policy has generally maintained a counter-cyclical stance. (Figure 1.4). But because of existing rigidities in the budget reviewed in chapter 4, when adjustment is needed, as in 2002-03, creating more fiscal space typically leads to cuts in the public investment budget, with a detrimental impact on growth potential.

10. Monetary policy has supported macroeconomic stability and has responded swiftly to changing conditions. The monetary policy framework aims to preserve the internal and external value of the dinar, by maintaining low inflation and preserving the external balance. To achieve its goals, the Central Bank of Tunisia targets a rate of credit growth consistent with the growth of domestic demand, while following a constant real effective exchange rate rule. Controls on capital movements provide some autonomy to

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1 The CPI inflation accelerated in the second half of 2003, reaching 4.7 percent in early 2004 on a year-on-year basis, partly reflecting in part the increase in the prices of some subsidized foods and partly the depreciation of the dinar versus the Euro, as most of Tunisia’s imports are denominated in Euros.

2 The primary structural budget deficit was estimated after removing the cyclical component from the actual deficit, related to automatic fiscal stabilizers (direct and indirect taxes). It excludes interest payments and privatization receipts and grants. Because the tax base of direct taxes is narrow, the cyclical component of the budget is relatively small. The cyclical component varies around ±0.5 percent of GDP, so that the estimated structural budget deficit comes very close to the actual deficit.
monetary policy and allow simultaneous targeting of domestic credit and the exchange rate. To rein in the growth of domestic demand, monetary policy was swiftly tightened in 2001, with the Central Bank drastically cutting its refinancing to commercial banks. The tightening of monetary policy was eventually reflected into a better alignment of credit expansion with the growth in domestic demand, and allowed an easing of monetary conditions in 2003.

11. **Targeting a constant real effective exchange rate provided a valuable anchor in Tunisia's economic management and is being implemented more flexibly in the run up to the free-trade zone with the EU.** Targeting a constant real effective exchange rate has contributed to maintaining a good level of competitiveness and the prudent budget management has provided an necessary anchor for this exchange rate policy. In particular, exchange rate depreciation was not substituted to fiscal and monetary adjustment to absorb the pressures from the current account. However, the real exchange rule was implemented in a more flexible manner in 2002 and 2003, as the government allowed some real exchange rate depreciation (Figure 1.5). Real exchange rate depreciation is supporting Tunisia's ongoing trade liberalization in the final stages of the implementation of the free trade zone with the EU, and it responds to increased competitive pressures from countries with exchange rates tied to a weaker dollar. Moreover, real exchange rate depreciation supports the preparation for a more flexible exchange regime and a more open capital account in the future.

![Figure 1.5: Real effective exchange rates-Tunisia and comparators](1995=100; increase indicates appreciation)

12. **Over the past two decades, Tunisia successfully controlled the public debt burden, while pursuing a prudent debt management policy.** Because of the structural current account deficit and the persistent primary budget deficit, public debt hovered at around 60 percent during the 1990s (of which, 39 percent foreign and 22 percent domestic debt in 2002). With foreign private debt representing an additional 13 percent of GDP, Tunisia’s total foreign debt amounted to 52 percent of GDP in 2002. The debt service ratio was brought down to around 15 percent of exports in recent years. Tunisia is among the few emerging market borrowers that have investment grade rating. Prudent macroeconomic policies have helped Tunisia improve its access to international financial markets, allowing borrowing at long maturities and under relatively favorable conditions. Strengthened creditworthiness helped Tunisia to extend the maturities of its long-term debt from 9.3 to 12.1 years over the 1990s. However, Tunisia’s foreign debt remains high in international comparison, especially in view of the country’s exposure to external shocks. Importantly, Tunisia’s foreign debt ratio is about 12 percentage points of GDP higher than in the average of 10 other countries with a similar sovereign rating (BBB-, BBB, and BBB+), suggesting that a faster reduction of public debt could yield substantial benefits in terms of access to international capital markets (Figure 1.6).
Achieving faster growth—the key role of private investment and human resources

13. **Tunisia has performed better, or at least as well as other developing countries, across all determinants of long-term growth.** Evidence from 38 developing countries reveals that Tunisia's strong growth over time reflects above-average performance mainly on three fronts (Figure 1.7; also see Anos Casero and Varoudakis, 2003): (i) progress in structural reform in foreign trade openness and the financial sector; (ii) above-average investment in the public sector (administration and public enterprises); (iii) strong human capital assets (education and health). Macroeconomic stability (accounted for by inflation, the foreign debt ratio, the external current account deficit, and the budget deficit) contributed to growth as much as in other developing countries. On average, private investment had a contribution to growth as in other developing countries, but seems to have lost steam since the mid-1990s.

![Figure 1.7 : Contributions to average growth—Tunisia vs. High-growth (in % per year)](image)

14. **But compared to other high-growth countries, Tunisia’s growth relied more on public investment, and less on private investment and human capital.** The contribution of trade and financial reform (in terms of trade openness and credit supply) to growth was as strong as in the five high-growth comparators (Chile, Korea, Malaysia, Mauritius, and Thailand). However, the high-growth countries took advantage of much stronger private investment. By contrast, public investment was not a significant factor in these countries (Figure 1.7). In addition, human capital assets had a stronger contribution to growth over time in the fast-growing countries than in Tunisia. Growth in the five comparators was also bolstered by better macroeconomic stability than in Tunisia, because these countries had, on average, smaller current account and budget deficits, and a lower foreign debt ratio.

15. **Despite solid macroeconomic fundamentals, Tunisia suffers from a structural private investment gap.** Over 1997-2001, average private gross fixed investment remained compressed at 13.5 per cent of GDP, moderately up from 13 per cent over 1990-1996. By contrast, over the 1990s, the private investment ratio in the five fast-growing comparators was 25 percent. Tunisia’s structural gap in private investment further broadened over the 1990s (Figure 1.8a). And the private investment ratio remained

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3 Using the coefficients of a panel growth regression, the difference of Tunisia’s growth to the average growth of 32 other developing countries was broken down into 6 components: macroeconomic stability; structural reform in trade and finance; private investment; public investment; human capital (education and health); other exogenous factors (convergence effect, reflecting the initial conditions in terms of income level, fixed effects, and the growth residual). The same decomposition was carried out for the difference of growth of 5 other fast-growing countries (Chile, Korea, Malaysia, Mauritius, and Thailand) to the average of the 32 developing countries. The results are summarized in Figure 1.7.
stagnant in 2002-03, amid a difficult economic environment. What are the reasons for Tunisia's private investment gap? International experience suggests that the limited openness of the Tunisian services markets and network industries to private investment, in particular telecommunications and transport, deprives Tunisia from significant opportunities for private investment, and probably also foreign direct investment. Telecommunications is a case in point because, despite recent moves, Tunisia still ranks low compared to other developing countries—including in MENA—in liberalization of the sector. Throughout the 1990s telecommunications have received the lion's share of private investment—US$ 330 billion out of US$ 755 billion in total private investment in network industries in developing countries (World Bank 2003d, and Figure 1.8b). At the same time, limited competition in network industries keeps the cost of backbone services high and hinders competitiveness, as consistently suggested by the results of business surveys in Tunisia (IEQ 2002b). This limits Tunisia's attractiveness to private investment.

16. **Heightened uncertainty in Tunisia's economic environment may have deterred private investment.** Businesses face uncertainty reflecting the surrounding risks in Tunisia's changing economic environment. Commercial risks stem partly from Tunisia's commitment to deeper international integration since the signing of the Association Agreement with the EU in 1997, and partly from the expected removal of MFA quotas for textiles and clothing exports, which will deprive Tunisia from preferential access to EU markets for these products. Structural weaknesses in the tourism industry, a main pillar to Tunisia's growth over the past decades (see Box 1.1), and the increased exposure of the sector to volatility, due to international security concerns, also amplify business uncertainties.
17. The quality of economic governance is key to attenuate business uncertainty and foster private investment. International experience suggests that uncertainty stemming from weaknesses in the regulatory framework for doing business may hinder private investment (World Bank 2003g). The Tunisian authorities have traditionally kept a high degree of discretion in regulating economic activity—including by providing generous privileges for exporting and investing in selected economic activities. This strategy has supported the country’s development in a context of limited trade integration. But Tunisia faces a turning point on the eve of a much deeper engagement with the world. Existing incentives systems run the risk of locking the country’s specializations into threatened activities, which may leave Tunisia ill-positioned in the face of stiffer international competition. Moreover, regulatory uncertainty and high discretionary intervention by the government weaken the investment climate, especially when competitive forces are weak. Discretionary intervention then runs the risk of strengthening the hand of “insiders”, thus reducing market contestability and discouraging risk-taking by less connected

Box 1.1: The Tunisian tourism sector—signs of “fatigue”?  

The economic benefits of the sector are important— Though calculations are surrounded with some uncertainty, the tourism sector is estimated to generate around 10 percent of GDP, while it secures direct and indirect employment to around 11 percent of the labor force, and earns hard currency revenue of more than US$1.5 billion per year (about 30 percent of total export receipts).

—but come at a high fiscal cost. However, this result is obtained with a high fiscal cost, through direct subsidies (approximately TND 20 million per year); tax exemptions (about TND 36 million per year for customs duties and VAT); and public investments aimed at diversifying tourist products, mainly in the field of cultural and historic heritage valorization (TND 80 to 90 million per year).

In competition with other Mediterranean Basin destinations, Tunisia’s position is stagnant and its market shares are decreasing. The strong growth of the sector (with the number of tourists growing from 52,000 in 1962 to more than 5 million in 2001), has slowed in recent years and revenues have decreased. Market shares are being lost compared to competitive destinations such as Egypt and Turkey. Moreover, revenue per visitor is particularly weak compared to destinations such as Morocco, showing that Tunisia is working on less profitable markets. The hotel occupancy rate in Tunisia, close to 50 percent, is comparable to that of competitive destinations, but the revenue per bed is 2 to 5 times lower than in Morocco, Egypt, Greece and Turkey.

There is little product variety and a low image, due to the predominance of the coastal resort industry. Tunisia is one of the preferred coastal resort destinations today for a vast European clientele. More than 90 percent of its tourists are attracted by the coastal resort setting. However, the Tunisian resort industry is losing steam due to strong competition from Mediterranean countries and increased demand for luxury accommodations, which Tunisia finds it hard to supply. Tunisia’s momentum even in the segment of popular resort destinations has been lower than countries such as Turkey or Egypt (55% during 1990-2000, compared to 78% in Turkey and 97% in Egypt).

The financial situation of several Tunisian hotels appears precarious. Although some hotels are well managed and profitable, others have low profitability, at times making even losses. The low profit margins, along with insufficient funding and a high debt ratio, account for weak financial returns and a difficult financial situation of several Tunisian hotels. Luxury hotels cannot absorb expenses and debt amortization because of high investment costs, to the detriment of maintenance expenses which need to be covered annually for hotel upkeep. The high debt ratio and not performing loans of some hotels pose a threat to the Tunisian banks involved in the tourism sector (see chapter 3). Only few companies seem to be able to list on the stock market, or seek finance through the bond market.

With support by the World Bank, the Tunisian authorities and sector professionals are considering steps to restructure the tourism sector, with the aim of improving quality, competitiveness, and market positioning, while strengthening the financial viability of the sector.

entrepreneurs. As further elaborated in chapter 2, to strengthen the investment climate, it is important that transparency and competitive market conditions prevail. In their absence, privatization, deregulation, and other supporting reforms may not produce the expected results, owing to mute investment response.

18. Reflecting business uncertainties, private investment has been losing momentum since the mid-1990s, with little help from the generous incentive system in place. Tunisia's structural private investment gap has been exacerbated by a weak responsiveness of private investment to healthy macroeconomic conditions since the mid-1990s. Based on past experience, private investment has been lower than expected by an estimated 0.5 percentage points of GDP per year on average—or a cumulative 3.5 percentage points of GDP from 1995 to 2001 (Figure 1.9; also see Anos Casero and Varoudakis, 2003). This may have deprived Tunisia of an estimated 5 percent of GDP over the same period, with a resulting "deficit of jobs" of 2.5 percent of total employment. It is worth noting that the "missing investment" occurs despite the generous investment incentives in place, and the subsidies granted through the enterprise "Mise à niveau" program. This calls into question the effectiveness of the existing incentives system as a means of stimulating private investment, and underscores the importance of a sound business environment to help Tunisian firms meet the challenges of the future.

19. In summary: Ensuring sustained fast growth in the years ahead would call for a business environment conducive to greater private investment, consolidation of human capital assets, and further strengthening the macroeconomic fundamentals. It is unrealistic to assume that public investment will continue to be a main driver of growth in Tunisia in the years ahead. This would strain the budget, at a juncture where Tunisia needs to improve budget flexibility and create enough room for adjustment to respond to external shocks. Moreover, investment by public enterprises has been declining over the last decade, and this trend is likely to continue with the gradual retrenchment of the state from commercial activities and a number of network industries. Stronger private investment is the key to stepped up growth and job creation, as well as to improved productivity and competitiveness. Sustaining and further improving Tunisia's human capital achievements is an additional precondition for faster growth—but has to go along with investment in high-skill activities, to meet the structural challenges in the labor market outlined above. Further strengthening the macroeconomic fundamentals is a third precondition for faster growth, as this will further bolster investor confidence and help mobilize more finance for investment.

Key challenges for agricultural development

20. Sustained agricultural growth would help consolidate recent progress in poverty reduction. Agriculture generates about 14 percent of GDP and employs about 22 percent of the labor force. Overall

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4 Examples of lack of transparency and predictability of the regulatory framework include: Prior approvals for investment in sectors where private investment is restricted; prior approvals for foreign majority participation in Tunisian companies; lack of transparency of the decisions of the "Commission supérieure d'investissement"; VAT refunds subject to tax controls for sales on the domestic market and companies non eligible for the "Mise à niveau" program; lack of systematic application of auditing requirements for companies that have significant access to bank credit; the absence of a Concession law that would clarify the "rules of the game" for private sector participation in the provision of infrastructure services. These issues are further examined in the following chapters.
food exports are about 10% of merchandise exports and food imports are around the same level. The traditional strengths of Tunisian agriculture are olive oil, and most fruits and vegetables. Fishery products are also highly competitive exports. Cereals production is generally competitive in high potential humid/sub humid zones on medium and large size farms, but not in arid and semi-arid areas on small and medium-sized farms. Ovine and bovine production are also competitive, but milk production is not competitive. A high degree of variability characterizes agricultural production, mainly because of the dependence of cereals on rainfall. Even though recent poverty trends reveal a balanced decline in rural and urban poverty, rural poor remain vulnerable due to agriculture’s volatile conditions.

21. Due to the small size of the domestic market, it is important to improve access to export markets for products in which Tunisian agriculture is competitive. Like other agricultural producers in the Mediterranean basin, Tunisia faces producer subsidies and restrictions on exports of products which are also produced in the EU and other export markets, including olive oil, citrus and fruits and vegetables. Despite significant progress in sectoral adjustment, some products including cereals are still protected domestically through high tariffs and producer subsidies, managed through public enterprises. Domestic protection further discourages production for export by diverting resources out of potentially more competitive products (World Bank, 2000). However, unless there is greater access to export markets, mainly in the EU, for agricultural products in which Tunisia is competitive, the scope for farmers to shift into these products would remain limited, and resources would be transferred out of the agricultural sector. The cereals sector, especially small to medium size producers in arid and semi-arid zones, would be the worse affected. Consequences could be destabilizing socially and politically.

22. But in the absence of more efficient management of water resources in the years ahead, projected water shortages may create bottlenecks and deprive Tunisia of potentially better export opportunities in high-income markets. If current trends persist, water shortages will be inevitable by 2015 as Tunisia would have developed by then its full water resource potential while demand for water would continue to increase. Though doing better than most other countries in the Region, Tunisia still only recovers about 90 percent of the operation and maintenance costs of irrigation water, and recovery rates vary from 50 to 125 percent, depending on the region and/or type of perimeter, creating disincentives for more efficient use of what is the country’s scarce natural resource.

23. Despite decades of Government efforts to protect natural resources, climatic factors, combined with over-exploitation and inadequate management practices, have led to significant resource degradation. It is currently estimated that about 47 percent of agricultural land is eroded, that 20 percent of rangelands have disappeared since 1972, that 24 percent of shall aquifers are over-exploited and that the irrigation efficiency rate in some small perimeters is only 40 percent. Tunisia’s fragile natural resources—water, soils and forests—need better management to prevent them from becoming a constraint to rural income growth. Improvement is needed both to introduce participatory management and strengthen administrative capacity to deal with the social, cross-disciplinary, decentralized and information-intensive nature of improved natural resource management.

24. The Government has adopted a long-term strategy to address water management issues. A first round of reforms is being implemented, with support by the World Bank, including: (i) delegating progressively overall responsibility for the management of irrigation perimeters, including those of the State, to water user associations; (ii) extending modern commercial cost and income accounting practices to all regional agricultural departments, with a view to introducing transparent billing and contracting procedures and reduce the cost of water delivery in the irrigation sector; (iii) introduction of a water tariff structure based on fixed and variable terms (tarification binôme) as part of current price increases. Implementation of second-round reforms to promote integrated management and conservation of water
resources, efficiency of irrigation water use and institutional restructuring and capacity building will help address the challenges ahead.

1.2. Medium-term outlook and policy priorities ahead

The medium-term outlook is encouraging, but raises important policy challenges

25. **Tunisia has made the firm choice of integrating more closely the world economy—a strategic move that has the potential to stimulate growth.** Tunisia has already seen the benefits of greater trade openness and of removing cumbersome regulations on the business sector. The best example is when it significantly deregulated offshore enterprises from the constraints imposed on the rest of the economy and the resulting robust growth of the offshore sector greatly contributed to employment, growth, and external sustainability. With the right regulatory framework in place, as explained in chapter 2, the completion of the Association Agreement with the EU, has the potential to facilitate integration of Tunisian firms into EU production networks, thus improving Tunisia’s attractiveness as a hub for export-oriented foreign direct investment. The free-trade zone will also expose firms supplying the still protected domestic market to greater competition, thus forcing restructuring, which eventually will result in improved efficiency and better prospects for growth.

26. **But greater integration into global markets will raise challenges, first, for the import-competing manufacturing industries**—The first challenge that faces Tunisia is to “extend” the offshore sector performance in the rest of the economy, which will be exposed to increased competitive pressures with the completion of the Association Agreement with the EU. As explained in chapter 2, the regulatory framework of investment incentives and trade facilitation, which currently discriminates in favor of the offshore sector, will have to become more even and supportive to the onshore sector. Without proper changes in the regulatory framework for investment and a more predictable business environment, the onshore sector faces the risk of a serious setback as a result of exposure to stiffer competition. The realizations of existing enterprise support programs, such as the “Mise à niveau” do not seem to provide the needed support to the import-competing sector (chapter 2).

27. **—and, second, for the traditional exporting sectors.** The second challenge is to help exporting firms strengthen their competitiveness, upgrade their market niches, and position into new, higher value added exports, while improving the quality and reducing the cost of services that facilitate trade. This will help exporting firms reap more benefits from the free-trade zone with a 25-member EU, and deal with upcoming threats. With the gradual phasing-out of the MFA quota system by 2005, Tunisia’s textile exporters will face stiffer competition from low-cost producers in traditional European markets. They will need to upgrade their market niches and their ability to respond to rapidly changing market demand, with more support from a much better transport and ICT infrastructure. This would call for bold steps in the liberalization of trade related services that still burden Tunisian exporters with high costs. As already discussed, the tourism sector would also need to undergo significant restructuring to improve the quality of services and better position in the global market, while improving the financial sustainability of large units. And, in the absence of reform, agriculture will continue to face significant challenges due to the looming water shortages and the degradation of natural resources.

28. **Surrounding macroeconomic and financial risks, both external and homegrown, should not be ignored.** The tariff reductions scheduled in the Association Agreement with the EU, combined with the need for large imports of equipment and intermediate goods to support fast growth, will make it more difficult to reduce current account deficits. The loss of tax revenues on external trade will enlarge the financing needs in the budget and make it harder to reduce the public debt. Deeper integration into EU markets will heighten Tunisia’s dependency on economic swings in the EU, where growth has proven less
resilient to global downturns, as seen in the 2001-2002 slowdown. Anemic growth in the EU, which absorbs more than 75 percent of Tunisia’s exports and is home to more than 70 percent of the country’s foreign visitors, is swiftly felt in Tunisia, as in the sharp slowdown seen in 2002. In the emerging international environment with heightened security concerns, growth and the external balance may also suffer setbacks from the increased volatility of tourism receipts. Risks also arise from “homegrown” vulnerabilities, such as the high level of under provisioned non performing loans (NPLs) of commercial and development banks—especially to the tourism sector. As further explained in chapter 3, the heavy reliance on overpriced and illiquid real estate guaranties for the provisioning of NPLs leaves the banking system, and thus credit to the private sector, vulnerable to the financial health of the tourism sector and a possible downturn in the real estate market.

29. **Over the medium term, relatively healthy growth, based on continuing reform efforts, could go in tandem with current account pressures and some loss of fiscal revenues.** Reflecting the momentum provided by the completion of the AAEU and ongoing reform efforts, but also the uncertainties and structural weaknesses mentioned above, real GDP could grow within a range of 4.5-5.5 percent on average, at about the same pace as during the Ninth Development Plan (1997-2001). Achieving continuing fast growth despite the competitive threats and surrounding risks, would call for coordinated efforts to strengthen the investment climate, by steadily improving the quality and predictability of the regulatory framework, while keeping up the pace of liberalization in sectors still under the government’s umbrella. At the same time, due to the tariff reductions scheduled in the Association Agreement with the EU, the current account deficit may increase by an estimated 0.8 percentage point of GDP. Moreover, reflecting the loss of tax revenues on external trade, the primary budget deficit may worsen by 0.6 percentage points of GDP.

30. **Despite tensions on the external and internal balances, debt would be sustainable—** With growth close to the high end of the baseline range, total public debt would decline to about 54 percent of GDP by 2012, from 61 percent in 2002—although at a slower pace after 2006 due to the widening primary current account and budget deficits (World Bank, 2003b). Foreign private debt would increase to 20 percent of GDP, from 12 percent in 2002, reflecting the persistent current account deficit and the improved access of the private sector to international capital market financing. However, total foreign debt would decline to about 44 percent of GDP, from 51 percent in 2002. The debt service ratio would be stabilized at around 11 percent of total exports, down from 14 percent in 2002. However, these favorable outcomes depend critically on maintaining a high rate of growth. With growth at the middle of the projected range, public debt would remain virtually unchanged in proportion to GDP, while with slower growth, close to the low end of the range, the public debt ratio would increase.

31. **—but unemployment would remain stagnant.** With the relatively low elasticity of employment to output observed in recent years (see chapter 2), growth even at the high end of the projected range would fail to reduce unemployment. Assuming no employment growth in the public sector and agriculture, the unemployment rate would actually increase, to a projected 16.4 percent by 2006 (World Bank, 2003a). In view of the projected trends in the labor force and the participation rate, reducing the unemployment rate by about 3 percentage points in 5 years would call for a higher growth rate, of about 6.5 percent per year. All else equal, this would require a much stronger private investment effort, of about 7 percentage points of GDP—compared to 2 percentage points in the high end of the baseline range.

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5 Assuming the incremental capital output ratio remains unchanged at its 1998-2001 level (5.06), achieving growth at the high end of the baseline scenario would call for an increase in the fixed domestic investment ratio by 2 percentage points of GDP (from 25.7 to 27.8 percent). With a large part of the budget absorbed by non discretionary public expenditures (see chapter 4), and given the need to achieve faster fiscal consolidation, there is practically no room for maneuver to increase public investment. The needed extra investment effort would thus have to come from private investment.
projection. To achieve such an increase in investment, mutual reinforcing, broad-based reforms would be necessary, to considerably strengthen the business environment and secure adequate financing for investment, as further explained in chapters 2 and 3.

32. **Further strengthening the fiscal framework would hedge against vulnerabilities and risks.** Taking early steps to achieve an ambitious medium-term fiscal consolidation would provide the needed fiscal room for maneuver to deal with surrounding risks. This should be underpinned by both better revenue mobilization and enhanced public expenditure efficiency. Main benefits from fiscal consolidation would include:

- Securing domestic finance for greater investment, by mobilizing more public savings, so as to minimize pressures on the external balance over the medium term.
- Keeping inflation in check, and avoid a sharp tightening of monetary policy that may hold back private investment and growth in the years ahead.
- Reducing the level of public debt. This would further bolster the confidence of domestic and foreign investors. As seen above, at 60 percent of GDP, public debt remains high by international comparison and possibly denies Tunisia a more favorable access to international capital markets.
- Creating enough room in the budget to (i) adjust to severe shocks, and (ii) possibly conduct counter-cyclical action, to offset part of the impact of adverse external shocks.
- Creating room for expanding the social safety nets, to offset the social impact of structural changes due to deeper trade integration.
- Promoting a policy mix that would sustain an easier monetary policy stance, and thus facilitate the move toward a new monetary policy framework, underpinned by greater interest rate flexibility.

33. **Taking early steps in fiscal consolidation would also hedge public debt from future calls on the budget that may arise from the contingent and implicit liabilities of the public sector.** Contingent and implicit liabilities may arise from a variety of sources: (i) The under provisioned, non-performing loans accumulated by the banking system, and by public banks in particular (see chapter 4). Non performing loans would be likely to spike in a low-case scenario, owing to the growing exposure of banks to the tourism industry and to exporting sectors. (ii) The unfunded liabilities of the pay-as-you-go pension system (chapter 7); (iii) guarantees on the foreign-currency debt issued by public enterprises; (iv) performance guarantees to private providers of infrastructure services, through BOT or BLT agreements, may also give rise to contingent liabilities in the future; (v) in a low-case scenario, foreign exchange guarantees may generate fresh debt if the adjustment to persistent external shocks were to partly rely on exchange rate depreciation. This would be the case with the unfunded foreign exchange guarantees provided by the government to external borrowing by public non financial enterprises. Funded guarantee schemes—such as the “Fonds de péréquation des changes”, which issues foreign exchange guaranties for loans by local or foreign banks operating in Tunisia—may also generate losses.

**Key development challenges and policy priorities ahead**

34. **With the right business environment in place, Tunisia's integration into global markets will create opportunities for faster growth, but will also raise a multi-faceted development challenge during the Tenth Development Plan and beyond.** Tunisia's strengths and weaknesses over the recent years, and the outlook and risks reviewed above, point to four key medium-term challenges:

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6 Improvements in total factor productivity could reduce the needed incremental investment effort to achieve faster growth. But such improvements would also call for continuing structural reforms, spurring diffusion of ICT in production and distribution, and ensuring better quality of production inputs and services, more efficient organization of enterprises, and better skills in the labor force.
- **Step up investment in the private sector**, to achieve the much faster growth required to reduce unemployment, while mobilizing enough public and private savings to finance investment so as to minimize pressures on the external balance;
- **Maintain fast productivity growth**, to improve competitiveness and meet the challenge of the free-trade zone with the EU and stiffer international competition;
- **Promote high-skill sector growth**, and the emergence of a knowledge-based economy, to match the rapidly changing skill mix in the labor force;
- **Reinforce the efficiency and sustainability of social services**, to consolidate Tunisia’s valuable human assets, nurture the knowledge-based economy, and shield vulnerable groups in the emerging more competitive environment.

35. **Companion policies will be needed to make Tunisia’s deeper trade integration work for growth and jobs.** As shown by international experience (EU accession countries, Mexico, East Asia), most countries that have created more open markets have been able to stimulate domestic investment and attract significant flows of FDI along with their integration into broader economic areas. But in all success stories the reduction of trade barriers had to go in tandem with **complementary policies**: broader regulatory reform that improved the attractiveness to investment; strengthening of human resources; and a solid macroeconomic framework (World Bank, 2003d). This will be all the more important to reap the benefits of the “Wider Europe” initiative, which may create new dynamics and opportunities for growth for the Southern Mediterranean countries (Box 1.2). The challenge is even greater in Tunisia because, as noted earlier, business risks stemming from the external environment are amplified by weak competitive forces, high discretionary intervention by the government, and regulatory uncertainty, which weaken the investment climate. Tunisia thus faces a turning point where, unless coordinated efforts to improve the quality of the regulatory framework for private sector activity are placed at the core of the Government’s reform agenda, the deeper engagement with the world may not fulfill its development promise.

### Box 1.2: The Wider Europe Initiative – what’s at stake?

With EU enlargement imminent, the Commission recently launched a comprehensive reassessment of its assistance strategy towards neighboring countries. The Council approved the Wider Europe Communication last June and the policy has taken a new momentum of its own. This not only includes MEDA countries, but the whole ring of neighbors of the enlarged EC. The objective is to apply similar policy instruments as in the accession process, in order to accelerate national economic reforms and facilitate regional economic integration. While the details of the strategy as still being discussed, important features are emerging: (i) Financial assistance is to be much more focused on socio-economic reforms. (ii) Action Plans as a programming tool are to define clear timetables and benchmarks for progress. (iii) New Neighborhood Agreements should permit neighbors to more deeply integrate with the EU and its Single Market, than existing Association Agreements. (iv) By applying the principle of differentiation, the Commission wants to reward fast-reformers with privileged economic integration and financial assistance.

For the southern Mediterranean countries, the Wider Europe strategy could have important implications. Eight years after the launch of the Euro-Med Partnership, the results on the ground are disappointing. A limited free trade area for goods should be completed by 2015, but otherwise there is very little momentum in the process of regional integration. Wider Europe could not only bring new political impetus, but also more powerful policy instruments, modeled on those used in the enlargement process. These include: (i) closer monitoring of reforms through annual progress reports and cross-country benchmarking; (ii) country Action Plans with verifiable reform indicators and implementation time-tables; (iii) and a clearly structured incentive regime (for example, in the form of trade concessions or increased financial assistance).

- Strengthening policies in some key complementary areas would help meet Tunisia’s development challenge.
- Improving the investment climate, by lowering transactions costs, enhancing transparency and predictability, and strengthening market contestability. This Will help unleash Tunisia’s business
potential, particularly for the creation of new enterprises. Continuing liberalization efforts will boost competitiveness by improving the quality and reducing the cost of backbone services and production inputs—especially of ICT services, the foundation of a knowledge-based economy.

- Improving the functioning of the labor market, by reducing protection within the firm, increasing protection of vulnerable workers outside the firm, and enhancing the efficiency of labor market policies.

- Strengthening the soundness of the banking system and fostering the development of government and private securities markets, to improve the diversification of sources of finance, ensure good access to finance for private investment, and ensure the resilience of the economy to financial risks.

- Securing a robust medium-term fiscal framework, by stepping up fiscal consolidation, through better fiscal revenue mobilization and increased public expenditure efficiency. This will help improve efficiency of public service delivery, while reducing medium-term pressures on the budget and improving the capacity of fiscal policy to deal with a potentially hostile external environment.

- Enhancing the efficiency of education policies, by improving the quality and links of the education system with the labor market and promoting an education and training system that facilitate the emergence of the knowledge-based economy.

- Strengthening the effectiveness and sustainability of social sector policies, by improving the quality and containing the costs of health care services; strengthening the cost-effectiveness of social protection; and securing the sustainability of the pension system.

The status of reform initiatives and policy options in these key areas of the reform agenda are reviewed in the following chapters.

36. **Improving the quality of governance deserves particular attention because it underlies the development reform agenda.** Progress on the four priority fronts will call for mutually reinforcing initiatives to improve the quality of governance, so as to establish an environment in which *fair and predictable rules form the basis for economic and social interactions*. As discussed in chapter 3, establishing an enabling environment for a competitive private sector would call for initiatives to promote competition, transparency, and predictability of regulations. The challenge of improved governance is also at the core of the financial sector reform agenda—for example to improve provisioning of non performing loans; upgrade risk management and credit allocation mechanisms by improving information flows in the credit market; improve corporate transparency; strengthen the protection of creditor rights (chapter 4). Tunisia has a strong track record in public sector management and internal accountability. However, rising up to the growth challenges would call for further strengthening public sector governance in a number of areas. As explained in chapter 5, initiatives should focus on improving the fairness and efficiency of the tax system, and strengthening efficiency of public service delivery, by creating new spaces for accountability and taking appropriate steps to sharpen incentives and reduce the cost of the civil service. Underlying the objective of better public service delivery is a structure of government that promotes checks and balances, transparency, and accountability, in particular through the participation and voice of civil society. For example, as further explained in chapter 7, greater accountability and autonomy in the management of public hospitals would help improve the quality of health care services, while better participation of the civil society in education establishments would support improved quality and help build better links with the labor market. And greater autonomy of higher education establishments would help produce the kind of excellence in research needed to move toward the knowledge-based economy.
Chapter 2. Meeting the Challenge of Job Creation

37. Promoting employment is at the heart of Tunisia's Tenth Development Plan—called le pari de l'emploi. According to the Plan, 400,000 new jobs are expected to be created between 2002 and 2006 (about 80,000 jobs a year compared to about 67,000 during the Ninth Plan). To achieve the job-creation objectives of the Tenth Plan and beyond, in view of the structural challenges ahead, the government is well aware that the overall employment strategy needs to be based on the fundamentals of sound economic and employment policy. As analyzed in the next chapter, most important is a commitment to economic policies that promote competitive product markets, productivity, and private-sector investment. This is the most promising path to raising aggregate demand for labor and increasing labor productivity and incomes. But to maximize the employment gains of Tunisia's international economic integration, labor market regulations and institutions need to be flexible so that employers and workers can adjust to changes in business conditions. As analyzed in this chapter, this approach requires less protective measures inside the firm and a more effective social protection system outside the firm through efficient active labor market programs and, perhaps, through income support for laid-off workers. The final ingredient in a job strategy for Tunisia is a human resource development framework that generates a skilled and employable workforce for a liberalizing and increasingly sophisticated economy. This will require continued reforms in the education and vocational training systems, as further highlighted in chapter 6.

2.1. Despite strong growth, reducing unemployment remains the major policy challenge

38. The number of jobs created was just enough to match the increase in labor supply. Nonagricultural employment (78 percent of total employment in 2001) grew by about 2.6 percent in 1994-2001, down from a healthy 4.4 percent in 1989-94 (Table 2.1). Agricultural employment grew more slowly, by 1.5 percent per year on average over 1989-2001. Tunisia's non agricultural employment growth was at par with regional comparators, such as Morocco, and much above the OECD average, but behind countries such as Ireland (4.5 percent) and Mexico (5.6 percent) with a strong job creation record. Employment growth slowed markedly in manufacturing and private services, where 60 percent of non agricultural workers hold a job (Figure 2.1). The slowdown was particularly sharp in the textiles industry—which provides jobs to 10 percent of workers—where employment grew by 1.9 percent in 1994-2000, down from 4.6 percent in 1989-94. By contrast, the pace of employment growth was stepped up in administration and public services.
Table 2.1: Employment and productivity trends in Tunisia: 1989-2001

<table>
<thead>
<tr>
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<tr>
<td>Non agricultural employment growth (Tunisia)</td>
<td>4.4</td>
<td>2.5</td>
<td>2.6</td>
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<tr>
<td>Elasticity of employment to output (Tunisia)</td>
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<td></td>
<td></td>
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<tr>
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<td>0.5</td>
<td>0.5</td>
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<tr>
<td>o/w manufacturing</td>
<td>0.6</td>
<td>0.7</td>
<td>0.5</td>
</tr>
<tr>
<td>o/w services</td>
<td>1.1</td>
<td>0.5</td>
<td>0.5</td>
</tr>
<tr>
<td>Productivity growth (Tunisia)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non agricultural sectors</td>
<td>0.1</td>
<td>2.4</td>
<td>3.4</td>
</tr>
<tr>
<td>o/w manufacturing</td>
<td>2.4</td>
<td>1.4</td>
<td>4.7</td>
</tr>
<tr>
<td>o/w services</td>
<td>-1.7</td>
<td>3.1</td>
<td>5.8</td>
</tr>
</tbody>
</table>

Source: World Bank staff

39. **Unemployment has persisted, partly reflecting continuing demographic pressures, and partly the decrease in the employment intensity of growth.** With the labor force growing rapidly, by an estimated 2.5 percent per year, unemployment remained sizeable, at about 15-16 percent. Despite slower projected demographic growth, strong labor force growth is expected in the years ahead, because, educational attainment is improving, while, at 26 percent in 2001, labor force participation by women still remains low. In the coming years, tensions in the labor market will also be intensified by the shedding of labor out of agriculture, which still ensured 22 percent of total employment in 2001, down from 26 percent in 1989. The non agricultural employment elasticity to output was halved, reflecting mainly a decline in the employment elasticity of services (Table 2.1). The overall employment elasticity in Tunisia is not out of line with international experience, but is close to the more capital intensive OECD countries, and lower than in Turkey, Mexico, or Ireland (World Bank, 2003a).

40. **The lower employment elasticity of growth reflects faster labor productivity growth, but may also partly reflect the impact of distortions in the labor market.** In manufacturing, a trend of declining productivity growth was reversed in 1997-2001 (Table 2.1), and productivity growth in private services continued to increase. The faster labor productivity growth largely reflects the ongoing modernization in private sector manufacturing, with the aim of improving efficiency in the context of Tunisia’s increased exposure to international competition. Labor shedding associated with public-enterprise restructuring also boosted productivity in the nonagricultural sector. However, remaining rigidities in the labor market, especially in employment termination procedures, may have contributed to the lower employment elasticity of growth. Changes in the relative costs of capital and labor, linked to the high non-wage costs of labor and the system of investment incentives in place, may have reinforced this trend (see below).

41. **Faster labor productivity growth supports competitiveness and real incomes growth, but calls for a significant acceleration of growth to step up job creation.** This is confirmed by the experience of the East-Asian countries with rapidly growing productivity, which succeeded to reduce unemployment thanks to exceptionally high GDP growth, and that of OECD countries with rapid productivity growth, such as Ireland. By contrast, in slow-growing EU countries, strong productivity gains have been reflected in declining employment. Not counting on administration, public services, and agriculture, growth would have to increase significantly to create enough jobs to absorb the fast growing labor force. Growth of about 7.5 percent per year in manufacturing and 11.5 percent in private services would be needed. This is beyond patterns seen in the past in Tunisia, but not out of line with international experience.

42. **Accelerating growth, to meet Tunisia’s employment challenge, would call for much higher private investment**— In the years ahead, keeping public expenditures under control to maintain a sound macroeconomic framework will limit the potential for job creation in the public sector, while traditional export and growth drivers are likely to lose steam. As explained in the previous chapter, private investment remains low by international comparison, depriving Tunisia from stronger growth and faster
job creation. Bolstering private investment should be the focal point of the development strategy, with ambitious steps to strengthen the investment climate, and create more opportunities for private sector entry in protected services sectors and network industries.

43. **along with continuing progress in productivity growth.** Tunisia cannot afford to increase employment at the expense of productivity growth. Sustained high productivity growth would be needed to further improve competitiveness in the face of intense global competition. With the right business environment and adequate opportunities for private investment, the relatively benign wage setting environment in the labor market would support competitiveness and employment growth. Over the 1990s, real wages have kept pace with labor productivity growth—reflecting the stability ensured by the collective wage bargaining practices in Tunisia (Figure 2.2). This bodes well for international competitiveness, firm profitability, and investment.

2.2. **Structural imbalances in the Labor Market**

44. **Promoting high-skill sector growth would help match the rapidly changing skills mix in the labor force.** Reflecting ongoing education reforms, workers with higher education will account for 23 percent of the labor force by 2016, up from 8.3 percent now, while the share of less-educated workers (primary education and below) will shrink from 61 to 40 percent (World Bank, 2003a). But, in recent years, job creation for skilled workers has slowed, so that unemployment of people with formal education has increased. At 10 percent on average, unemployment rates are lower for those with less than primary education, suggesting a relative abundance of low-skilled jobs. Jobs for educated workers are mainly created in administration and public services, which have limited absorption capacity. Workers in textiles, the largest manufacturing industry, have below average levels of education, as workers in commerce, another net job-creating sector. Thus, on current trends, unemployment among higher educated groups may increase significantly, to a projected 28 percent by 2016, from nearly 10 percent now, while falling for groups of less educated workers. The burden of unemployment would be more severe for young educated workers, because new entrants to the labor market with higher education may account for 55 percent of first job seekers by 2016, up from 23 percent now (World Bank, 2003a). Creating more and better jobs would call for moving up the value-added ladder, toward higher-skill exports and services, while facilitating the emergence of the knowledge-based economy in the long term.

45. **Labor demand has not kept pace with structural changes in labor supply.** This is reflected most directly by the fact that unemployment declines with age. For younger age groups, unemployment actually increases with education. Among 20-29 year olds, unemployment rates are higher for those with a secondary and postsecondary education compared to primary school graduates—the opposite of what we observe among the older age groups and for the population as a whole. This tendency suggests that despite robust economic growth and job creation, youth and in particular better-educated youth have not fully benefited. Given that rising educational attainment is likely to persist in the future, youth will continue to have difficulty finding employment.

46. **Public wage policies are generally distorting for both men and women.** The public sector is centrally important both in terms of its size (public administration including health and education accounts for 16 percent of total employment) and its role in managing the economy and generating
employment. Public sector hiring mitigates unemployment and public wage policies (excluding nonwage benefits) are distorting: there is a positive public sector wage premium compared to the private sector (18 percent overall and 24-30 percent for women). Public sector work is even more attractive when nonwage benefits are included.

47. **The gender composition of the labor force remains unbalanced.** The participation rate of men averages 76 percent and is much higher than the participation rate of women (26 percent). The probability of a woman participating in the labor force increases with her education level. Among men, by contrast, those with primary degrees or less are more likely to participate than those with a middle school education or higher. Women holding postsecondary degrees are the most likely to enter the labor force, with participation rates for this subgroup averaging 55 percent. With respect to hours of work, men work more hours as they get older, whereas the opposite is true for women, reflecting early exit from the labor force due to child bearing.

48. **Tunisia’s important potential to integrate women into the economy has yet to be fully realized.** As a result of past investment in human capital, Tunisia has made substantial progress in closing gender gaps in education, reducing fertility and building strong legal rights and privileges for women. But although these achievements create an enormous potential for increases in female participation in the labor force, the actual female labor force participation rate is lower than the expected level (31 percent), and even this gap has increased between 1980 and 2000. Moreover, labor force participation by women with higher education has declined to 55 percent in 2001, from 58.5 percent in 1997. Tunisia is thus including women in the labor force at a slower pace compared to the improvement in women’s educational attainment and declines in fertility (World Bank, 2003i).

49. **The low level of participation of women in economic activity is the result of factors affecting both the supply and demand for female labor.** On the supply side, married women are much less likely to work, and women work less hours as they get older, reflecting early exit from the labor force. However, the lack of generosity of maternity leave regulations and the limited coverage provided by the child care system are likely to impede labor force participation by married women. It is noteworthy that the coverage rate of kindergartens was only 14.3 percent in 2000, slightly up from 11.4 percent in 1966. On the demand side, the lack of sufficient job creation in high-skill sectors has particularly hurt educated women, for whom the likelihood of being unemployed generally increases with schooling. Restrictive employment termination regulations, that usually protect primary workers (essentially male and more experienced workers), may also limit the demand for female workers. Moreover, public sector attractive pay policies for women are likely to affect female labor supply decisions and encourage queuing for “good” public sector jobs rather than less attractive opportunities in the private sector. Further investigation is needed to understand why Tunisia is not utilizing fully its potential to integrate women in economic activities.

2.3 Addressing impediments to Job Creation

50. **The contribution of SMEs to employment generation is small, particularly in high-skill sectors.** Although in Tunisia SMEs and micro-enterprises are dynamic in terms of job creation and destruction, they do not lead the way in terms of job creation. Overall, only 10 percent of the employment is in enterprises with less than 50 persons. Such enterprises are mainly concentrated in the traditional sectors, manufacturing and trade; their production is primarily oriented to the domestic market, and they preponderantly create temporary low-skilled jobs at low wages. This may be due to institutional constraints (labor regulation and indirect labor cost), which limit the flexibility to adjust to cyclical
changes in the economy. Despite recent government reforms to improve investment climate, the main obstacles of SME development are regulatory framework (business start-up, labor relations and flexibility), infrastructure quality, and difficulties in access to finance (see Chapters 3 and 4).

51. **The non wage costs of labor remain relatively high and may constrain job creation.** Workers and employers in the private sector contribute the equivalent of 23.75 percent of the wage bill to a social security fund—the employer contribution amounting to 16 percent of gross wages. However, other indirect social charges (such as group insurance, protective clothing, safety provisions) bring total social charges on labor for employers to 28 percent. Thus, the many small charges add up to a substantial supplementary indirect cost on labor (World Bank, 2003a). Since over 70 percent of the formal non agricultural labor force is covered by the social security system, it is crucial to evaluate the impact of social charges on job creation. High labor costs may discourage job creation and put Tunisia in a disadvantage to its competitors.

52. **The impact of investment incentives on job creation in Tunisia is uncertain.** Tunisia provides generous incentives for investment (see chapter 3). These incentives may help promote employment if they effectively foster investment. But generous investment incentives also reduce the user cost of capital. Among the various tax breaks and financial incentives in the investment code, investment grants, the deductibility of equity investments from (corporate and personal) taxable income, the exemptions from customs duties, and the reduced VAT for equipment investment are the most likely to lower the user cost of capital, thus distorting the relative price of capital and labor. Estimations suggest that the financial and tax incentives in the investment code that are biased in favor of capital are likely to have reduced the level of the user cost of capital by 8.8 percent in 2001 (World Bank, 2003a). The decrease in the user cost of capital has reinforced a trend of increasing relative cost of labor since the mid 1990s. This may have contributed, as an unwanted consequence, to less labor intensive investment projects. Supporting evidence is provided by recent enterprise surveys (IEQ, 2002b): In 2002, investment by surveyed Tunisian enterprises was mainly geared toward equipment modernization (37 percent) and replacement (25 percent), which are likely to be labor saving. By contrast, investment toward expanding capacity was only 26 percent of total.

53. **Labor regulation reforms have introduced flexibility in hiring**— Traditionally there was a regulatory preference in Tunisia for indeterminate contracts. However, reforms were introduced in the 1996 Labor Code to significantly expand the possibilities for fixed-term contracts and part-time work. As a result of these reforms, Tunisia compares favorably with other countries in terms of flexibility in hiring (Figure 2.3, adapted from World Bank, 2003f).

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7 The subsidies to investment by the “Mise à niveau” program further reduce the user cost of capital. By contrast, tax incentives that reduce the corporate income tax rate—accounting for about 40 percent of the total fiscal cost of incentives in the investment code—are likely to have a neutral impact on the relative user cost of capital and labor. By increasing corporate profits, such incentives favor greater investment without altering the relative capital intensity of production.
54. **but the use of temporary help agency workers is not allowed**— In many countries, the other main source of flexibility on the hiring side is the use of temporary help agency workers. These are not permitted in Tunisia, according to the Labor Code. It does appear, however, that temporary hiring does occur through agencies, e.g., sometimes operating as training firms. This reflects the fact that firms in modern economies sometimes do need the flexibility provided by temporary labor and will find ways to meet the need.

55. **and hiring of expatriate employees is highly restricted.** Hiring of expatriate staff by Tunisian companies is limited to 4 employees for two years in off-shore firms and one employee for one year, renewable once, in the general regime. These restrictions aim to promote employment of local staff with similar competencies, but may end up limiting the flexibility of companies when such competencies are not readily available in the local market. They may thus discourage foreign investment, and also impede the transfer of know-how to start-up companies in new market niches. Instead of protecting local skilled workers, such restrictions may limit overall job creation and hamper the diversification of the economy toward higher-skill sectors.

56. **Dismissals for economic reasons are still heavily regulated with strong Government interference.** Reforms to the Labor Code in 1994 and 1996 accelerated the administrative procedures and clarified the definition of “licenciement abusif”. However, firms wanting to adjust their workforces for economic or technological reasons still must engage in a heavily bureaucratic process where government and a tripartite mechanism have substantial powers to intervene (World Bank, 2003a). Companies must notify the labor inspector of planned dismissals in writing one month ahead, indicating the reasons and the workers affected. The inspector may propose alternatives to layoffs. If these proposals are not accepted by the employer, the case goes to the regional tripartite committee of labor inspector, employer organization, and labor union (commission du controle des licenciements). The committee decides by a majority vote (if the inspector and union reject the proposal, no dismissal is possible). It may also suggest retraining, reduced hours, or early retirement. Only 14 percent of dismissals end up being accepted. Reflecting these rigidities, Tunisia’s employment termination procedures appear rigid in international comparison (Figure 2.4, adapted from World Bank, 2003f).

57. **Severance payments can be too generous.** In the case of retrenchment, minimum severance requirements are established in the Labor Code—although “Conventions collectives” can set levels above these established rates. The base formula is one day of pay for each month of service, with a 3-month maximum. This level is not excessive by international standards. However, severance requirements are high by international standards in the case of “licenciements abusifs”.

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**Figure 2.4: Flexibility of Firing Index**

<table>
<thead>
<tr>
<th>Country</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jordan</td>
<td>55</td>
</tr>
<tr>
<td>Poland</td>
<td>46</td>
</tr>
<tr>
<td>Slovenia</td>
<td>45</td>
</tr>
<tr>
<td>Thailand</td>
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<td>Tunisia</td>
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<td>Dominican Republic</td>
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<td>Bulgaria</td>
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<td>Chile</td>
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<tr>
<td>Romania</td>
<td>30</td>
</tr>
<tr>
<td>Hungary</td>
<td>22</td>
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<tr>
<td>Turkey</td>
<td>20</td>
</tr>
<tr>
<td>Morocco</td>
<td>11</td>
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</table>

Source: World Bank 2003b
58. **Thus, enterprises find it hard to restructure, and small firms often find solutions outside the legal framework.** The overall magnitude of layoffs suggests that Tunisian firms are not restructuring. With an employed labor force of over 2.5 million, the total number of proposed layoffs represents less than 1 percent of total employment. Comparable figures in OECD countries are generally in the 10 percent range (OECD 1996). Yet, the unemployment rate in Tunisia remains obstinately high, above the OECD average. Experience also shows that restrictive employment protection legislation also nurtures the informal economy (Figure 2.5). In Tunisia, an estimated 38 percent of business activity takes place in the informal sector (World Bank, 2003f). Firms in the informal sector do not operate at full capacity, while their counterparts in the formal sector suffer from unfair competition, and may not expand capacity at potential. This ends up hampering private sector investment.

59. **Tunisia provides greater than average employment protection within the firm, while income support for the unemployed is limited.** There is no unemployment benefits system in Tunisia. Arrangements exist for providing limited social assistance through the CNSS to unemployed workers whose jobs were lost for economic or technological reasons. However, the safety net coverage for the unemployed is still limited: in 2001, only about 8,000 workers benefited from the assistance, which amounted to just over TD 1.4 million. International comparisons based on (i) the strictness of employment protection rules ("inside the firm"), and (ii) the amount spent on active and passive labor market programs (protection "outside the firm") suggest that Tunisia is well above average in "inside the firm" protection, and in the middle region in protection outside the firm—reflecting above average in spending on ALMPs (World Bank, 2003a, see chapter 5 on ALMPs).

60. **Improving flexibility of employment protection rules in a context of an increasingly open economy.** International evidence on the impact of employment protection rules shows that a flexible labor market arrangements would enable enterprises to adjust swiftly to rapidly changing conditions, to macroeconomic shocks, and structural changes, thus promoting competitiveness and creating conditions for sustained employment growth and job creation. Heavily regulated systems are associated with labor markets that are less dynamic and with lower formal sector employment growth. Rigid rules and procedures discourage enterprise restructuring by imposing excessive costs and large administrative burdens. Main options for reform include:

- **Providing less protection within the firm and offering more effective protection outside the firm.** This would call for social safety nets that go beyond the very limited aide sociale now in place and well-targeted active labor market programs.
- Increasing flexibility in the rules and procedures governing retrenchments. This would facilitate enterprise restructuring, as overall retrenchment levels are extremely low in Tunisia.
- Eliminating current ban on temporary help agency work. This would increase enterprise operational flexibility and help terminate informal practices to find temporary help workers.

2.4. Improving targeting of Active Labor Market Programs

61. During the last two decades the government has developed a vast number of programs covering broad categories of interventions. In Tunisia, as in other countries without a national unemployment benefits system, active labor market programs (ALMPs), as a risk reducing mechanism, constitute a key instrument of national employment policy. ALMPs cover broad areas of intervention: (i) Public employment services and administration of "Agence Tunisienne d'Emploi"; (ii) training and retraining programs for unemployed, at-risk, and employed workers, as well as the administration of the in-service training; (iii) youth measures, including job placement programs for first-time job seekers and general vocational training; (iv) wage subsidies; (v) micro-credits and other means of supporting entrepreneurs; and (vi) public works (World Bank, 2003a, see chapter 5 on ALMPs).

62. ALMP expenditures of about 1.5 percent of GDP are high by international comparison. Spending on ALMP increased throughout the Ninth Development Plan (about 1.5 percent of GDP in 2002), and overall ALMP expenditures are expected to be 36 percent higher in the Tenth Plan. This level of spending remains well beyond many OECD countries, including both high-income (e.g., United States, Japan, United Kingdom, Canada, and Australia) and all middle-income countries (e.g., Czech Republic, Greece, Hungary, Mexico), which allocate between 0.8 to 0.1 percent of GDP to ALMP (World Bank, 2003a).

63. Job-creation schemes, mainly micro-credits and youth interventions, are the most important categories of ALMP spending. Since most of the unemployed are young, the existing ALMPs are mainly tailored for this group. Micro-credits and youth interventions represent 80 percent of total expenditures (Figure 2.6). In absolute terms, spending in youth programs will double and will be the single largest expenditure item in the ALMP portfolio from 2002 to 2006. One notable area where spending in Tunisia is especially low is labor market training for unemployed or at-risk adults (only 0.04 percent of GDP in 2002). In OECD countries average spending on this training is almost four times higher at 0.15 percent. International experience demonstrates that with continued liberalization, these programs are crucial to assist workers who are displaced by inevitable restructuring changes.

64. Beneficiaries of Tunisia's ALMP activities do not always correspond to the profile of the unemployed. Emphasis on youth seems justified, given this group's very high unemployment rate. However, the bulk of the programs should not benefit the post secondary graduates, which account for only 6 percent of the unemployed, while the pool of unemployed is dominated by those with primary schooling or less (86 percent of the unemployed).
65. The Active Labor Market Programs (ALMPs) need to become more efficient, cost-effective, and adapted to the transformation and new needs of the economy in the context of international integration. As Tunisia becomes more engaged in opening and restructuring its economy, employment policy would need to move away from a model where the government played a central role in social protection through large public sector employment, close regulation of the labor market, and tight control of vocational education and training. Additional social protection schemes would need to be considered for those who risk losing their jobs. Options exist to improve efficiency of active labor market interventions:

- **Streamlining the Programs.** The number of ALMPs in Tunisia has proliferated, and as a result there are many different initiatives that are similar in purpose and target group. A streamlined menu of interventions could simplify coordination, render monitoring and accountability more transparent, and make it easier for clients to understand their options and to make informed decisions.

- **Considering the introduction of social protection schemes for those at risk of losing their job.** Options should be considered to minimize the risks of income losses for vulnerable workers who may lose their job. As already suggested, termination practices need to become more flexible, and ALMPs need to be directed more at workers already in the labor market. In this context, the ALMPs need better focus on employment services to facilitate job search and retraining programs to adjust workers skills to changes in the economy.

- **Considering faster implementation of vocational training reform agenda and addressing obstacles to development of in-service training.** Training reforms aim to improve demand-side orientation and management decentralization, but their implementation is slow. Impediments for enterprises to undertake training for their workforce need to be identified and addressed, because in-service training is important to equip workers with needed skills. Good international practice shows that the government can play an important role in addressing obstacles for firms to provide in-service training, but its role as provider of services needs to be minimized. Finally, the costs and benefits of the vocational training tax would need to be reviewed.

- **Developing adequate impact evaluations of the ALMP.** Tunisia is one of the few countries in the MENA region that has begun to use impact evaluations. However available results are not reliable because of design problems. Therefore, effectiveness of ALMPs is not known at this stage and additional work is needed to better-evaluate the programs’ impact on unemployment.

66. Summary of reform options

**In the short-term:**

- Increasing flexibility in the rules and procedures governing retrenchments
- Eliminating current ban on temporary help agency work
- Relaxing restrictions on the number of expatriate staff that can be hired by domestic companies
- Streamlining Active labor market programs to simplify coordination, improve delivery, render monitoring and accountability more transparent, increase cost-efficiency.
- Identifying obstacles to development of in-service training, considering faster implementation of vocational training reform agenda, and reviewing the costs and benefits of the vocational training tax.
In the medium term:

- Taking steps toward providing less employment protection within the firm and offering more effective protection outside the firm.
- Reviewing options to minimize the risks of income losses for vulnerable workers who may lose their job and directing ALMPs more at workers already in the labor market (such as employment services to facilitate job search, retraining programs to adjust workers' skills to changes in the economy, and safety nets).
- Considering introduction of efficient social protection schemes (safety nets) outside of enterprises for those at risk of losing their job.
- Promote development of in-service training and encouraging development of private provider of training while reducing Government role.
- Developing adequate impact evaluations of the ALMP to better-evaluate the programs’ impact on unemployment.
Chapter 3. Fostering Private Investment, Competitiveness, and Job Creation

67. **International experience shows that the quality of economic governance matters for private investment.** Businesses react to incentives, costs, and constraints, which are often summarized as the 'business environment' or, more narrowly, as 'the investment climate'. Economic governance refers to the actions of the government in shaping and implementing policies that in turn determine whether there is a sound, attractive environment for business and investment. There is growing evidence that good economic governance is critical to foster private investment; take advantage of increased global flows of information, goods, and capital; and improve resilience to shocks (World Bank, 2003g). Three main areas are key to ensure a high-quality environment for doing business:

- Lowering transaction costs for business entry, operation and exit, by ensuring a good regulatory framework, protecting and enforcing property rights, and curbing burdensome administrative and judicial rulings;
- Enhancing predictability of rules and regulations, by ensuring transparency and reducing the scope of for arbitrary government policy-making;
- Strengthening market contestability, by promoting competition, making more room for private sector involvement in sectors where public enterprises are still the main players, and promoting corporate transparency.

68. **Tunisia’s deeper trade integration would call for a high-quality business environment that fosters flexibility, predictability, healthy competition, and promotes a level playing field for investors.** As explained earlier, the old model with excessive government interference in private investment decisions will be losing steam in the more competitive environment associated with the free zone with the European Union. In the upcoming environment, efforts to upgrade economic governance in Tunisia should be geared toward all three areas outlined above. Although Tunisia has made significant progress in lowering transaction costs for businesses, much remains on the agenda, especially for the so-called onshore sector that will soon be facing stiff competition. But the core of the reform agenda should include initiatives to improve the predictability of rules and regulations and strengthen market contestability. Moreover, steps to ensure needed flexibility in the labor market would foster private investment and job creation. Coordinated progress on these fronts would help make Tunisia’s deeper trade integration work for growth and jobs in the years ahead. A deeper understanding of factors affecting the investment climate, through appropriate firm surveys and benchmarking of Tunisia with competitors, would help better target policies in these areas.

3.1. **Lowering transaction costs for business entry, operation, and exit**

Starting and closing a business: mixed progress

69. **In Tunisia, business registration is fast and efficient.** In a recent World Bank survey on the costs of doing business, Tunisia scores relatively high in several business entry indicators (World Bank 2003f). Business registration is relatively fast and efficient, as it takes 9 procedures and 47 days to start a business (Figure 3.1). The one-stop shop (guichet unique) of the Industry Promotion Agency (API), which was certified ISO 9002 in June 2000, has undoubtedly facilitated business registration.

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A systematic benchmarking of Tunisia against a number of countries at similar levels of development across indicators of business regulators is contained in Anos Casero and Varoudakis, 2003
However, the minimum capital requirement is still high, and delays in securing finance, land and construction permits still persist. Paid-in capital at registration amounts to 350 percent of income per capita—about the same amount as the capital requirements to start a business in France. Recent evidence shows that high minimum capital requirements can thwart the establishment of new businesses (World Bank, 2003b), and is also reported as an obstacle to starting a business in Tunisia, particularly for small size companies (Institut d’Economie Quantitative, 2002b). Prior authorizations relating to environment, labor and sectoral regulations are still relatively numerous and impinge on the establishment of new businesses in non-manufacturing sectors. Delays are also reported in securing finance, land and in obtaining the construction permit. If these are added up, the effective period to start up a business in Tunisia may exceed two years (World Bank, 2000a; Lahouel, 1999).

Small commercial contracts are rapidly enforced. Tunisia is the world’s leader in speedy resolution of small commercial disputes (World Bank, 2003f). The process lasts only 7 days and includes 14 procedures, from the moment of filing the claim with the tribunal cantonal in Tunis until the moment the credit receives payment. The recovery of overdue small debts is normally achieved by means of a special procedure called ‘injonction de payer’ before a general-jurisdiction judge, provided that the debt has been proven and established. This simplified procedure, which does not mandate legal representation, helps reduce the legal costs which amount to 8 percent of the total enforcement cost.

Closing a business is difficult due to lengthy bankruptcy process and broad power of courts in bankruptcy proceedings. The bankruptcy process takes about two and half years, longer than in countries at similar levels of economic development (Figure 3.2, and World Bank, 2003f). But the bankruptcy process is not very costly, as it represents about 8 percent of estate, compared to 18 percent in Poland and 38 percent in Hungary and Thailand. The Tunisian jurisdiction, like many other French-legal origin jurisdictions, has attempted to reach the goals of insolvency by giving broader powers to the court. But evidence shows that court power is inversely related to the likelihood of achieving the insolvency goals (World Bank, 2003f). As further explained below, involving creditors and other stakeholders in the insolvency process is important to preserve absolute priority of creditors’ claims, and can help ease access to credit.
Improving the efficiency of customs clearance rules and procedures

73. Despite substantial progress on trade facilitation reforms, procedural complexities and inconsistencies in administrative decisions remain. The number of customs documents has been reduced and a new system of normalized and simplified documentation for external trade transactions has been put in place (liaison unique). The government plans to introduce the electronic payment of customs duties and the clearing of goods before arrival in ports. Import authorizations are on decline, but these are increasingly been replaced by technical controls (Figure 3.3 and IEQ, 2003b). For several goods (fertilizers, cement, tires, cereals, petroleum, sugar, coffee, tea) the removal of licensing has been conditioned upon compliance with 'cahiers de charge' which specify quality requirements. For these goods licensing is removed only if the 'cahiers de charge' is issued by the administration.

74. Customs clearance is still perceived by importers as a serious non-tariff barrier to trade. While there is transparency in the type of products subject to technical control, the major problem resides in knowing the delays required to get laboratory clearance. The time, flexibility and discretionary power that the relevant authorities have cause a great deal of uncertainty and significantly increases in the cost of imported goods. Inconsistencies in administrative decisions (e.g. the same merchandise being certified one time and rejected another time) have been reported by importers. Technical barriers tend to lengthen clearance delays by weeks with storage costs increasing as time goes by. The excessive clearance delays are also due to low productivity in cargo handling in the main port of Rades which is still run by a state-owned monopoly, STAM. In recent surveys, Tunisian firms report that it can take three weeks or more to comply with administrative requirements (Zarrouk 2003). Customs procedures rank as the second most regulatory and administrative constraint after hiring and firing regulations and before tax procedures (IEQ 2002b). Overall, the cost of non-tariff barriers for Tunisia is estimated at about 10% of the value of the goods shipped.

3.2. Enhancing Predictability of Rules and Regulations

Establishing an incentive structure that reduces uncertainty and levels the playing field among investors

75. The Tunisian investment incentive regime grants very generous tax advantages, especially to exporting firms. The system of investment incentives established in 1993 has aimed to replace the sector incentives of the old system with a generous system of horizontal incentives for exporting, agriculture, priority regions, and certain categories of entrepreneurs. The most significant beneficiaries of this system have been offshore, export-oriented enterprises. Any manufacturing firm exporting at least 80 percent of its production, located anywhere in the country and being of any nationality, including the Tunisian nationality, benefits from the off-shore regime. This regime grants duty-free imports of capital and intermediate goods, exemptions from VAT and excise taxes, and exemption from the corporate income
tax. Under the existing investment incentives law, the corporate tax holiday is limited to the first ten years of the life of the off-shore firm after which profits are taxed at half the legal rate, currently equal to 35 percent. In addition to tax advantages, the regime allows off-shore firms to avoid the customs and other administrative procedures that other importers selling goods on the local market are confronted with. These important fiscal and administrative advantages gradually attracted not only foreign investment but also national investment to export-oriented activities.

76. **The off-shore sector contributed to developing manufacturing and fostering exports and employment.** The off-shore regime corrected the import substitution bias of Tunisia’s trade policy and thus helped promote export-oriented growth. Out of a total of 5065 manufacturing firms with more than 10 employees surveyed in the year 2000 by the "Agence de Promotion des Investissements" (API), 43 percent are off-shore or totally exporting firms. The majority of these firms (89 percent) work in textiles and garment, leather and shoes, and the electrical sector—although the textiles and garment companies hold the lion’s share (75 percent). These firms employ 57 percent of the total labor force employed in manufacturing. Tunisia’s success in exports is also largely due to the off-shore firms which account for over 63 percent of total merchandise exports.

77. **But investment incentives entail sizeable fiscal costs and administrative complexity.** At an estimated TD 668.3 million in 2001, the total cost of tax and financial incentives in the investment code amounted to an estimated 26 percent of private corporate nonfinancial investment—about 2.3 percent of GDP. The total cost of incentives was up by 65 percent from 1997, largely outpacing the growth of nominal GDP. This cost is overwhelming when compared to the annual FDI flows in manufacturing, privatization proceeds excluded, which averaged TD 147 million annually during the years 1997-2000. Moreover, the comparatively high rate of corporate income taxation of on shore firms may entail fiscal costs in terms of reduced tax compliance and tax evasion of these firms. Another cost associated with the incentive regime relates to its complexity, and thus, the administration’s difficulty to administer it effectively. It imposes a considerable administrative burden, and this results in delay and uncertainty for investors, increasing the cost of investment.

78. **Despite the generous incentives in place, the responsiveness of private investment has been rather mute.** As documented earlier, Tunisia’s private investment has not made a contribution to growth above the average of developing countries, and has been losing momentum since the mid-1990s. Fixed investment in the textile and leather industries—which account for more than half of offshore regime investment and absorb the lion’s share of the associated tax and financial incentives—grew by 8.9 percent per year on average, in nominal terms, over 1997-2002, about the same rate as in the nonagricultural enterprise sector as a whole (9.2 per cent). The electromechanical industry is an exception, with a strong investment growth over this period of 12.5 percent per year in nominal terms. Tunisia’s evolving comparative advantage in this industry, as well as the low starting level, are main factors in explaining this investment boom. Competitive advantage, rather than investment incentives, is likely to have been a much more important determinant of Tunisia’s success in export-oriented industries.

79. **Ongoing trade liberalization is changing the rationale for the existing investment incentives.** Before the onset of Tunisia’s trade liberalization, firms producing for the domestic market benefited from high import duties protection, which favored local sales over exports. Once tariffs on imports of manufactured goods from the EU are fully removed by 2007, preferential tax treatment of exporting firms will become much harder to justify—in any case not on the ground that off-shore firms earn hard currency for the country while other firms don’t. Both off-shore and on-shore firms will become equally exposed to foreign competition. Saving on the import bill, thanks to better competitiveness of the “on-shore”, import-competing firms, will become as important as earning hard currency for the country through exports of the off-shore firms.
80. **Rebalancing taxation in favor of firms working for the local market will improve the investment climate for these firms.** This would strengthen incentives for investment and job creation at a juncture of trade liberalization that will intensify tensions in the labor market. Despite the other tax incentives local firms can take advantage of (investment in less-developed regions etc.), the *effective* corporate tax rate they face remains high, at an estimated 27 percent (World Bank, 2002a). The Tunisian authorities are considering moving toward alignment of the off shore and on shore tax regimes by 2007, through the taxation of 50 percent of export profits and an increase in the minimum tax rate. To strengthen the investment climate, it is important that the reform be phased in appropriately, while ensuring a simpler and more transparent taxation policy. In a first stage, a new corporate tax rate could be applied to all off-shore firms, new or old. In a second stage, the non preferential rate could be unified with the off-shore rate and brought down to a *tax-neutral* rate, at around an estimated 20 percent (World Bank, 2002a).

81. **A reaction of foreign off shore firms to investment incentives reforms could be managed.** The Tunisian authorities have constantly expressed the concern that foreign off-shore firms may relocate in other countries that offer fiscal or other types of advantages. However, international evidence shows that tax incentives do not play an important role in the distribution of FDI between countries (Morisset, 2003; Oman, 2000). Most importantly, the effect of tax exemptions on FDI may vary according to whether, (i) the off-shore firm is a subsidiary of a multinational company, or created in Tunisia under Tunisian law, and (ii) whether there is a tax convention of non-double taxation between Tunisia and the country of nationality of the shareholders. For a subsidiary of a multinational, and in the absence of a bilateral tax convention, any difference between tax dues paid in Tunisia and dues to the country of origin will have to be paid to the latter, provided of course the rate in Tunisia is lower than in the country of origin. If there is a tax convention, corporate income is taxed only in one country. Thus, *for a foreign firm*, it is not clear to what extent the fiscal exemption granted in Tunisia is a real advantage. By contrast, in the case of off-shore companies created under Tunisian law, in the absence of bilateral tax conventions, foreign shareholders may indeed be sensitive to the amount of corporate taxes due in Tunisia. It is thus important that reform of the investment incentive regime be accompanied by bilateral tax conventions that clarify the taxation of corporate and personal incomes earned in Tunisia.

82. **Other incentives schemes, such as the “Mise à Niveau” program, have a positive impact on corporate transparency in financial reporting, but suffer from selectivity bias.** Disbursement of “*Mise à Niveau*” (MAN) grants is conditional upon meeting financial soundness requirements, and necessitates auditing of corporate accounts. Essentially two financial criteria are considered: a ratio of equity to fixed assets equal at least to 30 percent, and a ratio of long-term financial resources to fixed assets at least equal to one. This creates conditions for better corporate transparency, a much needed improvement in the governance of the Tunisian corporate sector, with a potentially positive impact on the diversification of the sources of financing (see chapter 4). Authorities consider that the program has significantly contributed to strengthening Tunisian companies. However, the program seems to have favored winners: firms that meet the performance criteria of the program are mainly large firms and exporting companies that also benefit from the generous investment benefits of the off-shore regime: In October 2003, out of 1492 firms participating in the program, 548 were totally exporting companies, while the majority (835 firms) were employing more than 50 workers—with 204 firms employing more than 200 workers. In spite of efforts to target small firms, MAN resources are mainly directed to well established large firms with easy access to finance. Importantly, the evidence regarding the effectiveness of the MAN program is

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* Total exemption from both the corporate income tax is certainly an important advantage for Tunisian off-shore firms, much less for foreign firms. But for Tunisian off-shore firms, the issue of moving elsewhere does not arise the same way as for foreign firms since capital movements are restricted. The alternative they have is to reallocate their resources to domestic sales. This may take place to some extent but given the limited size of the domestic market and that imports are liberalized, this alternative is no longer as attractive as it used to be under the old regime of protection.
mixed, also reflecting the selectivity of the program, warranting further examination of its cost-effectiveness. The MAN could shift its focus towards improving the incentive structure for greater immaterial investments. This will help companies better absorb the benefits of ICT developments, improve linkages with foreign partners, and, more generally, help Tunisia prepare the ground for the knowledge-based economy.

Box 3.1: Performance of the “Mise à Niveau” Program—mixed evidence

Owing to the strict financial eligibility criteria, MAN disbursement ratios remain low. Over the period 1996-2002, the MAN program approved a total number of 1350 applications for assistance while total committed investment and approved subsidies reached respectively 2323 MD and 300 MD. Three sectors account for almost two thirds of investment and subsidies, food processing, construction materials, and textiles and clothing. Disbursements are made in three installments with the first one served upon completion of 30% of committed investment. Only a few firms have claimed and obtained the full subsidy. And only 92 MD of subsidies have been disbursed so far.

The impact of MAN on additional investment and employment is unclear. Enrolled firms have had a somewhat higher performance than total manufacturing in terms of sales and exports, and marginally so in terms of employment. The sales of enrolled firms grew at an annual rate of 11%, against an average growth rate of 8.3% in total manufacturing. Exports increased at 16% annually, against 13.5% for all manufacturing, and employment grew by 4% per year, compared to 2.9% for the whole sector. But the differences with the sector average on the three fronts are not all due to the impact of the program. They also reflect selectivity bias, as the firms that meet the performance criteria of the program were better performers than other firms in the first place (export-oriented and large firms). The limited impact on employment raises questions about the tendency of MAN-supported modernization to favor capital-intensive projects. The cost-effectiveness of the program is also at stake. Simulations show that even in a high elasticity case of investment with respect to the user cost of capital, the investment due to MAN would represent 0.65 percent in terms of GDP. The total amount of subsidies approved over the same period would have represented between more than 50 percent of the additional investment induced by the program.

Reducing regulatory uncertainty stemming from private investment restraints

83. Restrictions still apply on majority capital ownership by foreign investors in key sectors. Two types of legal constraints apply to FDI: (i) restrictions on capital ownership by foreign investors; (ii) general private investment constraints—especially in services and network industries (examined below). Majority participation of foreign investors is permitted only in manufacturing industries, tourism, services for exports, and industry-related services. Prior approval of the Tunisian’s administration is required for a majority foreign equity share in service activities producing for the local market and for the acquisition of more than 50 percent of equity of existing Tunisian companies. Administrative authorization is also required above an equity threshold for investing in agriculture and fishing—ownership of land is prohibited. Tunisia has reaped important benefits from foreign investor participation in export-oriented manufacturing. But improving Tunisia’s strategic positioning in the free-trade zone with the EU would call for greater openness of still restricted activities to foreign investment. Besides limiting FDI, restrictions on foreign investor participation hamper restructuring of Tunisian firms, and also hinder the deployment of venture capital by preventing exit from venture capital investments in partnership with foreign investors (see chapter 4). Moreover, the process of prior approvals is lengthy, uncertain, and lacks transparency, and thus does not contribute to strengthening the investment climate.

84. General restraints to entry apply to both national and foreign investment. While the administrative procedure is limited to simple reporting for some activities, government authorization is required for many other activities that could have attracted significant private investment. Despite steps to reduce the number of such administrative controls, 225 activities still remain restricted. And in a number of sectors where prior approvals have been eliminated, potential entrants have to comply with
cumbersome entry regulations ("cahiers des charges"), such as for example in internet service provision. Activities needing simple reporting are manufacturing, agriculture, some of the services producing exclusively for exports, industry-related services. Activities still subject to prior approval include fishing, tourism, transportation, telecommunications, health care, real estate development, film production, vocational training, education and training, among others. The list of activities subject to prior approval becomes even longer when adding other activities regulated by specific laws: banking and investment companies, insurance, brokerage, etc. As for foreign investment restriction, the prior approval process in the case of activities subject to general investment restrictions is a source of regulatory uncertainty and lack of transparency. Moreover, as explained below, the number of restrictions on service activities is a factor explaining the weak private investment in the sector. Prior approvals should be replaced with simple entry regulations verified ex post ("cahiers de charges"), while simple reporting of business entry would be enough for competitive activities that do not produce externalities or public goods.

3.3 Enhancing market contestability by reducing restraints to entry and strengthening competition policy

Opening up infrastructure services to competition: a key to greater private investment and improved competitiveness

85. Tunisia has reached a reasonably good quality of infrastructure service delivery, but major challenges lie ahead. The coverage with basic services is higher than in most other countries of the region; subsidies to the sector are very limited; and the technical efficiency of the service providers is high. However, Tunisia’s deeper trade integration and the need to promote faster growth raise a number of challenges:

- Making more room for private sector investment in services—particularly in network industries—holds a key role in promoting total investment and job creation and attracting more FDI. Contrary to global trends, and apart from small FDI amounts directed to tourism, Tunisia receives negligible FDI in the non-energy services sector.
- The quality and price of telecommunications and transport services are of particular importance for Tunisia, because the service sector—which is expected to be a major source of GDP an employment growth—significantly depends on those services. Given the government’s objective to reduce the public debt and promote fiscal consolidation, the public sector is unable to finance all new investments.
- Competition in certain market segments remains limited, and there is room to improve the economic efficiency of service providers. The traditional model of a Ministry attempting to regulate a monopoly using performance contracts with detailed targets has shown its limits, given uncompensated and ill-defined public service obligations, soft budget constraints, and the absence of sanctions for breach of contract by either the State or the enterprise.

86. Contrary to steps taken elsewhere, and despite recent initiatives, Tunisia still lags behind in regulatory reform to open services to competition. Other countries in Eastern Europe, also geographically close to the EU and potential competitors, have been more eager to commit to services liberalization. Tunisia has granted WTO commitments for tourism, financial services and communication services (Table 3.1) This will help further realize the country’s tourism potential and improve the efficiency of financial transactions, laying the groundwork for the development of domestic financial markets. But the absence of commitments in other key sectors such as the transport and distribution sectors will impinge on Tunisia’s ability to deepen trade integration.
87. **The overall pace of private participation in infrastructure has remained slow.** The strategy for private participation in infrastructure, initiated in the mid-1990s, has been to limit private participation to new investments, while holding back the privatization of state-owned enterprises (except for selected minority stakes sold on the local stock market). In power and water, the government has limited private participation to service contracts and greenfield projects, thus maintaining the state-owned enterprises' monopoly to interface with clients.

88. **Allowing for stronger competition is key to enhance infrastructure's contribution to growth and employment.** The scope for increased competition is greatest in telecommunications services (see below). Benchmarking competition through the collection and publication of comparable performance indicators on a regional basis may have the greatest potential in electricity distribution as well as in water and sanitation. Competition in the water, sanitation and electricity sector could be tested through the award of private sector contracts for electricity distribution or water and sanitation in selected parts of the country within an established regulatory system allowing to benchmark the performance of the public operator against a private operator (World Bank, 2003e).

89. **Improving utility regulation is a precondition for competitive opening of network industries.** Only in telecommunications a regulatory agency exists, whose functions and autonomy are limited (see below). The benefits of private sector participation could be greatly increased if regulatory capacity was improved. Enacting the concession law would set out a fair and transparent process for the award and modification of concessions within a clear regulatory framework. Initially, Ministries can perform regulatory functions, but in the long term it is preferable to create autonomous regulatory agencies with an established reputation of independent professionalism, insulated from undue influences by public or private service providers or the government.

90. **Improving cost-recovery and financial management is key to sound financial outcomes.** The established policy on cost recovery could be refined in at least two important ways. First, tariff adjustments could be based on intelligent indexation mechanisms that allow for frequent automatic adjustments linked to changes in selected key prices, while allowing for an adjustment factor based on increased productivity targets. Second, a reduction of cross-subsidies between different users of the same service should be considered in favor of targeted, means-tested subsidies. In terms of financing, Tunisia could rely on an appropriate mix of private and public funding for privately managed projects. Tunisia could also encourage infrastructure funding by the local financial sector through syndicated loans among local and foreign banks, in order to cover the portion of costs in local currency and to mitigate foreign exchange risk (World Bank, 2003e).
Opening up the Information and Communications Technologies sector: a strong promise for growth

91. The openness of the telecommunications sector in Tunisia is still limited, but the authorities are committed to expanding the liberalization agenda. International experience indicates that openness of the telecommunications sector to competition and pro-competitive regulation is associated with better competitiveness and international trade benefits, including the development of electronic commerce (Schware and Kimberly, 1995, 2000; Rossotto, Sekkat, and Varoudakis, 2003). Low-cost, high quality telecommunications networks are a prerequisite for the development of high-growth ICT services (World Bank, 2002b). The Government of Tunisia, in cooperation with the World Bank, has elaborated a ICT Strategy which served as an input for the Xth Development Plan (World Bank, 2002c). Main objectives are to increase ICT revenues from 3.3 percent of GDP in 2001, to 6-8 percent in 2006, and to create 30,000 jobs in the ICT sector. So far, the Government has implemented certain measures to enhance competition in the telecommunications sector:

- In 2002, it has introduced competition in the mobile cellular market, through the award of a competitive license to Orascom;
- The number of Internet Service Providers has been increased;
- The Government has recently awarded a private company, Divona Telecom, with a voice and data transmission license using VSAT (Very Small Aperture Terminal) technology, ending Tunisie Télécom monopoly;
- Global Mobile Personal Communications Services (GMPCS) services have been introduced through the incumbent operator, Tunisie Telecom.

92. Several important steps have also been taken to upgrade the regulatory framework. These measures include: a) the enactment of a new Code des Communications; b) the passing of implementing regulations in several areas, including interconnection, numbering and spectrum management (a regulation covering the area of private networks is under consideration); c) the establishment of the Instance Nationale des Telecommunications (INT), a semi-independent agency which oversees over interconnection matters, numbering and other disputes among telecommunications operators; d) the creation of the Agence Nationale des Frequences, and EPIC under the responsibility of the Ministry. In addition, the Government has also undertaken several measures aimed at enhancing the diffusion of ICT among Tunisian enterprises and citizen.

93. However, Tunisia still lags behind in key ICT sector development indicators. Both the number of Internet servers and the number of hosts per capita, are lower than in other regional benchmarks, though the number of users is in line with, or higher than MNA values. At the beginning of 2003, there were 65 Internet hosts in Tunisia, against 1383 in Morocco, 7667 in Lebanon, and 20541 in Egypt. Similarly, the number of secure Internet servers per 1 million inhabitants, although higher than in Morocco and Egypt, is about 10 times lower than the number in Lebanon and Turkey (Figure 3.4). The fact that a large number of Tunisian enterprises decide to host their website abroad reflects the weakness of Tunisia’s infrastructure in this area, and may reflect both cost and regulatory impediments. An acceleration in the liberalization of the data infrastructure, with the introduction of new data network operators, would contribute to improve the
situation. A review of the regulations in the Internet area, in order to promote the diffusion and use of Internet and ICT by enterprises, should also be a priority.

94. **Tunisia still holds high costs in international communications.** The cost of a three minutes call to the US is several times higher than the cost in Western and Eastern European countries. This too can be an impediment to competitiveness, especially for the development of ICT-intensive services, such as call-centers. It is estimated that Morocco, in the years 2001-2003, has attracted around 5,000 jobs in the call-center business. Accelerating the introduction of competition in the international (voice and data) communications market, with the award of competitive licenses, would help Tunisia improve its competitive position in this area.

95. **A number of measures could enhance the program of regulatory reform.** Aside the two high-priority areas, Internet and international communications, a series of measures could enhance the program of regulatory reform: a) the announcement of a full liberalization date (similarly to the 2008 date for the AAEU); a date in which all numerical barriers to entry will be removed; b) the enactment of fair competition rules, and the attribution of powers to INT or other bodies, to sanction dominant operators in anti-competitive behavior cases; c) the reorganization and streamlining of regulatory attributions in the ICT sector (presently shared by five different agencies, INT, Ministry, ANF, Agence Tunisienne de l’Internet, Agence Nationale de Certification). Ideally, the attributions of INT should be broadened to cover some of the functions of the other bodies, and INT’s independence should be strengthened.10

96. **Overall, services liberalization in Tunisia holds the promise of substantial macroeconomic gains.** Recent studies have developed a series of trade policy scenarios to evaluate the combined effects of goods and services liberalization (Konan and Maskus, 2002; Konan and Kim, 2003). The combination of the EU Partnership Agreement and a broad based reform of the services sector would potentially increase output by 11.4 percent. In this scenario, services liberalization would increase GDP roughly 5 percent above that achieved purely by the EU Association Agreement. These gains are primarily attributed to pro competitive and efficiency gains arising from FDI in services sectors. While the wage bill increases with services liberalization (4 percent more than with the AAEU), the capital bill increases even more significantly (by 8 percent compared with the AAEU). Income distribution tends thus to shift slightly in favor of capital income. According to these simulations, the contributions of the ICT, transport and finance would amount to 17, 13 and 6 percent respectively of the estimated output growth under combined EU partnership and services liberalization.

97. **But benefits would depend on the extent of regulatory reform.** As established by simulations based on international experience in a high-case scenario, ICT development, spurred by opening up telecommunications markets to competition and exports of software and ICT-enabled services could boost GDP by as much as 4.4 percent and raise total employment by about 2.6 percent in the medium term (World Bank, 2002c). Because of its low starting level, the IT segment will grow even faster than telecommunication services, with software and IT-enabled services realizing the most dynamic growth. The high case scenario highlights a fully-fledged absorption of ICT benefits and the right regulatory and business environment in place. By contrast, in a base-case scenario, the benefits would be mute, reflecting a failure to remove the existing barriers to ICT development.

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10 In some areas, INT does not have attributions that other regulatory agencies in the region have. There is a different agency for the regulation, management and monitoring of radio spectrum frequencies. In addition INT does not prepare or intervene in the preparation of the license text for new telecommunications operators, a prerogative that, for example, ANRT in Morocco has. Another example is that INT does not prepare or proposes new draft implementing legislation. This also is in contrast to the attribution of other agencies in the region.
Strengthening competition policy and ensuring the coordination and integration of regulatory functions across sectors

98. An important element of a sound business environment, conducive to greater investment, is market contestability, underpinned by a credible and enforceable competition legislation. International experience suggests that when competitive forces are weak risk-taking, entrepreneurship, and investment are discouraged. To strengthen the investment climate, it is thus important to ensure transparency and competitive market conditions. In their absence, privatization, deregulation, and other supporting reforms may not produce the expected results, owing to mute investment response.

99. Tunisia has made considerable progress on the legal front of competition policy. Tunisia is one of the few MENA countries that have enacted competition and anti-dumping laws. It established a competition legislation as early as 1991, which was subsequently amended in 1995 and 1999. This law abolished margins on retail prices in 2000 and created a Competition Council. Two institutions are responsible for applying competition rules: the administration (Department of Competition at the Ministry of Commerce) and the Competition Council (Conseil de la Concurrence). The administration is primarily responsible for the implementation of competition policy and consumer protection, as well as drawing up the related regulations, monitoring the operation of the market and conduct of economic surveys. The Conseil de la Concurrence has a dual role: a judicial role in which it is a judicial authority in respect of anti-competitive practices, and an advisory role whereby it can be called on to give its opinion on draft legislation and regulations and all competition-related issues.

100. However, anticompetitive practices remain. The competition law bans abuses of dominant position and also prohibits exclusive distribution contracts and cartels with an anti-competitive purpose. However, the law provides discretion to the Minister of Commerce to grant derogations for specific situations which, although anti-competitive, may generate technical or economic progress and thus may give rise to benefits to consumers. Moreover, the public sector is at least as responsible as the private sector for anticompetitive conduct. Imports of several products, such as petroleum products, drugs, cereals, seed oils, tobacco, alcohols, coffee, sugar, and tea, remain monopolized by state trading boards or public enterprises. Such import monopolies cover about 15 percent of the import bill. State monopolies are much more prevalent in services markets (see below).

101. To create more business opportunities for the private sector some state trading monopolies can be dismantled, along with continued liberalization of controlled prices. Dismantling of some import monopolies, such as that for pharmaceutical products, would be premature, as they provide key support to social sector policies and have not impeded the development of successful private sector activity. By contrast, dismantling of import monopolies in products where domestic prices are higher than international prices (e.g., sugar, tobacco, alcohols) would be much easier, with the use of tax instruments substituted for the administered prices. Dismantling of trading monopolies in products where domestic prices are subsidized (cereals) or administered at below international prices (some petroleum products, coffee, tea, soybean oil), would call for appropriate adjustments of domestic prices. Such adjustment could be completed rapidly for some products (coffee, tea, seed oils), but may require more time in petroleum products.

102. Enforcing the competition law by strengthening the role of the Competition Council remains a central challenge. The scope of work of the Competition Council was broadened in 1995 and again in 1999. In practice, however, the Council is still developing as an institution and after twelve years of existence it has acted on only a very small number of cases presented by the private sector and the
Ministry of Commerce. In only three cases did the Council find firms guilty of anti-competitive practices and imposed sanctions on them.

103. **The Competition Council is weak for a number of reasons.** First, its legal powers are limited. By law it cannot initiate investigations on its own but in two very special circumstances, and practically all cases are brought to it by the Minister of Commerce. Second, it is dependent of the Ministry of Commerce. It functions in fact more or less as a department within the Ministry. And it does not have the authority to lodge suits. In Tunisia, only the Ministry of Trade can initiate cases. If the government is the only agent with this authority, the effectiveness of the competition law in promoting competition can be undermined. Third, the Council lacks resources, material and human. It has a very limited budget and lacks the staff needed to carry out investigations adequately or to monitor firms’ behaviour or market structure and conduct. A competition council requires strong expertise and capacity in competition law and economics. It requires skilled, specialized lawyers, economists and accountants.

104. **A number of options could be considered to strengthen the Council’s role in ensuring a competitive and contestable business environment.** The powers of the Council could be further expanded to prevent restrictive practices, investigate anti-competitive conduct, mergers and acquisitions or privatizations cases; undertake studies and make suggestions concerning the promotion of competition; and advise the Government on any draft legislation related to competition. It could assume a larger role in regulating competition, and the law could be amended to make it obligatory, not optional, for the Government to consult the Council on matters related to competition. The Council should also be given sufficient resources to strengthen its regulatory capacity in the areas of competition, law and economics. Allowing appeals to higher courts, particularly for the larger cases, would ensure the necessary checks and balances on the Council’s activities. In addition, decisions by the Council could be made publicly available. Public availability of competition decisions has a deterrent effect on potential future violations of the competition law, which should help promote the effectiveness of the law and, by providing checks and balances, could also help ensure the fairness of the proceedings.

105. **Coordination between the competition council and sector regulatory bodies will be necessary.** With progressive opening of infrastructure sectors to competition, it will become necessary to better define the respective roles of the Competition Council and the sector regulatory agencies (currently there is only one regulatory body in Tunisia in the telecommunication sector), to ensure coordination of the regulatory functions across sectors. This will help prevent harmful cross-subsidization practices by consortia that may develop across sectors in the future. As discussed above, the regulatory fragmentation and the lack of separation between the incumbent operator and most of the agencies in the telecommunications sector should also be tackled, because the existing environment may become an obstacle to further private participation and more dynamic development of the sector.

3.4 Furthering Tunisia’s international trade integration

106. **Tunisia is making considerable progress in tariff dismantling in the context of the Association Agreement with the EU.** The implementation of the tariff dismantling schedule under the AAEU is on track. Around 55 percent of the tariff reductions are already in place. Tariffs were totally removed for capital goods in 1996. Tariffs have been totally dismantled on the second list of goods, that of raw materials and intermediate goods since the year 2000. Import duties on the third and fourth lists have been cut by about one half and one fourth respectively by the end of 2001. This liberalization excludes agricultural goods as well as the agricultural components of processed food. Negotiations with the World Trade Organization for further tariff dismantling are ongoing and the Tunisian authorities are harmonizing the various regional and bilateral trade agreements in place.
107. However, the gap between tariffs applied to imports from the EU and from the rest of the world has widened. In 2003, average (unweighted) Tunisian MFN tariffs were 28.6 percent, slightly down from 35.9 in 2000, compared to 24.3 percent for imports originating in the EU. The gap is much larger for non-agricultural products, for which average Tunisian MFN tariffs in 2003 were 22.2 percent, against 10.9 percent for EU imports. The gap with EU preferential tariffs is set to further increase in the years ahead, following the completion of the Association agreement with the EU. High MFN tariff differentials with respect to EU preferential tariffs may be at the origin of trade diversion, denying the Tunisian producers and consumers the benefit of less expensive imports from outside the free-trade zone with the EU. Targeting tariff reductions that bring Tunisia’s MFN tariffs as close as possible to the EU’s external tariffs for industrial products would be essential to prevent such distortions and reap the full benefits of trade liberalization.

108. Despite significant measures taken in the 2004 budget to reduce trade protection for imports outside the EU, protection remains high in Tunisia. The number of customs duty rates has been reduced from 30 to 10 and their level has been reduced across the board. Although these initiatives go in the right direction, MFN tariffs remain high in Tunisia, particularly in comparison to neighboring countries. As indicated in figure 3.5, Tunisia has the highest MFN tariff after Morocco. This high level of tariffs is contrasting with East European countries’ low tariff rates. Though protection is primarily aimed at raw materials and consumer goods, tariff rates are comparatively high for intermediate goods (22.7%) and capital goods, for which Tunisia applies the highest tariff protection in the region (Table 6 in annex).

109. Despite progress in nominal tariff reduction, the trade regime remains protected. Tunisia’s trade liberalization has focused on AAEU, yielding significant gains in protection for Group 1 and 2 products (capital goods and intermediates). However, Group 3 and 4 products (consumer goods and close substitutes to domestic production) still receive long-term exemptions. As a result, effective protection has increased in the run up to the free trade with the EU, at more than 60 percent (IEQ, 2002a). The IMF trade restrictiveness index assigns Tunisia a high rating (8 out of 10) due to high top marginal rates (215 percent) and a variety of non-tariff barriers. Average tariffs are also high and non-tariff barriers remain extensive, some 33 percent of all tariff lines – among the highest coverage in the world. The earlier extensive quantitative restrictions have progressively been relaxed. But some items still remain subject to import licenses or quotas, particularly consumer goods that compete against locally produced equivalents manufactured by “developing” industries (e.g. textiles). For such products an importer must obtain a license from the Ministry of Commerce specifying the product, quantity and amount of foreign exchange needed.
110. **Summary of reform options**

**In the short-term:**

**Lowering transaction costs, enhancing transparency and predictability of the regulatory framework, and strengthening market contestability**

- Reviewing minimum capital requirements for business entry
- Improving efficiency and predictability of customs clearance rules and procedures
- Reviewing the incentive structure to reduce uncertainty and improve firm visibility
- Accelerating opening up of infrastructure services to competition, especially in ICT services and transport
- Reducing restrictions to majority capital ownership by foreign investors and prior approvals, to ensure nondiscriminatory treatment of investors in market access
- Strengthening the independence of the telecommunications regulator and reducing regulatory agency fragmentation in the ICT sector

**In the medium term:**

- Implementing reform of the incentives system with the aim of leveling the playing field between off-shore and on-shore companies
- Simplifying regulatory framework to secure land and construction permits
- Simplifying bankruptcy procedures and narrowing court powers by ensuring greater involvement of creditors and other stakeholders
- Strengthening the autonomy and the role of the competition council
- Ensuring the coordination of regulatory functions across sectors
- Focus “Mise à niveau” initiatives on SMEs and immaterial investments
- Accelerate the reduction of tariffs on imports outside of the EU
- Consider dismantling existing import monopolies
Chapter 4. Finance for Growth: Promoting an Efficient Financial Sector

111. **Strengthening the soundness of the banking system, and improving diversification of the sources of finance is key to ensuring adequate finance for private investment.** The Government has taken important steps to strengthen the supervision of the banking system, absorb non-performing loans of public enterprises, modernize the infrastructure and the regulatory framework of financial markets. But important elements remain in the financial sector reform agenda. Reducing the level and improving provisioning of non-performing loans is a key element in the reform agenda, because it would hedge major risks posed to the banking system by excessive reliance on illiquid real estate guarantees. This would also help reduce the cost of financial intermediation, improve access to finance by SMEs, and holds major benefits for the international image of Tunisian finance. At the same time, energizing the domestic finance markets were held in 2000 by the 14 commercial banks and another 8 percent by the development and offshore banks. The government retains control over the three largest public banks because of their role in financing sensitive sectors: Banque Nationale Agricole (BNA, agriculture), Banque de l’Habitat (BH, housing), and the Société Tunisienne de Banque (STB, small and medium-sized enterprises). In October 2002 the French group Société Générale bought a 52 percent stake in the state-owned Union Internationale des Banques (UIB). The privatization program in the banking sector is set to continue with the planned sale of controlling stakes in the Banque du Sud. Following the recent privatization moves, the public sector controlled in 2002 about 46 percent of total commercial bank’s assets, down from 55 percent in 2000.

4.1. **Managing the vulnerabilities of the banking system**

112. **The Tunisian financial system is dominated by the banking sector, where government ownership, though significant, is being gradually reduced.** Almost two thirds of the total assets of the Tunisian financial system were held in 2000 by the 14 commercial banks and another 8 percent by the development and offshore banks. The government retains control over the three largest public banks because of their role in financing sensitive sectors: Banque Nationale Agricole (BNA, agriculture), Banque de l’Habitat (BH, housing), and the Société Tunisienne de Banque (STB, small and medium-sized enterprises). In October 2002 the French group Société Générale bought a 52 percent stake in the state-owned Union Internationale des Banques (UIB). The privatization program in the banking sector is set to continue with the planned sale of controlling stakes in the Banque du Sud. Following the recent privatization moves, the public sector controlled in 2002 about 46 percent of total commercial bank’s assets, down from 55 percent in 2000.

113. **Foreign ownership in the financial sector is still limited but growing.** The significant involvement of the government in the financial sector limits somewhat the possibility for foreign participation, although foreign institutions do own stakes in commercial banks. In 2000, majority foreign owned commercial banks accounted for one eighth of total commercial bank assets. Another 4 percent of banks’ total assets are held by branches of foreign banks. The share of majority-owned foreign banks in Tunisia has increased to 20.5 percent at the end of 2002, following the privatization of UIB, and could further increase to around 26 percent when the privatization of the Banque du Sud is finalized. However, the presence of foreign banks in Tunisia remains below that seen in other developing countries, especially in EU accession countries that have modernized their banking systems with a significant involvement of foreign banks (Figure 4.1). International experience shows that foreign bank presence has helped improve the quality of financial services in a number of ways (World Bank 2001): by increasing competition and cutting
excessive loan pricing; by helping domestic banks assimilate superior banking techniques; and by training staff to modern banking.

114. **Commercial banks have become increasingly exposed to vulnerable sectors but remain well capitalized.** Following the restructuring of the banks' claims on state-owned enterprises, over 90 percent of commercial bank credit is to the private sector. Credit to the private sector is about 68 percent of GDP, and compares favorably with credit supply ratios in other middle-income developing countries. Credit growth has been fastest to the services sector, particularly in tourism, which now accounts for over 15 percent of total credit. Lending to sectors related to construction, public works, property development and tourism represent 38 percent of total commercial bank credit. Commercial banks are thus increasingly exposed to sectors that are vulnerable to a cyclical downturn or to a recession in the EU. The capital adequacy ratio of commercial banks remains satisfactory, at 9.8 percent of risk-weighted assets in 2002, but has declined from 13.3 percent in 2000, due to the difficult economic environment for a number of sectors, especially tourism, agriculture, and exporting industries.

115. **Despite considerable improvement, commercial banks continue to be burdened with large non performing loans.** Non performing loans (NPLs) have been reduced significantly, to about 19 percent of bank assets in 2001, from over 30 percent in 1993. This decline was caused by the writing off of fully provisioned NPLs and their cession to asset recovery companies, and by the repayment of public enterprise NPLs by the state. However, NPLs have been on the rise since 2002, reflecting the strong exposure of banks to the tourism sector, hit by the unfavorable international environment. NPLs are higher for public banks, at 24.3 percent of their assets in 2002, compared to 18 percent for private banks. The bulk of NPLs are in services (51 percent) and industry (42 percent). Reflecting a slow rate of loan recovery, 60 percent of NPLs are now more than 5 years old. Non performing loans of development banks have been reduced but remain sizeable, at 28 percent of their total assets in June 2003. Development banks continue thus to represent an important contingent liability for the government.

116. **Provisioning of non performing loans remains low.** Although most banks are in compliance with current provisioning regulations, the level of provisioning of commercial banks' NPLs remains low, at 44 percent in 2002. The provisioning rate gradually rose from 24 percent in 1992 to 57 percent in 1999, but declined in 2002 partly owing to the write off of fully provisioned NPLs ceded to asset management companies (Figure 4.2). The low level of provisioning of NPLs is the result of heavy reliance on real estate collateral in calculating the required provisions, even though realizing real estate collateral suffers from long delays in judicial procedures.

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11 NPLs have slightly increased in 2000 to 22 percent as a result of the merger of STB with two development banks (BDET and BNDT) that had high NPLs.
117. Reflecting a benign competitive environment and fast growth, the level of profitability of the Tunisian commercial banks has remained consistently high. For the banking system as a whole the return on assets over the period 1995-2000 has been on average equal to 1.6 percent, while the return on equity has amounted to 12.5 percent (IMF—World Bank, 2001). Profitability of domestic banks has been somewhat lower, but still on the high end of the range seen in other developing countries (Figure 4.3). The fast and stable rate of growth of the Tunisian economy over the last decade has generated a sustained demand for bank credit, providing support to bank profitability. The low level of provisioning of NPLs considerably shields reported bank profitability. Bank margins are also protected by regulations that still cap the remuneration on savings deposits at the interbank rate minus 200 basis points.

118. Consumer credit is becoming an increasingly important market segment for commercial banks. The consumer credit market was opened up to banks in 1998 and is rapidly becoming an important area of activity. Outstanding household loans amounted to 13 percent of gross commercial bank assets in 2002, of which 60 percent were mortgage loans and the rest consumer credit. Retail credit offers good growth opportunities to banks and attractive risk-return characteristics. Market growth is fostered by relatively low interest rates, at about 3-4 percent above money market rates, compared to spreads of 1.5-2 percent on loans to large corporate borrowers. Although growth of retail credit is boosting bank profitability, overstretching may also increase the vulnerability of banks to economic downturns, and also to a fall in the real estate market that provides collateral to this market segment. To improve risk monitoring and reduce overlending, in November 2002 the CBT created a central reporting unit for consumer credit.

119. In recent years, the range of financing facilities available to SMEs has broadened, although commercial banks continue to demand high real estate guarantees. Numerous leasing and factoring companies have been established and are building up their operations at a rapid pace. Export financing mechanisms have also been directed at small firms. At the same time, bank lending to SMEs has benefited from the reform of the operations of the National Guarantee Fund. However, detailed information is missing on the level, types, and cost of financing available to SMEs. With stronger competition in the banking system, lending conditions appear to have somewhat improved, but the high level of real estate guarantees required by banks continues to hinder access to credit by SMEs.

120. Commercial banks are participating more intensively in the financing of housing. Housing represents a major sector of economic activity with annual investments amounting to 5 percent of GDP and with multiplier effects on other related sectors. The Banque de l’Habitat (BH) has been traditionally the key actor in housing finance: it grants over 65 percent of housing loans. At present, participation by other commercial banks entails the opening of “savings/housing accounts” (comptes d’épargne-logement), which should eventually make it possible to obtain housing loans. Most commercial banks have traditionally granted financing to high-income individuals for housing purchases in the upper segment of the market. In spite of recent efforts by all banks (including the BH) to finance their housing loans through longer-term resources, they are still confronted with refinancing risk. And even if the interest rate risk is limited by recourse to mortgage loans at variable rates, banks may face a larger credit risk if borrowers are unable to shoulder higher mortgage rates. These risks are exacerbated by weak provisioning of non-performing loans.

121. Further modernization is key to improve the efficiency of Tunisian banks in a more open environment. Tunisia’s deepening economic and financial international integration and the increasing importance of the retail credit market call for upgrading bank technology. Absorption of modern technology will increase the operational capacity of banks, including risk management. In the long term,
this will help reduce the cost of credit and strengthen the soundness of banks. Bank technology varies across individual banks but remains moderate overall, compared to more developed markets. In the past, investment in technology has been upheld by the banks' lower profitability and the need to deal with large NPLs. Subdued competition, due to the government's heavy presence in banking, also weakened modernization incentives. With greater competition and increasing presence of foreign stakeholders in the banking system, prospects for modernization are improving. Bank modernization will be greatly facilitated by better and less expensive ICT infrastructure, especially in data networks. The pace of modernization is also constrained by rigid labor market regulations that hinder restructuring of operations and bank networks.

Managing non-performing loans of commercial banks

122. Strengthening the banks' balance sheets on a sustained basis holds major benefits for bank management and for the international image of Tunisian finance. Large non-provisioned NPLs increase the cost of bank intermediation and keep interest rates high, so that interest-paying loans are penalized in order to subsidize bad loans. Assuming a risk-free rate of interest of 7 percent, the impact of unproductive assets on bank margins could be between 100 and 200 basis points (IMF—World Bank, 2001). Large NPLs also place affected banks at a competitive disadvantage against new banks and existing banks that do not suffer from such weaknesses. A continuing weakness of leading banks will constrain the authorities in their efforts to move towards a more market-based implementation of monetary policy and to develop more active money and bond markets. Most importantly, large, under provisioned NPLs create a negative perception of the Tunisian banking system, which is probably not justified in view of the broad-ranging reforms undertaken so far and the strong fundamentals of the economy. This likely deprives Tunisia from an even better access to international capital markets, as it affects investor confidence.

123. The low liquidity of the real estate guaranties prevents adequate provisioning and cleaning up of commercial banks' balance sheets. On average, over 1996-2001, the annual rate of realization of real estate guaranties was 2.1 percent of NPLs in litigation and 1.4 percent of all NPLs, outstanding at the end of 2001. This slow rate of realizations reflects the inefficiencies of the judicial process, and contradicts prudential regulations stipulating that, for guarantees to be considered in setting provisioning requirements, “the possibility of a speedy realization at their appraised value must be assured” (article 10 of CBT circular 91-24). Realizations of real estate guarantees made a very small contribution to the fall in the level of NPLs from 1996 to 2001. They amounted in total to TD 165 million, against TD 1,012 million that were written off or ceded and TD 633 million that were taken over by the state.

124. Because of excessive reliance on real estate guaranties, commercial banks are exposed to risks. Real estate guarantees mainly comprise bank claims on borrowers' real estate assets—including claims on productive units and hotels. Over reliance on these guaranties poses financial risks to the banking system because the real estate assets are illiquid and also possibly overpriced, given the questionable viability of some loss-making borrowers—especially in the tourism sector. For real estate guaranties associated to older loans, the appraised values used by banks as collateral may be fully realizable. But the real estate boom of recent years may have contributed to overpricing of collateral for more recent loans. In the presence of overpriced guaranties, the capacity of commercial banks to withstand shocks may be overstated by posted solvency ratios: In stress tests which applied a 50 percent discount in the value of

12 For example, the financial strength of Tunisian banks is rated D- by Moody's, on a scale ranging from E (weakest) to A (strongest). Tunisian banks are rated less favorably than banks in Morocco and Lebanon, and on a similar scale as banks from Romania, Turkey, and Bulgaria.
admissible real estate collateral, the overall risk-weighted capital ratio fell to around 6 percent, while the capital ratio of week banks fell to 3.5 percent (IMF—World Bank, 2001).

125. **The authorities are fully aware of the risks posed to the banking system by the large non provisioned NPLs.** Broad reforms were initiated in the past with the aim of strengthening the banking system, including: cleaning bank balance sheets from the large arrears of public enterprises; establishing debt collection agencies to deal with the arrears of private enterprises to the banking system; strengthening prudential and supervision regulations. The BCT has issued a circular requiring all large bank borrowers to issue audited corporate accounts—a rule that, if consistently enforced, will improve the financial information available for sound risk management by banks. Reforms of the civil and commercial procedures have been initiated more recently, with the aim of accelerating the recovery of the NPLs and the realization of the real estate guarantees. The bankruptcy law is also being revised to tighten the bankruptcy filling conditions.

126. **Encouraging banks to fully provision NPLs would help create a more sound banking system.** Though recent initiatives go in the right direction, waiting for a more efficient judicial system to help resolve the existing NPLs runs the risk of delaying until an uncertain date the strengthening of commercial banks. Cessions to asset management companies (AMCs) do not improve the consolidated financial position of banking groups, except if the rate of realization of collateral is accelerated, because AMCs are de facto a specialized department of parent banks. Banks thus have to be encouraged to increase provisioning, especially of old delinquent loans. Foreign banks, as well as the better managed private banks, have much higher levels of provisioning and rely less on realizations of real estate guarantees. Applying a discount rule on real estate guarantees for old loans would be one among different options to encourage increased provisioning. Increased provisioning would create appropriate incentives for the banks to recover the collateral. Moreover, better provisioning would offer greater protection against the risk of a sudden crisis in the real estate market.

127. **Writing off fully provisioned NPLs, and their transfer to Asset Management Companies, would contribute to modernizing credit policies.** Under such an approach, banks would be forced to be more careful in selecting their borrowers, and to charge higher spreads to their more risky customers. Wider bank margins could induce stronger companies to seek cheaper finance from the securities markets (see below). Restricting the amount of bank credit in order to avoid excessive leverage would also induce companies to strengthen their balance sheets by obtaining equity finance and/or resorting to venture capital finance. Concerns are often voiced that increased provisioning—especially by discounting real estate guarantees—would hit bank profitability and thus the banks' willingness to lend, especially to SMEs and new ventures. The experience of the second half of the 1990s, when provisioning rules were substantially tightened, suggests that this concern may be exaggerated. Lending to firms that have high leverage and cannot provide the required collateral would have to be ensured by venture capital finance. Such financing should be provided in the form of external equity, rather than by traditional bank loans—since bank loans by definition assume all the downside risk, without any participation in upside profit potential.

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13 The Banking Commission of the West African Monetary Union applies a 50 percent discount to retained guarantees in the third year of delinquency and a 100 percent discount in the fourth. Canada limits the total value of real estate guarantees to 70 percent of bank capital.
4.2. Fostering diversification of the financial system.

128. **Development of the domestic securities markets is key to promote diversification of the sources of finance and reduce the reliance of enterprises on the local banking sector.** The role played by the banking sector until now has supported Tunisia’s investment effort, but to ensure adequate finance for greater investment while avoiding overstretching the banking system, development of the domestic capital market is critical. The development of the bond market is particularly important, because it will allow the emergence of a yield curve that will serve as a reference for risk pricing. This is a much needed development in Tunisia where credit is universally indexed on the money market rate (TMM), thus impeding adequate risk assessment. The government has taken important steps to promote the market of the domestic public debt. However, issuance in the primary market remains concentrated on short maturities, while the secondary market remains fairly inactive. Despite modernization and better regulation, primary private securities markets also remain underdeveloped, with only 46 companies listed on the Tunis stock exchange, while growth of corporate bond issuance has been very slow.

**Government securities markets could become more active**

129. **Despite adequate technical infrastructure and regulatory framework, issuance in the primary market remains limited while the secondary market remains fairly inactive.** The average maturity of domestic debt remains short—about 41 percent of total outstanding has remaining maturity of less than one year (Figure 4.4). Moreover, bonds outstanding are concentrated in the hands of a limited number of investors, the majority of which are public entities—such as the CNSS. The number of transactions in the secondary market is still very limited, while most of these transactions take place within investment groups and lack transparency. The absence of secondary market prevents the emergence of a yield curve.

130. **An active money market would be a prerequisite for the development of a bond market.** An efficient money market allows to price liquidity properly, thus providing the necessary benchmark for the pricing of fixed-income assets that differ in terms of maturity, liquidity, and other risk characteristics. This provides the needed short-term anchor for the yield curve (Schinasi et Smith, 1998). The money market also supports the bond market by increasing the liquidity of bonds and provides bond traders with a mean to fund their temporary inventory of bonds. A rigid monetary framework that does not allow sufficient interest rate flexibility prevents the development of an active money market.

131. **The stability and the predictability of the money market rates have hampered the development of an active money market.** To achieve the intermediate policy goals for credit growth, the Central Bank of Tunisia relies on a number of instruments aiming to control the level of refinancing of the banking system (see IMF—World Bank, 2001; IMF 2003b). Reliance of banks on the CBT’s refinancing facilities has conferred a dominant position to the CBT in the money market. Moreover, access to CBT refinancing is at stable and predictable interest rates. Since the interest rates of many deposits and loan agreements are indexed on the money market rate (TMM), changes in monetary policy are quickly reflected in the financial system and the economy as a whole. This has created rigidity in interest rates, promoting dependable and easy access of banks to liquidity at a predictable rate, and thus hindering the development of an active interbank market. The delay in the introduction of legislation for repurchase agreements has
also hampered the development of the money market. The emergence of an active money market could be promoted by better interest rate flexibility, through a monetary policy framework geared toward the control of the base money, rather than bank refinancing as is currently the case. Besides, base money has stronger links to credit growth than bank refinancing (IMF, 2003b). Monetary policy should be increasingly implemented through market-based instruments, such as open market operations.

132. **The Treasury, despite its stated willingness to adhere to the rules of the market in order to meet the government’s financing needs, finds it hard to build its credibility as an issuer.** Treasury issuance is perceived as lacking transparency, because the issuance calendar undergoes many changes, such as cancelled auctions, sometimes for a long period. Lack of transparency and predictability makes market participants uncertain about the issuing policy and reduces the perceived liquidity of the market. The Treasury’s credibility is also hampered by a reluctance to issue at yield levels deemed higher than what is seen as the appropriate market levels. As a result, bond auctions meet little success. Developing an efficient domestic public debt market is a long-term endeavor and entails a cost at the beginning. The benefits come only later on, when the credibility of the Treasury as an issuer has been well established. A rule to enhance credibility would call for the Treasury to issue not when it needs but when it can. Moreover, the limited amount of securities outstanding does not support the liquidity and the development of the secondary market.

133. **Although the secondary market remains inactive, there exists a “parallel” secondary market for intra-group transactions.** Over-the-counter, intra-group transactions do exist, but they lack transparency, as they are not reported to the market authority (the Stock exchange). Their financial conditions may also be questionable, as they may be underpinned by accountancy and balance sheet reasons. Improving the transparency of these transactions, mainly carried out by the banks, would promote the development of the secondary market, but would call for close coordination between the supervisory authorities of the banking system and the capital market (an action plan for domestic public debt market development is outlined in World Bank 2003b).

134. **The development of domestic markets for government securities has been held back by the absence of domestic or international investors with a strong appetite for long maturities.** The pension funds are not largely developed in Tunisia, while the global financial health of the insurance sector is precarious and life insurance is still in its infancy (see below). Collective Investment Institutions (SICAV) have absorbed significant amounts of government bonds, and could contribute to the development of the secondary market if the “intra-group” transactions were properly regulated. Partial opening of domestic debt issuance to foreign investors could also be envisaged as a step to strengthen the demand for government securities. However, extending part of domestic debt issuance to foreign investors would call for careful planning to secure the liquidity of the secondary domestic debt market, because setbacks can shake investor confidence and affect Tunisia’s good access to the international capital market (options are highlighted in World Bank, 2003b).

**Private securities markets remain anemic**

135. **Despite a modern and robust regulatory framework, the private securities markets have remained anemic.** The laws and rules on the operation of market intermediaries, on public offerings of securities, prospectuses, information disclosure, mergers and takeovers, reporting of insider transactions, insider trading, and market manipulation are well established (IMF—World Bank, 2001). However, compared to bank credit, reliance on market sources of finance by the corporate sector has continued to be very limited. Stock market capitalization was at 9.5 percent of GDP in 2002, down from 14.5 percent in 2000, while the value of equity trading was a mere 1 percent of GDP. Market capitalization is dominated
by financial sector companies, banks as well as insurance, leasing, and investment companies (Figure 4.5). Concentration in stock market capitalization is high, with the 5 largest companies accounting for 44 percent of total capitalization in 2002. Capitalization in the corporate bond market remains limited, at 2.6 percent of GDP in 2002, slightly up from 1.7 percent in 2000. About 84 percent of outstanding corporate bonds have been issued by banks and leasing companies. The secondary bond market is almost nonexistent.

136. **Collective investment institutions have invested dynamically in corporate bonds, but have lost steam in more recent years.** Tunisia is one of the first MENA countries to have passed legislation for the creation of collective investment institutions and institutions (SICAV) invest predominantly in government and corporate bonds. In 2002, corporate bonds represented 34 percent of their assets, and government securities 23 percent. But only 3 percent of SICAV assets were invested in equities. The SICAV grew dynamically in the late 1990s, with their total assets reaching 5 percent of GDP in 2000, but have been stagnant more recently, reflecting a weaker investor appetite (Figure 4.6). Insurance companies and the social security funds have played a smaller part in the corporate bond market. More than 50 percent of admitted insurance company assets (3 percent of GDP) are placed in government bonds, while about 25 percent is invested in equities.

137. **Though venture capital companies (SICAR) could become an excellent vehicle for start up financing, a large part of their resources is misdirected into low-risk activities.** The SICAR—most of which have been created by banks and insurance companies—were first authorized in 1995 and obtain their funds from investors, both companies and individuals, who want to take advantage of the significant tax advantages they offer. In 2002, there were 35 SICAR, with total assets of 1.4 percent of GDP. However, a large part of the resources they mobilize—about 44 percent of new projects approved in 2002—are channeled into firms undergoing modernization as part of the “Mise à niveau” program. Financing of new ventures, such as under the program for “Nouveaux promoteurs”, accounted for only 18 percent of new projects in 2002 (Figure 4.7). The SICAR have also been encouraged to focus on businesses operating in the less-developed regions.

138. **Traditional reliance on easy bank financing has hampered the development of private securities markets.** About 30 percent of private investment is financed by bank credit, under relatively easy conditions, and often weak practices of risk assessment, as evidenced by the high level of non
performing loans. The number of listed companies could be expanded by changing the financing patterns of companies and projects that have long gestation periods, such as hotels, other tourist projects, and real estate developers. Instead of relying on bank loans and excessive leverage, such companies should be encouraged to seek equity and venture capital finance. As already noted, the loan loss provisioning rules applied on commercial banks, and their strict enforcement, could be a major indirect factor for the development of the securities markets.

139. **The small size of Tunisian firms, as well as reluctance to dilute controlling positions, pose obstacles to the development of private capital markets.** There are only about 500 companies with capital greater than US 1 million, while only an estimated 83 companies realize total sales above TD 50 million (SMART, 2002). The number of potential candidates to the stock exchange market, as well as their capitalization, is thus limited. The adoption of the new law on business groups would facilitate the creation of a larger number of companies fit for listing on the stock exchange, but calls for genuine transparency on accounting standards (see below). Moreover, family groups reluctant to list on the exchange, to prevent dilution of control, continue to predominate in the Tunisian private sector. Such attitudes might be easier to overcome if finance for family groups were no longer coming from inadequately priced bank loans, but took the form of external equity or venture capital finance. The number of listed companies and the supply of suitable securities could be increased by a more ambitious privatization program. This should include the public utilities that are large users of capital.

140. **Reducing the high cost of transparency faced by listed companies would lower the reluctance of many private groups to list on the stock exchange.** Lowering the transparency cost would require an increase in the disclosure requirements of unlisted companies, especially large companies that raise funds through public issues or obtain large amounts of bank finance. Only about 30 percent of Tunisian companies have audited accounts, suggesting that corporate transparency is still perceived as a cost of doing business. Adoption of the new draft laws on business groups and holding companies and the new draft accounting standards on consolidation of accounts represent a major step forward toward creating a level playing field for listed and unlisted groups. However, the draft accounting standards do not include a number of significant International Accounting Standards (IAS) requirements and proposed amendments to IAS—which is also increasingly important for financial relationships with foreign partners (Box 4.1). The recent central bank circular requiring audited accounts, as well as a rating or stock exchange listing for companies that have outstanding bank borrowings over a specified threshold, would also contribute to lowering the cost of transparency of listed companies but has to be strictly enforced. Reform of the corporate tax system, by leveling the playing field among offshore and onshore companies, as well as reduction of the top VAT rates (see chapter 4), would improve corporate transparency by reducing the incentives for tax evasion.
Reinforcing corporate auditing procedures would strengthen investor confidence and bolster the development of private capital markets. Overall, the quality of accounting and auditing professionals is considered good, especially those of the younger generation. However, greater independence of corporate auditors and higher turnover would strengthen the transparency of corporate accounts. A move toward greater corporate transparency, for example, by adopting standards along the lines of the Sarbanes-Oxley law in the US, could also be envisaged. These higher standards require in particular: (a) consolidation requirements in Tunisia fall short of IFRS because Tunisian Accounting Standards failed to incorporate the body of international standards that together form IFRS. Tunisia enacted TAS 35, Consolidated Financial Statements, in 2003, largely based on IAS 27, Consolidated Financial Statements and Accounting for Investments in Subsidiaries. The adoption of standards based on IAS 27 does very little if other international accounting standards are not adopted. Other international accounting standards such as IAS 1, Presentation of Financial Statements, IAS 39, Financial Instruments: Recognition and Measurement, are equally important; (b) TAS lag behind improvements to IFRS. International accounting standards are continuously being improved in part based on changes in the business environment. Tunisia’s choice to develop its own standards based on IFRS rather than adopting IFRS preclude Tunisia from improving financial reporting at the same pace as other developed economies; (c) TAS do not require that information be reported for business segments and geographical segments. The lack of segment information hinders analysis of a group’s financial performance, and its absence is severely criticized by investors and bankers; (d) TAS require that gains and losses on long-term unsettled foreign currency monetary items be deferred. IAS 21, The Effects of Changes in Foreign Exchange Rates, does not permit such treatment; (e) TAS do not include a standard on accounting for leases. Under IAS 17, a finance lease is recognized in the lessee’s balance sheet both as an asset and as an obligation to pay future lease payments (i.e., as a debt). Applying Tunisian Accounting Standards result in an understatement of an enterprise’s outstanding debt; (f) TAS do not mention deferred tax accounting. Consequently, deferred tax liabilities derived from situations where future taxable income will be greater than future financial accounting income due to temporary differences (e.g., due to differences between tax depreciation and book depreciation) are not reported under TAS.


Venture capital companies have a large role to play in supporting the creation of new firms, but their operation should be overhauled. A major drawback of the SICAR is that they remain essentially sponsored by banks, so that they are ill-equipped to adequately assess the risks and growth potential associated with new ventures. Moreover, as the repurchase of SICAR shares at pre-established rates of return has been generalized, SICAR investments are directed toward less risky projects.
Facilitating exit from SICAR investments through partnerships with foreign investors could improve the attractiveness of SICARs. Currently, prior approval by the “Commission Supérieure de l’Investissement” is needed for the purchase of majority stakes in local companies by foreign investors, through a slow and uncertain process. The tax benefits provided for SICAR investments appear to be generous. However, a differentiated approach, with relatively more generous tax incentives targeted to investments without a repurchase convention, and to long-term and risky projects, could help improve the allocation of venture capital.

143. The limited role played by contractual savings institutions, such as insurance companies, is an important obstacle to the development of private securities markets. Life insurance is little developed with most of the premiums earned in non life business, especially motor insurance (40 percent of total premiums). Insurance premiums remain compressed at around 1.7 percent of GDP, while the assets of insurance remain stagnant at close to 5 percent of GDP (IMF—World Bank, 2001). The insurance sector has yet to respond to the extension of major fiscal incentives to life policies. The ongoing restructuring and consolidation of the insurance sector, with support by the World Bank, is a major first step in the reform of the contractual savings system. The supervision capacity of the “Direction Générale des Assurances” has been substantially enhanced. The smaller of the two state-owned companies was restructured and was offered for sale to a strategic investor through an international tender. A revised law to modernize the legal framework of the auto insurance branch has been approved by the Parliament. To eliminate the deficit of the auto insurance branch, insurance premiums were increased in 2002 and 2003. Future initiatives should complete the restructuring and consolidation of the sector by recapitalizing the capital-deficient companies and ensuring that all companies are owned and managed by reputable owners with strong capital and experienced professional management. Providing appropriate income tax and social security charge treatment of group life insurance contracts would help remove remaining obstacles that impede their growth. Development of distribution of life insurance by the banking sector would also provide support to long-term contractual savings.14

144. Like other types of financial institutions, mutual funds require a robust regulatory framework and effective supervision for their successful operation and growth. The supervision of collective investment institutions has been strengthened in recent years, but regulatory gaps still remain. There is widespread concern that the valuation of assets may be deficient and misleading. Accounting standards on mutual funds require “mark-to-market” pricing of most assets for which liquid markets exist. In practice, however, debt instruments are still priced at their book value, owing to the inadequate functioning of secondary markets. Building effective “Chinese walls”—between the founder or sponsor of a SICAV, the fund manager and the depositary bank (all of which usually belong to the same banking group)—would contain transactions with related parties that may give rise to situations of potential conflicts of interest and work to the detriment of mutual fund investors (IMF—World Bank, 2001). Moreover, it is important that the regulation of collective investment institutions allows the creation of genuine money market mutual funds. This will open the way for greater specialization of mutual funds, e.g., by type of security or by sector, which will allow SICAVs to offer better returns and improve mobilization of long-term savings.

145. Well-targeted tax incentives may help better mobilize long-term savings. The current system provides generous incentives, as capital gains and dividends go untaxed, while interest income is subject to a small withholding tax. Although tax neutrality is a desired feature of the tax system, in the case of an

14 Since November 2003, following an agreement reached between banks and insurance companies, banks are authorized to market life, agricultural, and export insurance.
economy with a shortage of long-term savings it may be helpful to differentiate the tax treatment of savings in favor of investments with longer holding periods.

146. **With the right framework in place, promoting a capitalization pillar for retirement benefits would put the pension system on a more sound footing and would strengthen the basis for the development of domestic securities markets.** International experience suggests that the development of funded private pension schemes that supplement the traditional pay-as-you-go pillar of the pension systems contribute to increase the supply of long-term contractual savings, and in some cases may also increase the rate of savings in a country, thus directly stimulating the development of domestic financial markets. But the benefits from the emergence of pension funds depend on a number of preconditions—such as, attainment of critical mass; an enabling regulatory environment that frees up pension funds from overly constraining investment regulations; a supervisory framework that preserves integrity; prevalence of competitive market structures; (Vittas, 2000).

147. **However, creating even a partially funded private pension system entails temporary fiscal costs, so that early action is advisable.** Moving to a partially funded pension system involves foregone revenues for the pay-as-you-go pillar. The budget will have to bear a temporary burden, to pay for the retirement benefits of those who will not be covered by the capitalization pillar during the transition to the new system (existing retirees and old-age contributors). To keep such costs at a minimum it is important that the transition be implemented from an early stage, well before the projected deterioration of the demographic fundamentals and the associated worsening of the financial situation of the pay-as-you-go system. The Tunisian authorities are aware of the benefits of developing a properly regulated capitalization pensions pillar and have established various working groups for this purpose, although no initiative has been taken to date.

**Improving financial information on the quality of borrowers and strengthening creditor rights**

148. **Improving financial information on the quality of borrowers would help ease overcollateralization.** Lack of assurances that borrowers are creditworthy may typically result in over collateralization and high cost of credit for entrepreneurs with otherwise promising business opportunities. In Tunisia, there exists a public credit bureau ("Centrale de Risques") established in 1958, which is supervised by the Central Bank of Tunisia. The length of historical data collected is 10 years, on a total of 56,000 credit reports. However, it records only loans above a certain minimum size, while only positive data is made available—that is, total loans outstanding, assets and personal information. Access to credit information is limited to the creditor's own customers. Thus, weaknesses in design makes Tunisia's public credit registry a less valuable tool for the assessment of the quality of borrowers than in similar countries (World Bank, 2003). Access of lenders to credit information is also impeded by the absence of private credit registries. Fewer regulatory restrictions on credit information sharing will benefit small firms' access to finance the most.

149. **Strengthening the protection of creditors' rights in bankruptcy would foster private securities markets and contribute to improving SMEs access to credit.** In deciding whether to extend credit and at what conditions, lenders need to know what share of debt they can recover if the borrower defaults. Bankruptcy laws define who controls the insolvency process, who has rights to the property of a bankrupt firm and with what priority, and the efficiency of realizing the rights. In Tunisia, legal protections along these dimensions are weak (Figure 4.8). This leads creditors to either increase the price of loans and the amount of collateral to adjust for the additional risk, or decrease the amount of loans. Involving creditors and other stakeholders in the insolvency process is also important to preserve absolute priority of
creditors' claims. In Tunisia, the bankruptcy report is filed only with the court and is not accessible to creditors. Such a report would inform the creditors and provide a higher chance of maintaining absolute priority. Another set of judicial procedures defines the powers of various stakeholders in formulating and adopting a rehabilitation plan. The Tunisian bankruptcy law mandates the formulation of a plan by the court, without the effective participation of creditors or management. Better involvement of creditors in bankruptcy procedures would help achieve the insolvency goal of preserving the value of creditor's claims.

150. **Summary of reform options.**

**In the short term**

- Encouraging increased provisioning of non performing loans, in particular old delinquent loans, to accelerate clean up of commercial banks' balance sheets;
- Improving interest rate flexibility in the money market by adopting a monetary framework anchored on the control of base money;
- Improving the transparency and strengthen the regulation of the secondary market for government securities;
- Taking early steps to strengthen corporate transparency by improving: (a) mandatory corporate financial disclosure; (b) the accountability of corporate executives; (c) the autonomy of corporate boards; (d) the independence of audit committees;
- Strictly enforcing disclosure requirements for companies that obtain large amounts of bank finance;

**In the medium term**

- Promoting the creation of genuine money market mutual funds; enforce “mark-to-market” pricing of SICAV assets; and strengthen prudential supervision;
- Improving information on the quality of borrowers by improving the design of the public credit registry and promoting the creation of well-regulated private credit registries;
- Strengthening the protection of creditors' rights in bankruptcy;
- Accelerating the privatization program of public utilities to increase the supply of suitable securities in the market;
- Overhauling regulation of venture capital companies (SICAR), to improve their attractiveness and their funding of start ups and innovative projects—including by facilitating exit strategies in partnership with foreign investors;
- Introducing well-target incentives in the tax treatment of savings in favor of investments with longer holding periods, to improve mobilization of long-term savings;
- Promoting adequate incentives for the development of life and group insurance;
- Taking appropriate steps to prepare for a well-regulated capitalization pillar for retirement benefits, in the context of a broader strategy for pension system reform (see Chapter 5).
Chapter 5. Strengthening management of the public finance system

151. **Further strengthening of the public finance system is needed, if the goals of improving public service delivery, maintaining expenditure allocation priorities, and accelerating the reduction of public debt are to be met.** Strengthening the fiscal stance is only possible via a combination of tax reform, improvements in revenue administration, and an increase in the efficiency of public spending. Initiatives in these areas should be implemented simultaneously and reinforce each other. The Government has already taken important steps to modernize the tax system, while public expenditure management (PEM) systems are already quite strong, with well spaced budget formulation process, strong Treasury execution, and rigorous compliance audit—including external audit by the *Cour des Comptes*.\(^\text{15}\) At the same time, the PEM system retains essentially a short-term focus, and the budgetary cycle is not well integrated with the medium-term economic planning exercise. And the tax system suffers from a number of exemptions and multiple preferential regimes that impede tax revenue mobilization and distort the playing field for doing business. Recognizing the policy priorities ahead, the Government has initiated important institutional changes in public expenditure management, aiming to both improve the quality of public service delivery, and to achieve further fiscal consolidation, primarily through implementing performance-based budgeting (*gestion budgétaire par objectif*). It is important to keep up the pace of reforms in these areas.

5.1. Strengthening revenue performance and tax neutrality

152. **Tunisia has made a major effort to restructure taxes and improve revenue mobilization.** Dismantling of trade protection, under the Association Agreement with the EU, raised a major challenge for fiscal revenue mobilization because customs duties constituted an important source of tax revenues—as much as 37 percent in 1990. Customs duties have declined from 8 percent of GDP in 1989-90 to 3 percent in 1999-2000, and they are projected to further decline to about 1 percent of GDP by the completion of the AAEU in 2007. The introduction of the Value Added Tax (VAT) in 1988 was highly successful, since VAT revenues have more than offset the loss of tax revenues from customs duties (Figure 5.1). At the same time, greater reliance on VAT than on customs duties has greatly contributed to efficiency by reducing price distortions associated with tax collection. Mobilization of direct tax revenues has also improved, and the neutrality of the personal income tax was enhanced, by reducing the number of tax brackets and limiting the top tax rate to 35 percent—at the same level as the statutory corporate income tax rate. During the 1990s, overall fiscal revenue mobilization has improved by 4.4 percentage points of GDP (Figure 4.1).

153. **The tax burden falls disproportionately on consumption and labor income.** Despite the better mobilization of direct tax revenues, only 27 percent of Tunisia’s fiscal revenue (excluding social security taxes) comes from direct taxes—a much smaller proportion of GDP than in comparator countries (Figure 5.2). This reflects the extensive tax breaks in the corporate and personal income tax in favor of investment.

\(^{15}\) The analysis below is preliminary and should be refined by more in-depth studies, in particular a Public Expenditure Review, and a CFAA.
(off-shore regime in the corporate income tax; untaxed dividends, reinvested profits, and capital gains; reduced tax on interest income). Moreover, reflecting the generous tax incentives for investment, the tax burden falls disproportionately on labor income: about 75 percent of personal income tax revenues stem from wages and salaries, while the tax base of the corporate income tax is undermined by the tax breaks. The tax burden on labor income is exacerbated by the high social security contributions that represent an amount equivalent to total personal and corporate income taxes. A high tax burden on labor income and the prevalence of indirect taxes, which are to a large extent passed on to consumers, undercut the fairness of the tax system and the redistribution objectives pursued through tax policy.

154. **The corporate income tax base is seriously eroded by the generous tax incentives for investment.** The overall cost of tax incentives for investment was an estimated TD 529 million in 2001, representing 8.5 percent of the central government's tax revenues. Total tax and financial incentives amounted to about 2.3 percent of GDP—as much as the budget deficit. The cost of tax incentives falls disproportionately on the corporate income tax, with forgone revenues representing 42 percent of corporate income tax revenues in 2001 (1 percent of GDP). The other major tax base eroded by investment tax incentives is customs duties. In 2001, exemptions granted by the investment code represented 21 percent of total customs duties collection. VAT exemptions for investment account for about 5 percent of total VAT revenues.

155. **The tax system of small companies narrows the tax base of the corporate income tax and is detrimental to tax equity.** Individual companies with sales not exceeding TD 30,000 are subject to a "forfaitaire" system of taxation. Tax due under the "forfaitaire" system is TD 700. But individual companies with sales not exceeding 100,000 may also opt for a higher lump-sum tax payment of TD 1,330, exempting themselves from the simplified direct estimation system of real benefits that applies to small companies with sales between TD 30,000 and TD 100,000. The main advantage of the "forfaitaire" system is to simplify procedures for tax compliance by small companies. However, the system narrows the tax base because total sales are difficult to assess. Moreover, the system does not promote horizontal taxpayer equity, because activities with very different profit margins are being taxed at a similar lump-sum amount. As the use of accounting is becoming more widespread, simplified direct estimation schemes of tax assessment should be more broadly introduced and the "forfaitaire" system should be phased out.

156. **Taxation of the self employed undermines the tax base of the personal income tax and also raises issues for tax equity.** The self employed with other than commercial revenue ("bénéfices non commerciaux"; BNC) may also opt for a "forfaitaire" system of taxable income, based on 70 percent of revenues. This system undermines the tax base of the personal income tax: In 2001, tax revenues raised under the BNC regime represented only 1.5 percent of income taxes raised on wages and salaries. The "forfaitaire" system for the self employed is also detrimental to vertical taxpayer equity. Taxation of the self employed could be enhanced by more systematic use of objective living standards criteria for the assessment of taxable income, and with systematic recouping of tax information with information on other sources of income (property and interest income; dividends).
157. **The VAT system includes multiple regimes and large exemptions that narrow the tax base.** Tunisia applies a multiple VAT system, with a standard rate of 18 percent. Three additional tax rates are applied, to contribute to the achievement of redistribution goals: A reduced rate of 6 percent applies to health services and to inputs to agriculture and handicraft; a rate of 10 percent applies to equipment goods, transport of goods, hotels and restaurants; and a high rate of 29 percent applies to so-called luxury goods—which also include textiles, audiovisual equipment, household appliances. A number of goods deemed to be necessities, such as, for example, flour, bread, pasta, milk, olive oil, are exempt from VAT. This category also includes cultural products, railway equipment, and also a number of products bought by the central administration and municipalities. Despite some recent improvements (such as the extension of VAT to water supply and telecommunications), the still large exemptions and multiplicity of VAT reduces the tax base, thus requiring high statutory rates to achieve the Government's revenue targets. High statutory rates, in particular the 29 percent upper rate, reduce incentives for tax compliance and favor tax evasion, thus further eroding the VAT base. Moreover, multiple rates and exemptions create incentives of activity misreporting, to reduce the amount of tax liability.

158. **Productivity of VAT is strong, but tax administration goes against standard VAT practices.** Despite the narrow base of the VAT, the productivity of the system—as measured by the effective tax rate over the standard rate—is strong, at an estimated 70 percent, higher than in a number of developing countries (Figure 5.3). This reflects strong tax administration, but also practices that go against standard rules of VAT taxation (see World Bank, FIAS, 2002). Small enterprises that opt for the "forfaitaire" system of taxation are exempt from the standard VAT regime, but liable to a surcharge of 25 percent on the VAT due on their purchases. Though the measure aims at encouraging broader adoption of the VAT regime, these enterprises are penalized because they cannot pass their high VAT charges forward. They also face strong incentives to evade the tax. Moreover, refunds of VAT credits to enterprises are routinely followed by tax controls, but limited to 50 percent of the amount due in the absence of verification. This boosts VAT revenues but goes against the desired neutrality in the VAT system, while reducing compliance incentives.

159. **Options for reforming the tax system should focus on enhancing revenue mobilization, redistributing the tax burden, and improving tax neutrality.** Overall, the Tunisian tax burden is not very high by international comparison, but its distribution appears to be uneven, between labor and capital income and across taxpayers, while serious non-neutralities exist in the taxation of corporate income and in indirect taxation. Existing non-neutralities undermine the fairness of the tax system; narrow the tax bases and hinder revenue mobilization; create complexities that increase the cost of tax administration; weaken incentives for tax compliance and foster tax evasion. With the upcoming completion of the AAEU and the loss of additional revenues from customs duties; the projected pressures on the budget for higher social spending; and the need to accelerate the reduction of the public debt by more ambitious fiscal consolidation, improving revenue mobilization is becoming of paramount importance. Reducing the number of tax exemptions and preferential tax regimes—especially for off-shore businesses—would broaden the tax bases and improve the fairness and efficiency of the tax system. A comprehensive

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16 Erosion of VAT revenues because of tax evasion will not show up necessarily as a lower effective tax rate, and thus lower VAT productivity, if consumption spending is also misreported.

17 VAT is totally refunded to exporting enterprises and for investments of firms eligible for the Mise à niveau program.
examination of the tax system would be required to inform policy decisions on future directions for tax reform.

5.2. Tunisia’s public expenditure system in the international context

160. **Over the past decade, significant fiscal consolidation was achieved.** Consolidated government revenues have remained broadly stable at 28-30 percent of GDP, while public expenditures were brought down from around 35 percent of GDP to 31-32 percent of GDP, mainly as a result of strong adjustment effort in the second half of 1990s. This level of public spending is lower than in the group of EU accession countries, but significantly exceeds levels recorded by the fast-growing non-MENA countries. There are not unambiguous answers to the question of whether the consolidated level of public expenditures is “right”, because much depends on the efficiency of public expenditures (Box 4.1). However, large public expenditures are likely to burden the economy with high tax rates, thus slowing growth and job creation.

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<tr>
<th>Box 5.1 How appropriate is public spending level for Tunisia’s current stage of development?</th>
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<td>Several recent studies have demonstrated positive statistical correlation between income levels and the level of general government spending (Gupta S. et al, 2001). This simply suggests that richer countries can afford to spend more on public goods and services. There is much less guidance on what is the appropriate size of government spending, and what can be judged as overspending. Barboune and Polastri (in World Bank, 1998) have shown that variables other than income levels (and primarily socio-cultural traditions) have a much greater explanatory power for the share of public spending in GDP. In Europe, for example, societies’ expectations with regards to the range of goods and services delivered by governments are traditionally higher than in some other OECD economies. Economic literature also does not suggest strong negative correlation between the size of government spending as such, and the rates of economic growth: much depends on the structure and efficiency of the former. Still, it is worth noting that Ireland, with smaller government than most of the EU-15, achieved the fastest GDP growth rate in this group of countries over the past 20 years.</td>
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161. **The Government of Tunisia has accumulated impressive experience in making hard expenditure allocation choices, but the allocative strategy could be further improved.** Throughout several decades, it consistently favored certain classes of spending, in particular investments in education and in infrastructure. For each Five-year Plan, the Government painstakingly defined development priorities, which are subsequently reflected in the Budget’s allocative patterns. Still, analysis of the allocation of public spending reveals certain distortions, suggesting that the Government’s allocative strategy may be further improved. Analysis of allocation of public spending reveals the following patterns: 

*Across economic categories:
- Spending on **wages and salaries** is higher than in most comparator groups and steadily rising;
- Spending on **non-wage goods and services** is low, suggesting distorted proportions between spending on wages vs. equipment;* 

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The analysis below should be treated with caution due to certain data and classification problems. First, the most widely used budget classification is the administrative one. It is an efficient tool of administrative control, but does not provide sufficient allocative information since spending on every individual economic category and function is typically spread over several agencies. Budgetary classification broadly follows the GFS methodology, but in reality GFS categories are approximated only at an aggregate level, while on more detailed level, traditional administrative classification is the only one in use. As a result, reported allocation picture should be interpreted with extreme caution, as it is always inexact. Second, modest municipal spending is not fully consolidated with the central government accounts. Third, while quasi-fiscal activities appear to be broadly under control, they are never fully transparent and distort the real picture of government priorities.
Subsidies to enterprises have been successfully reduced from very high levels of the mid-1980s, and are now relatively low;

Capital spending is comparatively high, warranting efficiency concerns.

Interest payments have fallen, suggesting an improving debt situation; this may be more related to historically low interest rates than to the Government’s active debt management.

Across key government functions:

- General Public Services receive high and growing spending allocations, indicating that the government may be oversized;
- Spending on public order and safety is much higher than in any comparator group;
- Tunisia assigns higher priority to social security and welfare than MENA and non-MENA high growth countries, but lags behind European comparator groups, as its social safety nets are modest, reflecting favorable demographic situation and steady decline in poverty levels;
- Education spending has been a top priority for the Government for decades, and has paid handsomely by boosting total factor productivity;
- On the contrary, health has never been in the forefront of government spending priorities.

Large non-discretionary components, comprising wages, interest payments, and social entitlements, account for over 70 percent of total public expenditures. At about 24 percent of GDP, non-discretionary spending introduces serious rigidity on the public expenditure system. Non-discretionary items cannot be easily trimmed in adversity without threatening social stability and/or the country’s creditworthiness. Tunisia’s fiscal stance appears to be less flexible than in any comparator group, such as MENA countries, high growth non-MENA countries, and even EU accession countries. Within the non-discretionary category in Tunisia, public sector wages are gaining in relative importance at the expense of the other two items – social transfers and interest payments. In the high-growth non-MENA countries, on the contrary, growth of the non-discretionary spending was due mainly to rising social transfers, which appears to be preferable to the Tunisian situation, when public sector wages are crowding out social transfers. Within the non-discretionary category, Tunisian social transfers showed more volatility around the trend than wages, suggesting that the transfers may have been used as balancing item. These patterns suggest that allocative flexibility of Tunisian public spending may be low (Figure 5.5a).

Of particular concern is the steadily rising government wage bill, which, at close to 12 percent of GDP, is among the highest in MENA. Although such levels are typical for MENA countries, a greater reason for concern is the steady rise in Tunisian wage spending, both in terms of its share of GDP, and its share of total spending (Figure 5.4). These shares are much higher than the levels registered both by the EU accession countries and by faster-growing non-MENA countries such as Malaysia, South Africa and Chile. Moreover, in most comparator groups wage spending has been declining in recent years. Spending on wages in Tunisia also displays a relatively low variance around the trend, which suggests that it is protected (Figure 5.5a). The 2003 Budget envisages further rise in wage spending. Such rise may be acceptable only if it is accompanied by civil service reform which delivers efficiency gains. Without improvements in efficiency, the public wage bill risks becoming merely a social safety net, hampering fiscal sustainability over the long run. Practices of personnel management in the civil service are outlined in Box 5.2, but more analytical work is needed to assess options for reform.
Figure 5.5: Volatility of Tunisia's public spending (deviation from the 1991-2001 trend in percent of GDP)

... by economic category...

![Diagram showing volatility by economic category]

...and by government function

![Diagram showing volatility by government function]

Source: World Bank and IMF staff estimates.

Box 5.2. Civil service management practices in Tunisia

Civil servants are exclusively hired on the basis of a competitive exam. Promotions (change of scale) are based on merit, combined with duration of service. Only once in a career span a promotion can be granted without specifically evaluating the candidate’s merit. Since 1999, all other promotions are granted after a competitive process based on past career and diplomas criteria or on a written exam. A specific jury is then created by a Prime Minister’s decision, which includes members of ministries and the MoCS. If recruitment for the next scale is not organised for one year, candidates will have to wait, which creates potential bottlenecks with the accumulation of civil servants who can apply for these promotions. However, changes of levels within a scale are automatic, based on duration of service.

Personnel is managed by each ministry. Budget positions are negotiated by category, based on the existing positions, attrition etc. Each recruitment has to be justified by ministries. A central data base for personnel, accessible by each Ministry, is in place in the “Centre national d’informatique”. The “corps communs”, comprising the “administrateurs civils” and the “public sector counsellors”, hired at a high academic level, are managed by the MoCS and the Prime Minister’s Office. Recruitment in the lowest scales has stopped since 1999.

Wage bill evolution is based on a three-year agreement with trade unions, which includes not only existing salaries, but also the future promotions, attrition, and the technical normal evolution of any wage bill: change of levels, scales, professional skills, and hiring. There is only one salary system, with many scales, for the whole civil service. Wage increases being controlled, the actual income increases are generated through raises of various compensation elements (“indemnités”), determined more by family composition, or professional skills level: the wage itself has not changed since 1999.

164. Spending on interest payments was lower than in other MENA countries and in EU cohesion countries, but somewhat higher than in other comparator groups (non-MENA high-growth and EU accession). Interest spending as a share of GDP declined from its peak in 1996, suggesting that the overall debt situation was improving. This is a welcome trend, particularly when contrasted with other MENA countries, where in recent years interest payments rose considerably as a share of GDP. However, this improvement could be due mostly to historically low interest rates rather than the Government’s active management of interest rate risks (World Bank, 2003b). The Government recognizes the need for more active debt management policy, and is taking steps to create the necessary institutions and build technical capacity.
165. **Subsidies to enterprises have fallen dramatically compared to the 1980-ies, and are now below 2 percent of GDP - much lower than in most EU accession countries.** However, support continues to be provided to Tunisian public enterprises off-budget, through exemptions on tax liabilities, regulated utility prices, and government guarantees on foreign borrowing by public enterprises. It is advisable to phase out such hidden subsidies or at least to absorb them into the budget. Budgeted subsidies are transparent and thus easier to manage, as they can be more directly assessed against alternative uses of budgetary resources.

166. **Capital spending by the central government has been consistently high.** Capital spending is much higher than in non-MENA comparator countries, as well as in the EU accession countries (Figure 5.6). Indeed, as observed in chapter 1, contrary to other fast-growing countries, public investment has been a main driver of growth in Tunisia. Certainly, Tunisian economy may still benefit from publicly-financed investment in infrastructure, which is needed for efficient functioning of modern economy, but is unattractive for private investors. However, as discussed in chapter 2, greater private participation in infrastructure would enhance efficiency and make more room in the budget for emerging pressures on social spending.

167. **Concerning functional allocations, General Public Services was the fastest-growing spending category in the 1990s, confirming the rapid expansion of the government and of its wage bill.** By 2001, Tunisia had almost caught up in spending on this function (in percent of GDP) with the EU accession countries. Indeed, as a share of total spending, Tunisia now allocates more to this function than the EU-15 countries. This indicates that the size of Tunisia's government may be larger than typical for countries at its development level. At the same time, spending on this function is very volatile, suggesting that it may have been used as a balancing item (Figure 5.5b).\(^\text{19}\)

168. **Defense and Public Order and Safety.** Budget allocations to the Ministry of Defense and the Ministry of Interior and local development combined accounted for about 15 percent of total government spending in recent years (excluding debt repayment), and are also the most protected, displaying very little volatility over the past 12 years.\(^\text{20}\) However, they display very different trends. Spending on defense was declining, dropping to below 1.5 percent of GDP in the early 2000s. Through the past decade, it was close to levels for the EU comparator groups and markedly lower than in many MENA countries. As a result, military spending has never been a burden and allowed to invest generously in human capital formation (Morrison and Talbi, 1996). Meanwhile, spending on public order and security is well above levels registered by all comparator groups, including MENA countries. While it is difficult to offer a judgment on an appropriate level of security allocations, significantly higher share of this protected

\(^{19}\) Reliable historical series of general government spending broken down by function are more difficult to construct than economic breakdowns, and are available with longer delays. Some functional presentations may be misleading, since spending on a certain function is obtained by aggregating spending of "relevant" ministries.

\(^{20}\) In the 2003 budget, allocations to the Ministry of Interior and Local Development (TD 697 million), responsible for public order, outpaced allocations to the Ministry of Defense (TD 510 million), but it should be noted that the former also include financial transfers to local communities.
function is a measure of allocative rigidity, which may constrain adjustment options in the time of adversity.

169. **Tunisia assigns higher priority to Social Security and Welfare function than other MENA countries, but still lags in this area significantly behind the EU accession countries.** This reflects a more modest development of Tunisia’s social safety nets. In this category, differences in the range of government-funded services are the most pronounced. For example, three Asian high-growth countries (Malaysia, South Korea and Thailand) are building up spending on this category from very low levels. On the contrary, in Chile these levels are already higher than in Tunisia, which still can keep this spending within reasonable limits—mainly due to favorable demographic situation and steady decline in poverty levels. However, as Tunisian population ages, the reversal of this trend is likely. Offsetting the social impact of structural changes due to deeper trade integration would also call for increased efforts in expanding social safety nets. Chapter 5 dwells on these emerging trends in greater detail.

170. **The Government of Tunisia had assigned top priority to funding education ever since independence.** At times, education accounted for over $\%$ of total central government budget—higher than in any other comparator group, including countries at much higher income levels. Wages of teachers are a major component of high and growing public wage bill. As school enrollments have steadily risen to near 100 percent levels, the spending effort in this area has decelerated in the late 1990s, and its share in total spending stabilized at 18 percent. These massive investments have paid off impressively: rising education standards were a major contribution to the rise in total factor productivity (Morrison and Talbi, 1996), but challenges for education reform remain (see chapter 6).

171. **On the contrary, Tunisia’s budgetary allocations for health were always modest, remaining at about 1/3 of allocations for education.** The participation of the public sector in the financing of health care has evolved in recent years, with a decrease in budgetary financing and a growing contribution of social security funds and private spending. Thus, private spending has increased to about half of total health care expenditures (see chapter 7). Nationwide programs, such as vaccination, were largely accomplished in the 1980s, and since then health spending has been declining as a share of total public expenditures. It remains well below the EU levels, mainly reflecting the demographic advantage of Tunisia. However, the outlook may be quite different, and health spending may be pushing up as the population will age.

172. **Budget allocation decisions will become more complex in the future, reflecting the need for greater budget flexibility and pressures on social spending.** The hard choices of the future may increasingly be about allocation of limited public funds within each broad category or function, with the aim to increase the efficiency of each function by optimizing its spending mix. Main issues that will require attention include:

- Contain the public wage bill in real terms as a percent of GDP, put in place an incentive structure in the civil service, and begin formulating public service reform;

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21 E.g. focusing on such tasks as finding an optimal mix of spending on remuneration vs. materials; or defining the mix of spending on remuneration across skill levels/grades to maximize growth outcomes.
• Proceed to active management of the government debt portfolio, and bring on budget quasi-fiscal deficits, to further consolidate the public debt situation;

• Gradually improve the allocative mechanisms by first better identifying and measuring various quasi-fiscal operations, and eventually - bringing them on budget;

• Define long-term plans for the restructuring of the social protection system, to enable it to meet the challenges of the ageing population.

5.3. The challenge of strengthening budget management

173. **Tunisia is well positioned to make further progress in the reform of budgetary processes.** Its public spending systems are already quite strong (even if not flexible enough), and the level of strategic and operational control of public funds and the accountability arrangements for their use is impressive. These mechanisms guarantee the capability of the Government to maintain the global fiscal discipline. The deviations during budgetary execution from the budget laws are typically very small, and do not create “surprises” capable to push the public debt out of control. Implementation of performance-based budgeting reforms, envisioned by the Government, would call for a supporting institutional environment, in terms of the quality of budget formulation and execution—including an appropriate Medium-term Expenditure Framework.

The Budget formulation framework

174. **The budget is reasonably comprehensive, but excludes the social security funds.** The organic budget Law No 96-103 dated 25 November 1996 establishes procedures for the whole budgetary cycle, beginning from formulation through audit. However, it only covers the Central Administration budget. In accordance with this Law, all revenues are included in the budget and serve to meet the entirety of authorized expenditures. Earmarked Treasury funds (Fonds Spéciaux de Trésor) are strictly defined in policy documents. Over 1995-2000, they accounted for only 6.2 percent of total central budget spending (excluding debt service). Earmarking is limited also with regard to external donor funds: even if they are targeted for specific investment projects, they are nevertheless included in the Investment Budget. There exist only two extrabudgetary funds with clearly defined tasks in the social protection area. At the same time, the Organic Budget Law covers neither the budgetary practices of social security funds (caisses de sécurité sociale), managed under their proper Laws, nor the municipal budgets.

175. **One deficiency that weakens budget comprehensiveness is limited integration between the recurrent and investment budget.** This integration only happens at a very aggregate level, and throughout the budget preparation cycle the formulation of these two budgets represents two separate processes—with much more attention given to the Investment Budget. This potentially may hamper the introduction of program and performance budgeting, which require a global vision of inputs, outputs and outcomes for each and every program, and therefore require one budgeting process, not two as is the case currently.

176. **Budgetary classification is sufficiently detailed to describe various government functions, but remains essentially an administrative classification and can be made compatible with the GFS only at an aggregate level.** More detailed breakdowns remain incompatible with the GFS and thus less useful for the purposes of program budgeting and for the measurement of budget outcomes (gestion par objectif). On the aggregate level, functional presentation often is arrived at by adding up spending of «relevant» ministries, thus leaving out relevant appropriations located in other ministries, and including non relevant appropriations in the ministries currently considered.
177. **Budget preparation calendar ensures timely adoption of the budget law.** The preparation begins early enough to allow the MOF and sector ministries to negotiate mutually acceptable sector allocations (Box 5.3). Budget amendment laws (*loi de finances rectificative*) are rare, and are passed only to cope with dramatically adverse circumstances (one was passed in 1991, one in 2002). The budgetary cycles of social funds and municipalities is broadly consistent with that of Central administration, but not synchronized with it.

<table>
<thead>
<tr>
<th>Box 5.3: The budget cycle in Tunisia</th>
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<td>Formally, the budgetary process begins in January with a call letter (<em>Circulaire Budgétaire</em>) issued by the Prime Minister, which outlines the budgetary framework (<em>les grandes lignes du budget</em>) for the next year. The <em>Circulaire</em> is primarily a policy document, outlining the key policy action areas, and does not include detailed quantitative framework. The Recurrent Budget and Investment Budget are formulated separately, but in coordination with each other. Next, the budgetary committee with representation from all sector ministers, holds meetings throughout February-May, and decides on the broad allocation parameters within the context established by the call letter. Detailed quantitative work begins once the Ministry of Economic Development presents its macro forecasts (typically in mid-May), which are then used to formulate more precise sector allocations. These allocations are then negotiated in senior-level meetings between the MOF and sector ministries. By late May these meetings would also take stock of progress in the execution of current budget, and aim to achieve greater precision in the proposed allocations for the next year. The reconciliation of spending requests with available revenues generally starts with prior year budgeted levels, is adjusted for actual spending changes, and then adjusted for specific policies, expressed in economic of functional classification terms. The second stage of budget formulation begins in September, when the inter-ministerial council (CMR) addresses situations that could not be resolved in technical meetings between the MOF and sectoral ministries. Once the overall envelope is agreed, the draft budget is endorsed by the Cabinet and is presented in early October to the Parliament for review and approval.</td>
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178. **The budget is prepared for one year, with no multi-year framework in place.** The Economic Budget (*budget économique*) is an aggregate multiyear projection, which is based on the guidelines of the five-year plan and focuses primarily on the key macroeconomic parameters of development. It includes only very aggregate budgetary numbers for the next year, and cannot be deemed a satisfactory medium-term fiscal framework, although it is part of the budget law. The annual Development Report is tracking the implementation of the plan, but also lacks any budgetary dimension. Even the Budget itself and intrayear execution reports are not anchored in the analysis of medium-term budgetary trends. In the absence of medium-term framework perspective, decision makers will find it hard to compare the costs of diverse policy engagements. The allocation of available funds to existing commitments and programs, and the identification of the most efficient allocation of expenditures for a given set of objectives can be substantially enhanced by introducing a medium term budgeting framework.

179. **Policy discussion and expenditure analysis at the Cabinet and the Legislature level could be improved.** Documents that flow within ministries, between line ministries and Ministry of Finance, and between the MOF and the Cabinet are primarily tables of numbers. There is little accompanying explanatory text, no analysis of implications or discussion of options, and no staffing or performance information. The use of efficiency indicators is quite rare. So far, inputs into budget formulation from the sector ministries are mostly set in physical terms of goods and services delivery. Another policy weakness is the absence of consolidated presentation of general government accounts (comprising the social funds and municipalities) at any stage of budget formulation. The time lag between submission of the draft Budget Law to the Parliament and its approval is typically quite short by international standards. The Parliament does not deliberate on the budgets of social security funds, since they are public corporations.
**Budget execution and disclosure**

180. **The budget execution monitoring system allows for a timely control of central budget.** For the central budget, the Government’s Financial Management Information System (ADEB, “aide à la décision budgétaire”), produces regular intra-year execution reports. These reports are timely, and provide sufficient detail to the decision makers, empowering them to take corrective action. The Treasury performs central budget execution and cash management functions, has a well-developed FMIS and operates an efficient commitment control system (although it is completely cash-based). The Treasury’s track record indicates that it is capable to assure that each line ministry stays within its spending authorization received under the annual Budget Law. At the same time, the Treasury system effectively implements the provisions of the Organic Budget Law, which allows to budget administrators (ordonnateurs) flexibility in shifting their funds across items and sub-items within the overall sector envelope. This flexibility will be further expanded under the ongoing budgetary reform, aimed at introducing “gestion par objectifs”. It is worth noting that competitive procurement practices are becoming the norm, with public procurement procedures established by a special Law on Public Markets.

181. **Broader information on budget execution is scarce.** Much less budgetary information is available for wider distribution to the general public, professional analysts and investors. Particularly limited is the intra-year disclosure. The budget execution reporting law (“loi de règlement du budget de l’Etat”) is passed with a delay of 1.5-2 years, which reduces the possibilities of following-up and rectifying problems. Meanwhile, neither the social funds nor the municipalities utilize the services of central Treasury; this complicates the intra-year monitoring and reporting of public spending on a consolidated basis. This limitation is partly redeemed via legal provisions, which impose no-deficit rules on the Special Treasury Funds and municipalities. Finally, since ADEB does not cover the social funds and municipalities, it is not capable to present a consolidated picture of general government spending.

**Public debt management**

182. **The debt management practices are strong, but will benefit from greater centralization and functional focus.** The debt management function is structured in a traditional way, with a number of fragmented administrative units working each on a separate class of debt instruments and an embryonic risk control function. The Central Bank acts as the State’s agent for its foreign debt management operations. The current setup provides good control over the individual debt instruments, but does not support the integrated view of public debt portfolio, and could obstruct active risk management. The debt management function must be centralized; and debt management units must be given more operational flexibility.

183. **The current approach managed to stabilize Tunisia’s overall risk profile, but the efficiency of public debt management could be enhanced.** Outstanding issues remain with regard to the strategic vision and the scope of Tunisia’s public debt management; the measurement and disclosure of risk; and the reinforcement of debt management institutions and domestic market infrastructure. Complementary actions should be envisaged on a number of fronts (see World Bank, 2003b):

- Anchoring the strategy in a medium-term, rolling macroeconomic and fiscal framework;
- Formulating an integrated risk management strategy, based on appropriate risk benchmarks, taking into account all types of risks the government portfolio of debts and related assets may contain;
- Taking steps to strengthen the domestic government securities market (see chapter 4)—especially its medium- and long-term ends—as this is the only viable means to manage the exchange and rollover risks while reducing borrowing costs.
• Working towards the reorganization of the debt management institutions, to improve focus and flexibility, so as to enable the implementation of an effective public debt management strategy.

**Budgetary audits and accountability**

184. **Internal auditing is performed by many instances, agencies and bodies.** Besides the internal control bodies in Treasury (internal inspection, General Inspectorate of Finance), several institutions are in charge of internal auditing: the general Controller of expenditures (at the Prime Minister’s office); technical inspectorates with financial auditing authority, which can be found, among others, in the ministries of education and health. Misbehavior by public spending authorities (including for the State Owned enterprises) are judged by a specific court, “cour de discipline financière”, which pronounces some twenty condemnations per year, sanctioned usually by financial penalties: judgments are public and published in the Official Journal of the Republic.

185. **External audit is performed by the Cour des Comptes alone, and is currently focused on compliance more than performance.** The Cour des Comptes judges the public accountants, and the compliance of budget expenditure with legal requirements (for instance it verifies Treasury operations are regularized before the end of fiscal year). To this end, it submits several reports on budget execution: the report on the budget financial execution (loi de règlement), and a report summarizing their own audits. The second is closer to the actual audit reporting and follows the contradictory procedure since observations from the audited are included: the Cour audits the accounts (including those of social security funds and State owned entreprises), judges the quality of the management, proposes improvements and remedies and since 1984-85, evaluates public institutions performance, reviews program (trans-ministries) expenditures and policy reforms efficiency. The follow-up to this report is ensured by the executive branch: a special committee is in charge of collecting the corrective measures taken after the Cour’s recommendations and reports to the Cabinet. Specific cabinet meetings are also convened to review follow-up of the Cour’s recommendations. Yet the disclosure of the audit report is limited to the administration, the government, and the Legislature. Only a summary of its contents (together with the responses from the audited entities to the Cour’s observations) is published. Nevertheless, the current structure of public expenditure presentation and execution would make it difficult to go deeper into performance audit, although the Cour’s personnel has already been trained to lead such audits.

5.4. Options for reform: Toward a medium-term expenditure framework and performance budgeting

186. **Both the strengths and the deficiencies of the existing PEM mechanisms are well known to the Tunisian authorities.** The first steps towards more flexible and efficient public spending mechanisms have already been made in the context of constitutional reform introduced by Law No. 2002-51 dated June 1, 2002, which established the second chamber of Parliament. Reforms aim to: (i) introduce outcome-based performance budgeting (*gestion par objectif*); and (ii) increase the flexibility of sectoral appropriations by allowing the budget users greater freedom in shifting resource between items and sub-items if they stay within the overall appropriation limits.

187. **Further increase in the efficiency of public expenditure management would free public resources without sacrificing the goals of economic and social development.** The following, closely related tasks can help achieve these objectives: Greater comprehensiveness of the budget will provide a common platform to compare different policy commitments, including those existing beyond the budget, thus equipping the policymakers with tools to better measure the efficiency and equity of spending across
and within categories and functions of the Government. This consolidated presentation will provide the missing link between the five-year plan and the annual Budget.

- Complete the transition to GFS classification of public spending (ideally at 3-digit level of detail), to prepare for the introduction of performance budgeting;
- Strengthen the budget by developing ministry-specific policy papers that include a review of spending trends, past performance (financial and programmatic), any audit findings, and identification of major policy issues. After adoption of the fiscal framework, these would form the basis of cabinet budget discussions.
- Consider adopting a program classification built around major activities in each Ministry.

188. A rolling Medium-term Expenditure Framework would be a key underpinning of performance-based budgeting and would help strengthen the overall fiscal framework. The MTEF will facilitate the implementation of performance-based budgeting by formulating indicators against which expenditure efficiency can be evaluated over the medium term. It will also strengthen sovereign debt management, by providing the necessary medium term framework to assess budgetary risks in the context of changing macroeconomic conditions. The MTEF should be embodied in a fiscal policy paper prepared early in the budget process, setting the overall macroeconomic and fiscal policy parameters for the budget. Different methods to elaborate an MTEF are outlined in Box 5.4. Major threats and challenges to the fiscal position over the medium term should be included. The fiscal framework should integrate the recurrent and investment budgets. Main objectives of an MTEF would be to:

- improve macroeconomic balance by developing a consistent and realistic resource framework;
- improve the allocation of resources to strategic priorities between and within sectors;
- increase commitment to predictability of both policy and funding so that ministries can plan ahead and programs can be sustained;
- provide line agencies with a hard budget constraint and increased autonomy, thereby increasing incentives for efficient and effective use of funds.

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**Box 5.4: Developing an Medium-term Expenditure Framework—different methods are possible**

Developing and implementing a medium-term framework for linking policy, planning and budgeting can be accomplished progressively at a pace that fits a country’s capacities. Countries often choose to begin at the sector level because this represents a manageable change from the status quo. However, this approach should only be viewed as a building block to achieving a comprehensive medium-term approach. Many of the potential gains at the sector level, however, cannot be realised until the sector approach is combined with a sector overall planning, resource allocation and budgeting system that supports a better balance between policies and resources at the inter-sector level. Furthermore, too much dependence on a sector focus can limit opportunities for responses that go beyond the sector.

Similarly, a framework to allocate resources between sectors can only be fully effective when it is complemented by a similar system for resource allocation within sectors and by information generated by sector ministries themselves. The ideal, therefore, is to develop a medium-term approach to decision making and resource allocation across the whole of government that combines top-down and bottom-up decision making for expenditure allocation.

Defining and implementing a sector MTEF involves conducting sector review and agree on sector objectives and policies, preparing estimates of overall resource availability, reviewing financing mechanisms, and preparing prioritised government spending plans, finally developing mechanisms to facilitate resource shifts when priorities change. This is clearly not a one-off process. Rather it is iterative and must take into account, on a periodic basis, changes in sector needs and priorities and changes in the overall resource envelope.


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22 For a good example of a fiscal policy paper, see Chapter 3 of Poland’s EU Pre-Accession Economic Program at http://www.worldbank.org/eca/eu/enlargement/publications_other.htm#pep
Summary of reform options

189. **Actions are needed to improve the fairness of Tunisian tax system and revenue mobilization, to cut the cost of tax administration, and to strengthen incentives for tax compliance.** To inform policy decision makers on directions for tax reform, it is advisable to begin with a comprehensive examination of the tax system. This examination should launch a process for:

- Reducing the number of preferential tax regimes, broadening the usage of simplified direct estimation schemes of tax assessment, and phasing out the “forfaitaire” system;
- Enhancing the taxation of the self employed by a system of objective criteria based on living standards;
- Reducing the multiplicity of the VAT regimes, to broaden the tax base and reduce the statutory tax rates

190. **Despite broadly successful expenditure allocation choices, public spending remains too rigid, with large non-discretionary component.** Increasing the overall flexibility of the budget and the efficiency of each function call for:

In the short term

- Taking early steps in the direction of containing the public wage bill as a percentage of GDP, create the incentive structure in the civil service, and formulating public service reform
- Evaluating the efficiency of various public investment programs;
- Consolidating the debt management institutions, to begin the transition to active government debt management.

In the medium term

- Further improving the allocative mechanisms by identifying and measuring various tax expenditures and quasi-fiscal operations, and bringing them on budget; and
- Proceeding to active management of the government debt portfolio, to further consolidate the public debt situation.

191. **Implementation of performance-based budgeting reforms calls for more flexible and efficient institutional environment, both in budget formulation and budget execution.** These budget management reforms should have the following goals:

In the short term

- Revising the budget classification for full compliance with GFS;
- Formulating a rolling medium-term fiscal framework for consolidated general government and thereby increasing the comprehensiveness of analytical budgetary accounts;
- Initiating program and performance budgeting in a pilot ministry or agency
- Increasing the integration between the recurrent and investment budget at all stages of the budgetary cycle;
- Harmonizing the budgeting practices, reporting requirements and disclosure of extra-budget funds with those of the central budget;
Over the medium term

- Supplementing the GFS classification with program classification built around major activities in each Ministry;
- Expanding program and performance budgeting to all public institutions
- Implementing a medium-term expenditure framework;
- Strengthening the budget dialogue between the MOF and the line ministries and the draft budget review by cabinet commissions
- Strengthening the internal audit and streamlining its organization;
- Reducing the time lag in the publication of budgetary reports.
- Develop performance audit.
Chapter 6. Long Term Challenges: The Knowledge-Based Economy and the Education System

192. To meet the goals of the Tenth Development Plan, Tunisia will need to ensure higher growth rates in high-productivity and high skill sectors by fostering the knowledge-based economy and promoting excellence in the education system. Nurturing the knowledge-based economy (KBE) will enable the raising in the value chain in established industries and a shift toward new high value added activities and exports. This will improve Tunisia’s positioning in the Euro-Mediterranean single market and create the right employment opportunities for Tunisia’s increasingly educated labor force. This is a long-term endeavor, given Tunisia’s stage in development, and touches all sectors from the artisan to the advanced enterprise. For this reason, it is important that the foundations be laid early on. Promoting the KBE clearly has important implications for the education sector in terms of improving its quality and increasing its links to productive market needs. Learning achievements, better linkages between education and the labor market, and scientific research and innovation need to improve markedly if Tunisia is to have the skills to compete in the global knowledge economy.

6.1. Promoting the knowledge-based economy

193. Several pillars are necessary to foster the knowledge-based economy. Human resources well trained, a dynamic innovation system, well established information infrastructure and an economic and institutional environment favorable to entrepreneurship in all forms are among the key enabling factors (World Bank Institute; http://www.worldbank.org/wbi/knowledgefordevelopment/) Moreover, in the particular situation of developing countries two phases are important: the upgrading of the society to make it receptive to KBE, and the emerging of the later. Typical examples illustrative of this double step approach are provided by Asian countries such as Korea in the past decades and more recently by Malaysia. In Latin America, Chile is following this path, as Ireland and Portugal have been doing it in Europe.

194. Tunisia appears to have made significant progress regarding its receptiveness to KBE over the recent years, but it is still far behind direct competitors in other developing regions. According to the methodology developed by the World Bank (see Box 6.1), Tunisia, close to the MENA average (which includes Israel), has significantly improved its position compared to the mid nineties -- only Jordan is doing better among MENA countries (Figure 6.1).

195. Most significant progress and achievements are noticeable in the ICT infrastructure pillar -- telephone and IT equipment -- and in the education pillar, thanks to sustained effort made in literacy and secondary and tertiary enrolments. The position of Tunisia on the innovation pillar -- measured by input indicators such as the number of researchers per inhabitants, publications and patents -- is also evolving favorably. Relatively few progress has been made in the incentive and regulatory framework, further improvement being needed in the opening of the economy, governance issues, etc (Figure 6.2).

196. A gradual insertion within global high and medium technology exchanges is noticeable. For instance mechanical and electrical machinery represented only 5 % of exports in 1990, they represented 12% in 2001, and technological products have gone from 0.5% of exports to 1%, a low performance, but the best of Arab countries. However, sector analyses show that Tunisia has yet a long way to go,
enterprises trailing behind direct competitors in terms of product quality, labor qualifications, etc. (see sector studies of the *Agence de Promotion Industrielle*).

**Box 6.1: Benchmarking countries' receptiveness to knowledge economy – the World Bank Institute Methodology**

The database and methodology, created and developed by the World Bank Institute (see www.worldbank.org/kam), gives an indication of the extent of Tunisia's evolution within knowledge economy trends at the global level. The database covers 120 countries, the positions of which are analyzed according to 76 variables. These variables describe the situation of the countries in relation to four pillars of the knowledge economy, namely:

i) the economic and institutional framework

ii) education

iii) the ICT infrastructure

iv) the innovation system

Primary data, measured in absolute values, are collected from different existing databases and are then normalized to allow comparisons between countries. A scale of 0 to 10 is then used to rank countries for each of the variables, where 10 equals best performing and 0 least performing of the 120 countries featuring in the database.

For each of the four pillars, three variables are retained for a simplified standard evaluation:

i) economic and institutional framework: tariff and non-tariff barriers, law enforcement, the quality of rules and regulations;

ii) education: adult literacy rates, level of secondary and tertiary enrollment;

iii) ICT: the number of telephone lines (fixed lines and mobiles) per inhabitant, the number of computers per inhabitant, and the number of internet users per inhabitant;

iv) innovation systems: the number of researchers per inhabitant, the number of patents filed in the American patent office per inhabitant, and the number of publications per inhabitant.

A summary index is calculated by taking the average of the twelve variables (normalized values).

These indicators provide information about the receptivity of the economy to knowledge, rather than on the performance of the countries in this field. There is a strong correlation between the level of development of the country and the degree of receptivity to a knowledge based economy, although a cause and effect relationship cannot necessarily be established. The reason is that to a certain extent, the richer the countries, the more they can invest in ICT infrastructure, or indeed in motorways or hospital beds.

**Figure 6.1: Fostering the Knowledge-based economy—Tunisia's global positioning**
Tunisia has relatively well articulated and implemented the upgrading policy on the various KBE pillars, but needs to engage vigorously in the emergence policy. Essential steps to move forward to a KBE in Tunisia would include initiatives in the following areas.

- Clearly positioning KBE at the core of the country’s development process. For doing this, begin with gathering in an annual document with a strong visibility all information relevant to monitor and evaluate the transition to KBE; policies and programs with budgetary elements and achievements of the plan’s objectives; changes observed in key actors (enterprises, schools); and estimated impacts on economic fundamentals (employment, productivity, etc).

- Strengthening economic governance and the regulatory framework (see chapter 2). Main enabling factors include strengthening competition policy and transparency in public management; reducing bureaucracy; furthering international trade liberalization (reduction of tariffs on imports outside the EU); and actions to boost the entrepreneurial capabilities of the private sector (corporate governance, finance for new ventures, labor market flexibility).

- Continuing to equip the country with world class ICT infrastructure by furthering the competitive opening of the ICT sector, strengthening the independence of the telecommunication regulator, and liberalizing IT services.

- Developing the innovation system. Key policy actions for this include: further use of the “Mise à niveau” program which could be increasingly targeted on immaterial investments; the rationalization of government support to innovative enterprises; the strengthening of the science infrastructure; and the gradual building of the planned technological poles (see Box 2 on these different points)

- Pursuing actively policies for the development of human resources (see the section below), by adapting the whole education system to labor market needs, improving its efficiency and organizing it around the notion of “competency” of application from the primary to the tertiary levels. This innovative approach, in line with initiatives taken by the Ministry of Education and Training, would make the whole education system an efficient instrument for a continuous improvement of human capital in a life-long training perspective.
The orientations given by the government for a knowledge-based development process are broadly right. The problem, however, is that related plans and investments remain so far much government-led, with little private sector initiatives. This is clearly in relation with the private investment gap issue discussed earlier in this report. Broader measures suggested in this report to address this gap are therefore essential. Concomitantly it is important to mobilize around the knowledge economy vision the business communities, including representative bodies such as UTICA or the “Institut arabe des chefs d’entreprise”.

Box 6.2: Developing the Tunisian Innovation System—policy thrusts and instruments

In addition to the overall business environment and investment climate, it is important to provide appropriate support and incentives. In the Tunisian context, key policy actions would include:

Adapting the mise a niveau program: the program has so far been focused on helping the enterprise to restructure and to invest in capital and equipment supported up to 70 per cent. Some 2500 enterprises are registered within the program, 1500 have gone through the strategic diagnosis phase. Results are convincing, e.g., in terms of competitiveness (the European market share of those enterprises has increased of 16 per cent) and impact on management (55 per cent of concerned managers estimate that the program has induced a radical change in their firm—see the program survey of May 2003). However, immaterial investments—training, marketing, research, design, quality, etc.—have been trailing behind, with a rate of completion of 40% only against 75% for material investments. Incentives should be increased for such immaterial investments and the criteria used for enterprise selection should be softened (see below chapter 2), for helping notably smaller and new enterprises—which cannot bring in credit records—to benefit of the proposed support.

Rationalizing innovation support schemes: there are currently a number of agencies providing some form of support either technical or financial to firms with innovative projects (the Programme de mise a niveau, Agence de promotion industrielle, the Fonds de promotion de decentralisation industrielle, the Ministry of science and technology, etc.). It would be appropriate to coordinate these different source of support in one single agency with local offices close to local needs and giving access to various sources of technical, commercial, and other competences. The French ANVAR provides a useful model that could be adapted to the Tunisian context.

Strengthening the research system: Tunisia counts today 9900 researchers in full time equivalent in 110 laboratories and 4008 research unit. The national R&D expenditure is about 0.75 per cent of GDP, with a very modest contribution from the business sector. The objective of the ten five year plan is to increase significantly the budget up to 1% of GDP in 2004, adapting the research effort to the economic and social needs through target sectoral programs (water, energy, ICT, health, agriculture, environment notably), increase incentives for innovation and use of research results (support to innovative enterprises, capital risk, mobility of researchers towards the private sector, etc.), and the development of international cooperation. It would be important to have a long term vision, including notably the development of excellence centers in selected areas (inserted in international networks), and the maintenance and upgrading of vital structures for the economy, such as networks of the technical centers crucial for the support of existing industries in traditional sectors.

Developing technopoles: the Tunisian government has the ambitious plan to establish six technopoles disseminated throughout the country, each has been focused on specific sectors, in building on existing educational and industrial resources. So far most concrete achievements have been made with the telecom technopole of EL Gazala developed in the Tunis suburb, around the nucleus formed by the telecom schools. Open in 1999, the technopole now counts 31 enterprises, of which 6 multinationals. 620 jobs have been created in the private sector which coexist with 300 cadres of the public sector and 110 teachers/researchers (for 100 students). About 50 millions of dinars have been invested in infrastructure and 50 millions are being generated by the enterprise turnover (half for exports). Prospects are good, although problems are perceived for the development of research activities. As seen through this example, direct job creations are moderate, but the concept of technopole is valid as an instrument of concentration of innovation capabilities and territorial development. The government program should be pursued steadily with a clear understanding of critical masses necessary for success.
6.2. Priorities in education sector reform

199. *Education is one of the principal pillars of Tunisia’s strategy for development.* The strategy aims to build the kind of human capital necessary to enable Tunisia to compete in the global knowledge-based economy. As a result of its long standing emphasis on social development, Tunisia has made significant progress in improving education access and equity. Reforms during the 1990s aimed at ensuring equal access to opportunities, by providing compulsory and free education until the age of 16, and at improving students' learning achievements. Improving completion rates, reducing failure, and modernizing the educational system through the widespread introduction of new technologies are among the priorities in the government’s vision of the school of tomorrow.

**Improving the quality of education and strengthening its links to labor market needs**

200. *Education access and equity have significantly improved.* Lower basic education is near universal, with 98 percent of 6- to 11-year-olds enrolled; enrollment rate for the 12-18 years old is 76 percent and gross enrollment rate of the 19-23 year-olds reached 26 percent in 2003. Gender equality has also been achieved at all levels of the education system. Female students are slightly under-represented in lower basic education, but slightly over-represented in upper basic education, secondary and higher education. Girls’ under-representation in lower basic education is the result of lower repetition rates, not lower enrollment rates.

201. *Tunisia’s education sector faces a critical challenge as a result of demographic transition.* Thirty-five years of declining birthrates are now resulting in a reduction in the lower basic education student population. While secondary and higher education student numbers are growing rapidly as a result of increasing primary completion rates and massification of the higher education. According to MET projections covering the period 2000-2010, basic education student numbers will decrease by 40 percent (or 470,000 students) and secondary education student number will increase by 80 percent (or 310,000 students).

202. *Learning achievement needs to improve markedly if Tunisia is to have the skills to compete in the international marketplace.* Recent performance in international standardized testing was poor, reinforcing concerns about the quality of education. Ensuring that all children successfully complete the two cycles of basic education remains a challenge, as the repetition and drop-out rates in upper basic education remain high (9.7% dropouts and 19.5% repetitions). Failures at the higher education level are important: repeaters represent about 20% of students, exam rates were about 66% in 2002.

203. *Education expenditure cannot be expected to increase and improvement in cost effectiveness need to be considered.* Tunisia’s emphasis on education is reflected in the high share of public spending on education compared to other countries (Table 6.1): 27 percent of total public expenditures and about 7.2 percent of GDP in 2003. Expenditure composition is more skewed towards the secondary and higher education levels. The Government is also making major investments to accommodate the growing numbers of students and to improve the quality of education outputs in line with the needs of the productive sector through emphasis on teaching and learning quality. Improving teaching quality will remain a major challenge for the next decade at the secondary and higher education level, as the share of qualified teachers is decreasing. Cost-effective solutions are considered that would guarantee the fiscal sustainability of its ambitious reform program.
Table 6.1: Education spending in Tunisia and comparator countries

<table>
<thead>
<tr>
<th>Expenditure per student</th>
<th>Tunisia</th>
<th>Ireland</th>
<th>Portugal</th>
<th>Spain</th>
<th>Korea</th>
<th>Malaysia</th>
<th>MENA</th>
<th>OECD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary (% of GDP per capita)</td>
<td>16.2</td>
<td>13.3</td>
<td>20.5</td>
<td>18.8</td>
<td>18.3</td>
<td>11.2</td>
<td>na</td>
<td>48.9</td>
</tr>
<tr>
<td>Secondary</td>
<td>28.4</td>
<td>15.2</td>
<td>29.4</td>
<td>25.5</td>
<td>16.8</td>
<td>19.9</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Tertiary</td>
<td>89.8</td>
<td>27.8</td>
<td>28.2</td>
<td>19.8</td>
<td>8.0</td>
<td>86.1</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Total Public spending (% of GDP)</td>
<td>6.8</td>
<td>4.4</td>
<td>5.8</td>
<td>4.5</td>
<td>3.8</td>
<td>6.2</td>
<td>5.3</td>
<td>5.8</td>
</tr>
</tbody>
</table>

a: 1999 or 2000
Sources: World Development Indicators

204. Although, compared to other middle-income countries, public spending on the education sector is high, the allocation of recurrent resources is inadequate and leads to low efficiencies in both upper basic and secondary education. Public spending on the education sector has reached a historical high level in 2003. Despite this high spending, the Tunisian education system shows signs of inefficiency in both upper basic and secondary education, with low rates of inter-cycle transition and high dropout and repetition rates. This inefficiency is mainly due to the allocation of resources: more than 90 percent of recurrent expenditure are on salaries and therefore spending on other pedagogical inputs is inadequate. This unbalanced pattern is a broader characteristic of current public expenditures in Tunisia, as noted in chapter 4.

205. Substantial part of the human resources in education are in the administration rather than teaching. Examination of human resources in education sector reveals that the current level of staffing yields class-sizes that are low in comparison to countries that have a higher levels of per-capita income (Brazil, Chile, Mauritius etc). In relation to the number of students in secondary education, significant number of staff are either employed in administrative positions or engaged in non-teaching activities resulting in a rather high non-teaching staff / student ratio.

206. Unemployment is particularly high amongst the educated and the youth. As already observed, unemployment rates are lower for those with less than a primary education, suggesting lower wage expectations and a relative abundance of lower-skill jobs. But among primary and secondary degree holders, unemployment rates are higher than average (World Bank, 2003a). Moreover, in 2001, almost one out of four young Tunisians was unemployed, whereas the national average is one out of six. For younger age groups, unemployment increases with education (Figure 6.3). The persistence of unemployment among young and educated groups raises two issues: (i) labor demand has not kept pace with structural changes in the labor force; and (ii) mismatch between skills in demand and skills produced by the education system.

207. Increase in unemployment among the educated labor force reflects weak links between the labor market and the education system. Although completion of higher education increases the chances of workforce employability, general and technical qualifications do not guarantee employment. The
increase in unemployment of the educated labor force (secondary and higher education) suggests that the education system is not adapting the skills of the future labor force to the needs of the labor market. Moreover, the increase in the employment of the educated labor force during the late 1990s, reflects to a large extent the capacity of the public sector to absorb educated labor force, a role that is not sustainable over time.

208. **Young women have not yet been able to benefit fully from their improved educational status.** In 2001, the labor force participation rate was 76.0 percent for men and just 25.8 percent for women. Overall, employment access is more difficult for women than for men and particularly women need a higher degree to penetrate the labor market. This phenomenon is partly due to the fact that women concentrate in the same education fields (such as social sciences) and are less specialized in technical fields.

**Key challenges facing the education sector**

209. **Major education reforms have been implemented since 1991, and the development of the new reform strategy, known as “Tomorrow’s Schools”, provided new impetus to these efforts.** The Government’s reform is focused on improvement of teaching and learning quality (Ministry of Education and Training, 2002). The “upskilling” assumptions of the Tenth Plan are consistent with the international evidence establishing that technological change and globalization increase relative demand for skilled labor. The education and vocational training systems will thus face major challenges to: (i) ensure that it can effectively accommodate the demand growth; and (ii) deliver employable trained workers in an efficient manner (link education and vocational training reforms to private sector needs). In this context, the reform program could focus on the following main directions.

210. **Improving quality and reducing selectivity.** To reduce the selectivity bias of the education system, it should be ensured that basic education is successfully completed by those between the age 6-16. At the primary and secondary level, it is advisable that measures also aim at reducing geographical disparities, improving the distribution of resources (particularly teachers), and promoting good quality private secondary education to reconcile enrollment ambitions with the constraints of the public budget.

211. **Improvement in overall efficiency is critical if the government wants to achieve high completion rates in secondary education.** Reducing the number of non-teaching staff and using the savings to increase spending on pedagogical inputs can gain substantial improvements in internal efficiency. Demographic projections indicate that during the next decade, primary school age population is going to fall by 6 percent while secondary school age population would increase by 20 percent. These changes in student population have significant policy implications for government budget, providing opportunities for intra-sector shifts in allocation of resources. Since salaries constitute more than 90 percent of recurrent expenditures, reduction of personnel through retirement or redeployment could help reduce the share of primary and lower basic expenditure, while additional recruitment would provide the requisite number of secondary school teachers. Simulations indicate that universal secondary education would require the government to raise the share of total education in its budget to almost 25 percent by 2015, or equivalently, increase recurrent education expenditures to 7.1 percent of GDP. Share of secondary education in total recurrent education budget would have to rise to 28.2 percent (from 18.5 percent) while the allocation for upper basic and primary education can be reduced to 16.1 and 34.2 percent from 20.3 and 39.8 percent respectively.
212. **Defining the new roles of secondary and higher education.** The MET has opted for a strategy of gradual specialization for secondary education students and a strategy of diversification. As part of its strategy to diversify the post-basic education curriculum, the MET is introducing programs to strengthen links to pre-employment vocational training, through the involvement of the private sector. However, these reforms are occurring at a slow pace. In higher education, the Government privileged the creation of short tracks and the diversification of tracks in universities. The strengthening of technical and technological tracks was among the objectives of the government as well, and their share in higher education has increased. However, despite these efforts, medium and long, as well as traditional tracks, are still prevailing.

213. **Diversifying specialties fields and increasing flexibilities to easily adapt education to the needs of the market.** The lack of adaptability of the training and education system to the needs of the market represents a key impediment. Reducing unemployment rates among educated youth requires a closer link between the education and vocational training system and the needs of the market. Although recently few structural links have been put in place between education establishments and the labor market (e.g., chambers of commerce participating in university councils), due to lack of incentives, higher education establishments do not see the need to design their services according to the needs of the productive sector. Main obstacles that impede the links between higher education and labor market needs are: the lack of structural links between education establishments and the labor market; the lack of flexibility in qualification of teachers; insufficient resources to increase scientific and technical capacity at higher education.

214. **Increasing coordination between secondary education and vocational training, combined with a closer review of the new fields offered by secondary education.** The role of secondary education is not simply to prepare students for higher education, but to prepare them for a range of post-secondary job opportunities. The vocational training system is still mainly designed to absorb secondary school dropouts. In this context, the objectives of the two systems should be redefined in parallel and according to employment market needs.

215. **Encouraging diversity in the orientation of girls in the secondary and higher education system to facilitate their integration into the labor market.** In Tunisia, girls' access to higher education is ensured and the proportion of girls among students may even increase to reach more than 60 percent. However, girls represent a minority of students in the technical fields whereas they are concentrated in literature and in social sciences.

216. **Reemphasizing equity in access to higher education.** The higher education system is becoming dual with "elitist tracks" and "mass tracks". Indeed, certain tracks (such as medicine, engineering) are more selective and limited to the best students whereas generalist tracks (such as literature, social sciences) are accessible to all. Access to elitist education depends largely upon the economic and social status of the students. This duality is made worse by the fact that generalist tracks suffer from a lack of resources. It is critical to ensure that all tracks are accessible to all students, independently of socioeconomic factors.

217. **Introducing partial cost recovery in higher education and promoting private sector involvement.** One way to relieve the current pressure on the budget is to implement partial cost recovery in higher education. Another is to encourage greater involvement by the private sector in providing secondary and higher education. Both measures would result in releasing scarce public resources that now subsidize the better-off and that could be reallocated to benefit the poor.
Summary of reform options

In the short term

- Diversifying the post-basic education curriculum through greater involvement of the private sector.
- Accelerating creation of short tracks and the diversification of tracks in universities.

In the medium term

- Improving the distribution of resources (particularly teachers) across sub-sectors to ensure that basic education is successfully completed by those between the age 6-16, including most vulnerable groups of children.
- Improving overall efficiency to achieve high completion rates in secondary education, through reducing the number of non-teaching staff and using the savings to increase spending on pedagogical inputs (improvements in internal efficiency).
- Redefining the role of secondary education and vocational training to better respond to employment market needs based on better understanding of enterprise demands.
- Promoting good quality private secondary education and introducing partial cost recovery in higher education.
Chapter 7. Enhancing the Effectiveness of Social Policies

7.1. Promoting the cost-effectiveness of the health care system

219. While the Tunisian health sector is performing well, a number of challenges remain. Main challenges in future health sector developments include increasing demand for high-technology health care, and an increasingly elderly population with chronic diseases that are expensive to treat. Given the reasonably successful developments during the past decade, Tunisia seems well placed to tackle these challenges with appropriate reform efforts.

Assessing health system performance

220. Health, nutrition, and population outcomes have registered substantial progress and Tunisia is on track to achieve the health and nutrition-related Millennium Development Goals. Life expectancy at birth has reached 72.1 years, indicating that Tunisia now is approaching OECD standards and reflecting the epidemiological transition it has been going through during the past decades (Table 7.1). It is also noteworthy that Tunisia has succeeded in controlling its rate of population growth more effectively than have the other Maghreb countries and the MENA region in general, as evidenced by both the lower total fertility rate (2.1) and a lower population growth rate (1.1) from 2000-2005.

<table>
<thead>
<tr>
<th>Health Outcomes</th>
<th>Tunisia</th>
<th>Algeria</th>
<th>Morocco</th>
<th>MENA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life expectancy at birth (years)</td>
<td>72.7</td>
<td>70.7</td>
<td>68.4</td>
<td>68.6</td>
</tr>
<tr>
<td>Infant mortality rate (per 1000 live births)</td>
<td>24</td>
<td>39</td>
<td>39</td>
<td>37</td>
</tr>
<tr>
<td>Immunization, measles (% of children under 12 months)</td>
<td>95</td>
<td>83</td>
<td>96</td>
<td>92</td>
</tr>
<tr>
<td>Under 5 child mortality rate (per 1000)</td>
<td>28</td>
<td>49</td>
<td>44</td>
<td>54</td>
</tr>
<tr>
<td>Maternal mortality rate (per 100,000 live births)</td>
<td>54</td>
<td>150</td>
<td>390</td>
<td>N/A</td>
</tr>
<tr>
<td>% births attended by skilled health staff</td>
<td>90</td>
<td>77</td>
<td>40</td>
<td>N/A</td>
</tr>
<tr>
<td>% children with malnutrition</td>
<td>4</td>
<td>6</td>
<td>9.5</td>
<td>14.5</td>
</tr>
<tr>
<td>Total Fertility Rate (average number of children per woman)</td>
<td>2.1</td>
<td>2.8</td>
<td>2.8</td>
<td>3.2</td>
</tr>
<tr>
<td>Average rate of population growth (2000-2005)</td>
<td>1.1%</td>
<td>1.7%</td>
<td>1.6%</td>
<td>N/A</td>
</tr>
</tbody>
</table>

*Child malnutrition (weight for age) is the percentage of children under five whose weight for age is less than minus two standard deviations from the median for the international reference population ages 0 to 59 months (WHO).


221. Access to basic health care is available to all the population. The Tunisian health care financing system is a combination of social insurance, general revenue, and out-of-pocket payments. To ensure that the poor have access to medical services irrespective of their ability to pay, the state provides free or subsidized health care to the lowest income groups: (i) 8 percent of the population which are classified as poor (familles necessiteuses) receive free care in Ministry of Health facilities; and (ii) an additional 25 percent of the population, who have low income, receive care in public facilities at reduced prices (co-payments). In addition, 66 percent of the population are covered by one of the social insurance funds (80 percent by the funds for the private sector, CNSS, 20 percent by the funds for the public sector, CNRPS).

23 Private insurance plays only a very limited role in Tunisia and is therefore not included in the analysis below. The military, which operates its own health care facilities and is financed by the Ministry of Defense, is also excluded from this analysis due to lack of available information.
Compared to many other, low as well as high-income countries, this level of health coverage to the Tunisian population is very high.

222. **But the extent to which the population is protected from becoming impoverished due to illness (financial risk protection) continues to present a challenge.** The extensive coverage hides the fact that the total out-of-pocket expenditures (i.e., not counting their social insurance premiums) comprise almost 50 percent of all health expenditures. This compares favorably with the average for the MENA region and that for Morocco, but less favorably with the average for Algeria (Table 7.2). Moreover, the percent of private expenditures in Tunisia has been rising the past two decades. Although detailed national health accounts do not exist, based on earlier work on benefit incidence analysis, the economic burden of health expenditures on the poor is substantial, and the poor are likely to spend a significant proportion of their income on private health care even though public services are available free of charge (World Bank, 1995). Household surveys indicate that the share of the household budget devoted to health care is positive at very low consumption levels and greater in rural areas at all income levels.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Tunisia</th>
<th>Algeria</th>
<th>Morocco</th>
<th>MENA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private health expenditures (% of total health expenditures)</td>
<td>49</td>
<td>18</td>
<td>70</td>
<td>38</td>
</tr>
<tr>
<td>Health expenditures per capita (US$)</td>
<td>110</td>
<td>64</td>
<td>50</td>
<td>171</td>
</tr>
<tr>
<td>Health expenditures (% of GDP)</td>
<td>5.5</td>
<td>3.6</td>
<td>4.5</td>
<td>4.6</td>
</tr>
</tbody>
</table>


223. **Growth of privately provided health services, for which there is generally no insurance coverage, suggests that population perceives the quality of care provided in the public sector inferior to that provided by the private sector.** Evidence suggests that patient satisfaction, whether based on technical or service quality, is an important determinant of care seeking behavior, and hence an important determinant of system performance, in particular as it relates to efficiency and cost escalation. During the past 5 years, the Ministry of Health has made considerable efforts to address issues of quality of care, with World Bank support, and notable progress has been achieved in both patient and provider satisfaction. However, the quality issue remains of critical importance if publicly provided health services are to successfully compete with the private sector in the future.

224. **Improving efficiency of health care performance remains a significant challenge.** Despite recent improvements, strengthening efficiency of health care services remains a major challenge, as evidenced by: (i) very low rates of occupancy at local hospitals (35 percent) and relatively low rates of occupancy at regional hospitals (55 percent); (ii) relatively short hours of operation for public outpatient health care providers with a resulting excessively high rate of non-emergency utilization of emergency services; and (iii) the multiplicity of providers of similar services (e.g., military, social security, public, and private providers) which result in an inefficient utilization of resources.

225. **Containing increase in health care costs remains a serious challenge.** Tunisia currently spends about US$ 110 per capita annually on health care: total health spending correspond to 5.5 percent of GDP and public health expenditures correspond to 2.2 percent of the GDP. This level of expenditure exceeds that of the other Maghreb countries but is below the regional average (see Table 7.2). While health expenditures have stayed relative stable during the past decade, both as a percent of GDP and of public expenditures, since evidence suggests that the income elasticity of health expenditure is greater than one, it is likely that health care costs will increase relatively faster than GDP in the future. Although Tunisia
demand for health care services has not grown as rapidly as in some other countries, such as Korea with an elasticity of 1.6, cost control remains a serious concern.

**Key challenges facing the health sector in the years ahead**

226. **Financial sustainability Issues: Implementing planned reform of the social health insurance system.** Key issues related to the health care financing system is the implementation of the social health insurance reform which has stalled for over seven years. The reform needs to tackle the financial risk protection concerns discussed above, but it should also tackle other system performance problems, such as, reforming provider payment methods to encourage cost containment, and improve efficiency and quality of care. Obstacles to reform are complex:

- lack of information system on part of the social security funds needed to analyze and manage health expenditures;
- lack of experience with being an effective purchaser of care (including, but not limited to, a lack of experience with competitive bidding, contract management and monitoring of quality of care);
- insufficient actuarial capacity and authority to create a package of benefits/services that are actuarially sustainable;
- fragmentation of the social security system, reflecting the existence of two different social security funds: Considerable inefficiency has resulted from the dual current management systems and any health insurance reform would need to include the merging of the different insurance funds; and
- lack of private health insurance markets: the high proportion of private expenditures indicate a potential demand for private insurance. However, gaps in the regulation of private insurance markets make such markets unsustainable due to large information asymmetries.

227. **Organizational Issues: Improving the performance of the health sector by encouraging competition between the public and the private sector and increasing decentralization.** The Tunisian health care system is modeled after the highly centralized French health care system. Reforms of the public university hospitals, with support by the World Bank, have increased the level of decentralization in the health sector. However, regional and local hospitals remain public, burdened by a high degree of centralization. Furthermore, the decentralization that has occurred has tended to focus on the implementation/administration of decisions taken at the central level. While this type of administrative decentralization has yielded notable improvements and greater autonomy for both regional hospitals and regional directorates of health, remaining centralization continues to constrain the improvement of health sector’s performance, as the incentives to improve performance remain weak. As a result of the lack of autonomy at regional hospitals:

- hospital directors have limited ability to influence the overall size of the budget, which is negotiated annually between the Ministry of Health and the Ministry of Social Affairs, based on hospital budgets from the previous year;
- hospital directors have no control in hiring or firing any of the regular staff, as such decisions are made at the central level;
- wages are set by the Ministry of Finance for all civil servants, thus a hospital director has very limited tools available to influence the performance of his employees, particularly the physicians and nurses.

It should be noted that one of the main obstacles to organizational reform comes from private sector providers, many of whom are politically influential and opposed to increased regulation and provider payment reforms.
228. **Governance Issues: Redefining an appropriate role of the central government in the health sector.** Depending on the decisions made on the organizational issues, the role of the central government is likely to change. To the extent that the system is decentralized (and/or privatized), the Ministry’s role as provider of services will be reduced while other governance functions will become correspondingly more important. In particular, it will be important to:

- (i) develop sufficient capacity to regulate private and autonomous public providers; (ii) develop the capacity to regulate viable, private insurance markets to provide added financial risk protection;
- expand the Ministry of Health’s current capacity to monitor, analyze, and evaluate health sector trends and problems (e.g., by developing clinical databases and patient registries for important diseases, to monitor and improve outcomes of medical treatment as well as the efficiency with which the services are provided);
- ensure that the necessary human resources are available for the health sector and develop entirely new professions, such as hospital managers (as opposed the current directors), quality of care specialists, medical information specialists, etc;
- ensure that the Ministry of Health will work closely with the Ministry of Education to ensure that the number of physicians graduating from medical schools in Tunisia does not become excessive, as that is likely to increase health care costs in the long run;
- ensure that the Ministry of Health will develop continuing-education requirements to ensure that the medical professions keep up with recent medical advances.

229. **Developing new approaches to doing things in the health care system is one of the key challenges facing Tunisia.** This involves a change in culture and behavior at all levels. In particular, the notion of evaluating the health outcomes of care is a new concept in Tunisia and currently virtually no data are available at the provider level. Thus, the development and expansion of the current information systems needs to be addressed as well if the reforms are to be successful. In addition, because of the ageing population, the health care system will also need to place greater emphasis on issues such as chronic disease and associated risk factors. In many ways, the Tunisian health care “paradigm” needs to be revised to move from the current medical/treatment-oriented perspective to one more focused on disease prevention and health promotion, something that the experience from other countries indicates is a difficult process.

7.2. Challenges in social protection

230. **Tunisia has developed a comprehensive social protection system that compares favorably with those of many countries with higher income levels.** The system combines three types of mechanisms:

- risk reducing mechanisms such as labor market policies that provide extensive active labor market programs (ALMPs) including vocational training (see chapter 2);
- risk mitigating mechanisms such as pension, health insurance and family allowances for the formal sector; and
- risk coping mechanisms such as social safety nets, including untargeted consumer food subsidies and targeted transfers (in cash and in kind) to vulnerable groups.

Expenditures, reaching about 9 percent of GDP on average, are financed either through the general budget, or through payroll contributions levied on the affiliates to the social security system.

231. **To preserve its achievements, the social protection system needs to become more efficient, cost-effective, affordable, and adapted to the transformation and new needs of the economy in the context of international integration.** As Tunisia becomes more engaged in opening and restructuring its economy, employment policy would need to move away from a model where the government played a
central role in social protection through large public sector employment, close regulation of the labor
market, and tight control of vocational education and training. Additional social protection schemes
would need to be considered for those who risk losing their jobs. With rising proportion of old people in
the population both financial sustainability and coverage of the pension system would need to be
improved. The safety nets programs would have to be better targeted and their impact on poverty
evaluated.

Reforming the pension system

232. Tunisia has developed a comprehensive contributive social security system. The system is
mandatory, covers the urban wage-earners (including civil servants), the agriculture workers and the self-
employed, and provides cash benefits against insurable social risks, such as retirement, disability and
survivors pensions, health insurance care, and protection against non-insurable risks such as family
benefits. The system is managed by the social security funds: the Caisse Nationale de Sécurité Sociale
(CNSS) for private sector workers, and the Caisse Nationale de Retraite et de Prévoyance Sociale
(CNRPS) for public sector workers. The system covers about 2 million people (60 percent of the labor
force or about 86 percent of eligible population) and its expenditures correspond to about 6 percent of
GDP (of which 4.5 percent of GDP is spent on pension benefits). However, the pension system is
fragmented, benefits are generous, and its financial sustainability in the long run is problematic.

233. The Tunisian pension system is fragmented. There are a multitude of mandatory and voluntary
schemes. For the private sector, the CNSS offers 4 schemes that offer different coverage for the same
risk, and various benefits and contributions according to different schemes (see Table 7 in Annex). In
addition, since 2001, to expand coverage which is very low for some categories, new schemes were
introduced to cover low income groups (i.e., public works, housekeepers, small farmers and fishing
workers). Contributions and benefits are highly heterogeneous across funds. The rules that apply when workers switch from one system to another vary by fund, adding complexity to the
management of the pension system and hindering labor mobility.

234. The pension system offers generous benefits compared to contributions. Overall, the formula to
calculate pension benefits is generous, jeopardizing the system’s financial sustainability in the long run
(Table 7.3): (i) replacement rates are quite high (on average 65 percent for public sector and 63 percent
for private sector); (ii) at 60 years, retirement age is relatively low; (iii) the minimum length of service
required to be eligible for a pension is low by international standards: 10 years in the private sector and 15
years in the public sector, compared to 18 years in OECD and 25 years in East European countries; (iv)
except for the self-employed, the reference salary for pension benefits is defined in a generous way,
encouraging under-reporting of salaries during most of a person’s career and the over-reporting of salaries
during the last few years before retirement; (v) the minimum pension, equaling about 2/3 of the minimum
wage is highly desirable for redistribution purposes, but it leads to highly unequal treatment of workers;
and (vi) lack of appropriate indexation produces erratic effects: although in the private sector, minimum
pensions are indexed to SMIG, higher pensions are only partially protected against inflation.

235. Most funds are in a delicate financial position. Because the pension system is based on the pay-
as-you-go partially funded defined benefit plan, as the population becomes older and the ratio of
beneficiaries to contributors increases, the promised benefits could be eroded in the long-term, unless
contributions are increased. The financial situation is particularly worrisome for the CNSS which is
already facing an operational deficit for its schemes. Part of the problem is related to low retirement ages
relative to life expectancies, inadequate penalties for early retirement, and high replacement rates across
levels of income.
Table 7.3: Main Parameters of the Various Schemes of the Tunisian Pension System

<table>
<thead>
<tr>
<th>Eligibility conditions:</th>
<th>CNRPS</th>
<th>RSNA</th>
<th>RSA</th>
<th>RSAA</th>
<th>RNS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>60 years</td>
<td>60 years</td>
<td>60 years</td>
<td>60 years</td>
<td>65 years</td>
</tr>
<tr>
<td>Vesting</td>
<td>15 years</td>
<td>10 years</td>
<td>10 years</td>
<td>10 years</td>
<td>10 years</td>
</tr>
<tr>
<td>Early retirement</td>
<td>55 or 50 years</td>
<td>55 or 50 years</td>
<td>55 or 50 years</td>
<td>55 or 50 years</td>
<td>55 or 50 years</td>
</tr>
<tr>
<td>Wage reference</td>
<td>Last wage</td>
<td>Average of last 10 years</td>
<td>Average of last 3 or 5 years</td>
<td>Average of last 3 or 5 years</td>
<td>Average of the whole carrier</td>
</tr>
<tr>
<td>Maximum wage reference</td>
<td>Na</td>
<td>6 * SMIG</td>
<td>Na</td>
<td>Na</td>
<td>Na</td>
</tr>
<tr>
<td>Replacement rates</td>
<td>35-90%</td>
<td>40-80%</td>
<td>40-80%</td>
<td>40-80%</td>
<td>30-80%</td>
</tr>
<tr>
<td>Minimum pension</td>
<td>2/3 SMIG</td>
<td>2/3 SMIG</td>
<td>40% SMIG</td>
<td>2/3 SMIG</td>
<td>30% SMIG</td>
</tr>
<tr>
<td>Pension indexation</td>
<td>Trend in actual wages</td>
<td>SMIG</td>
<td>SMAG</td>
<td>SMAG</td>
<td>SMIG or SMAG</td>
</tr>
</tbody>
</table>


236. **Ageing of the population will deteriorate the financial sustainability of the system.** Demographic factors have already began to play an important part in the recent financial deterioration of the pension scheme. Currently 33 percent of the population over 60 years old are receiving pension benefits, compared to 15 percent in 1984. The dependency rates is projected to increase substantially for the public sector during the next 10 years (Table 7.4). To ensure the financial equilibrium of the existing system, contributions rates will need to increase substantially: for CNRPS from 16.7% to 31.7% in 2015 and 58.3% in 2030; and for CNSS from 12.5% to 14% in 2015 and 31.3% in 2030. As suggested by the experience of other countries with ageing populations, high payroll tax may discourage job creation and put Tunisia at disadvantage with respect to its competitors.

Table 7.4: Dependency rate projections for pension funds

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2010</th>
<th>2020</th>
<th>2030</th>
<th>2040</th>
<th>2050</th>
</tr>
</thead>
<tbody>
<tr>
<td>CNRPS</td>
<td>29.8</td>
<td>40.8</td>
<td>60.3</td>
<td>82.4</td>
<td>82.2</td>
<td>80.9</td>
</tr>
<tr>
<td>CNSS</td>
<td>22.3</td>
<td>20.6</td>
<td>28.1</td>
<td>42.6</td>
<td>61.6</td>
<td>78.6</td>
</tr>
</tbody>
</table>


237. **Governance structures and investment policies do not follow best international practices.** In addition to issues related to the organization of the pension system, based on various evaluations, the following general issues were also identified: (i) governing bodies are not well shielded from political pressure; (ii) unclear mandates, responsibilities, and accountability, leading to the plans not being managed in the best interest of plan members; (iii) lack of a clear statement of investment policies that ensures proper diversification; and (iv) weak or non-transparent policies regarding auditing, custody, and reporting.

238. **To contain the financial deterioration of the pension system, the Tunisian authorities have taken short-term reform steps.** Consultations regarding pension reform have been taking place for the last ten years. To address the short-term sustainability issues, actions have focused on: (i) improving investment performance of the funds; (ii) rationalizing the benefit formula through revision of the pensionable salary in the private sector; (iii) reducing evasion of contributions for self-employed; and (iv) controlling early retirement in the public sector.

239. **A broader reform program could focus on both parametric and more radical measures.** Various actuarial studies have been launched to assess the financial sustainability of the various schemes
and to initiate broad reforms. Still, to date, a unified concept for an integrated reform of the Tunisian pension system has not emerged. Main options for reform would include:

- **Pension reforms within the existing framework are essential in order to improve the financial sustainability of the system, reduce fragmentation and possibly to increase the coverage.** The feasibility of implementing parametric reforms would need to be explored (such as reviewing benefit formula and eligibility rules, rationalizing pension indexation).

- **To cope with the ageing pressures, more radical reforms would need to be considered:** (i) reviewing alternative designs for the main pillars of the pension system to which the Tunisian society could aspire in the future; (ii) assessing, for each option, transition mechanisms, fiscal impacts, and to the extent possible social impacts; (iii) exploring mechanisms to improve the governance and management of public pension funds; (iv) addressing the main issues regarding the regulation and supervision of publicly and privately managed voluntary plans; (v) assessing progress in the reform of the regulatory and supervisory framework for the insurance industry and eliminating factors that constrain the expansion of pension and long-term-savings products within life insurance companies; (vi) assessing the tax treatment to pensions, annuities, and long-term-savings instruments in general to eliminate possible distortions impairing their development; and (vii) considering coverage expansion through evaluation of current non-contributory schemes for the elderly poor (zero pillar).

**Strengthening the social safety nets**

240. **Reflecting better targeting, expenditures on social safety nets has declined.** Tunisia has used two types of social safety nets to alleviate poverty: (i) Consumer food subsidies; and (ii) direct transfers in kind and in cash, to the needy (the elderly, the handicapped, schoolchildren, and needy families). Expenditures on these programs, about 1.5 percent of GDP, have fallen considerably in recent years, mainly reflecting improved targeting of consumer subsidies on food (from about 3 percent of GDP in early 1990s to about 1 percent in 2002).

241. **Continuing assessment of consumer subsidy targeting is needed.** Consumer food subsidies were introduced in Tunisia almost three decades ago. Originally the subsidies were not explicitly targeted: basic staples were available in unlimited quantities at below-market prices to anyone who chose to buy them, and the Government paid the difference between the producer prices and the subsidized consumer prices. This approach made the subsidies cheap to administer, but poorly targeted and therefore excessively costly. In early 1990s, the Government launched an innovative reform of its consumer food subsidy program designed to improve the targeting of subsidies and reduce expenditures with the least possible impact on lower-income groups. The program relied on a self-targeting mechanism based on quality differentiation—"inferior" and "superior" goods. The reforms transformed the program from one that transferred more absolute benefits to the rich to one that disproportionately benefited the poor. During 1990s, additional steps were taken to sharpen the effectiveness of the reform, and to control budgetary costs. However, further up-to-date work is needed to define the targeted group, assess impact of the program on poverty and monitor the progress of the reform.

242. **Direct transfer programs would benefit from impact evaluation and their targeting could be further improved.** These programs are aimed at providing protection to the core poor. Targeted on the basis of indicators, they include (i) food aid through school cafeteria and food rations for preschoolers; (ii) financial aid to the handicapped and the elderly poor; and (iii) direct cash transfers to poor families who need income support (about 140,000 familles nécessiteuses in 2002). Overall, these programs are pro-poor, and are expected to play an important role in poverty alleviation. But their coverage is limited, there is no impact evaluation, and their targeting could be improved. Direct cash transfers to needy families
suffers from the difficulties that typically arise in targeting assistance to the poor using means tests and specific eligibility criteria: administration is complex, eligibility lists are rarely updated, and coverage is not always extended to those newly identified as eligible. Household Consumption Surveys could be: (i) exploited to further the understanding of the effects of socioeconomic characteristics (family size, age, education, and the like) on poverty; (ii) used to identify the characteristics of poverty groups and analyze the impact of policy initiatives on the poor; and (iii) analyzed to refine a set of indicators for monitoring living conditions in Tunisia.

243. Summary of reform options

Health care system

In the short term
- Introducing information system for the social security funds to analyze and manage health expenditures.
- Reviewing regulation for the development of a sustainable private insurance markets.
- Increasing autonomy at regional hospital levels.
- Improving the current information system, particularly at the provider level.

In the medium term
- Developing packages of benefits/services that are actuarially sustainable;
- Eliminating fragmentation of the social security funds.
- Introducing provider payment reforms to encourage cost containment, and improve efficiency.
- Reviewing needs in human resources at the Ministry of Health to develop entirely new professions, such as hospital managers, quality of care specialists, medical information specialists, etc.
- Developing sufficient capacity at the Ministry of Health to regulate private and autonomous public providers, and private insurance markets, and evaluate health sector trends and policies. as hospital managers, quality of care specialists, medical information specialists, etc.
- Revising the Tunisian health care “paradigm” to move from the current medical/treatment-oriented perspective to one more focused on disease prevention and health promotion.

Pension system

In the short term
- Continue introducing parametric reforms (such as reviewing benefit formula and eligibility rules, rationalizing pension indexation) to improve the financial sustainability of the system, reduce fragmentation and possibly increase the coverage.
- Exploring feasibility of alternative designs for the main pillars of the pension system and assessing their fiscal and social impacts and transitional costs
- Improve the governance and management of public pension funds;
- developing an integrated reform strategy that fits the Tunisian context and launching social dialogue on pension reform to build consensus with various partners.

In the medium term
- Revising regulations to implement the reform programs.
- Eliminating factors that constrain the expansion of pension and long-term-savings products within life insurance companies.
- Considering options for coverage expansion through evaluation of current non-contributory schemes for the elderly poor (zero pillar).
**Annex – Statistical tables**

**Tunisia: Table 1: Sectoral Origin of Gross Domestic Product at Constant 1990 Prices, 1998 - 2002**

<table>
<thead>
<tr>
<th>Year</th>
<th>Agriculture</th>
<th>Manufacturing</th>
<th>Mining</th>
<th>Hydrocarbon</th>
<th>Electricity and Water</th>
<th>Construction</th>
<th>Trade Services</th>
<th>Transport and Communications</th>
<th>Hotels/Restaurants/Cafés</th>
<th>Government Services</th>
<th>Other Services</th>
<th>Real GDP at factor cost</th>
<th>Real GDP at market prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>2077</td>
<td>2767.7</td>
<td>134.5</td>
<td>669.2</td>
<td>322.6</td>
<td>704.9</td>
<td>1383.6</td>
<td>1310</td>
<td>795.3</td>
<td>1993.7</td>
<td>1503.4</td>
<td>13661.9</td>
<td>15477.4</td>
</tr>
<tr>
<td></td>
<td>(in millions of Tunisian dinars)</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>1999</td>
<td>2306.3</td>
<td>2923.7</td>
<td>142.1</td>
<td>674.3</td>
<td>346.2</td>
<td>743.7</td>
<td>1483.8</td>
<td>1431</td>
<td>850.1</td>
<td>1557.4</td>
<td>1892.3</td>
<td>14522.2</td>
<td>16414.5</td>
</tr>
<tr>
<td></td>
<td>(annual percentage change)</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>2283.0</td>
<td>3116.6</td>
<td>149.2</td>
<td>651.4</td>
<td>358.5</td>
<td>819.3</td>
<td>1550.9</td>
<td>1580.9</td>
<td>880.1</td>
<td>1626.7</td>
<td>1993.7</td>
<td>15187.6</td>
<td>17181.3</td>
</tr>
<tr>
<td></td>
<td>-1.0%</td>
<td>5.6%</td>
<td>-3.4%</td>
<td>5.0%</td>
<td>1.0%</td>
<td>-1.0%</td>
<td>10.2%</td>
<td>7.0%</td>
<td>4.5%</td>
<td>5.5%</td>
<td>4.5%</td>
<td>5.6%</td>
<td>7.8%</td>
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<tr>
<td>2001</td>
<td>2237.3</td>
<td>3332.1</td>
<td>150.7</td>
<td>644.9</td>
<td>379.2</td>
<td>876.7</td>
<td>1636.2</td>
<td>1744.1</td>
<td>902.1</td>
<td>1762.8</td>
<td>2103.4</td>
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<tr>
<td></td>
<td>-1.0%</td>
<td>4.7%</td>
<td>-2.0%</td>
<td>4.5%</td>
<td>7.2%</td>
<td>7.9%</td>
<td>7.8%</td>
<td>6.0%</td>
<td>4.5%</td>
<td>4.5%</td>
<td>4.9%</td>
<td>4.2%</td>
<td>7.8%</td>
</tr>
<tr>
<td>2002</td>
<td>1991.2</td>
<td>3394.9</td>
<td>147.7</td>
<td>686.8</td>
<td>395.3</td>
<td>929.3</td>
<td>1709.8</td>
<td>1833</td>
<td>861.5</td>
<td>1900.9</td>
<td>2130.7</td>
<td>16187.7</td>
<td>18318.4</td>
</tr>
<tr>
<td></td>
<td>(sectoral contribution in percent)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: National Statistics Office*
## Tunisia: Table 2: National Expenditure Accounts at Current Prices, 1998 - 2002

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Consumption</strong></td>
<td>17246.9</td>
<td>18735.9</td>
<td>20346.4</td>
<td>22035.7</td>
<td>23624.6</td>
</tr>
<tr>
<td><strong>Government</strong></td>
<td>3530.4</td>
<td>3835.9</td>
<td>4165.0</td>
<td>4527.4</td>
<td>4925.8</td>
</tr>
<tr>
<td><strong>Private</strong></td>
<td>13716.5</td>
<td>14900.0</td>
<td>16181.4</td>
<td>17508.3</td>
<td>18698.8</td>
</tr>
<tr>
<td><strong>Gross Domestic Investment</strong></td>
<td>6071.5</td>
<td>6487.1</td>
<td>7280.3</td>
<td>8004.0</td>
<td>7531.8</td>
</tr>
<tr>
<td><strong>Fixed Investment</strong></td>
<td>5610.2</td>
<td>6277.6</td>
<td>7020.3</td>
<td>7527.0</td>
<td>7540.0</td>
</tr>
<tr>
<td><strong>Changes in Stocks</strong></td>
<td>461.3</td>
<td>209.5</td>
<td>260.0</td>
<td>477.0</td>
<td>-8.2</td>
</tr>
<tr>
<td><strong>Gross Domestic Expenditure</strong></td>
<td>23318.4</td>
<td>25223.0</td>
<td>27626.7</td>
<td>30039.7</td>
<td>31156.4</td>
</tr>
<tr>
<td><strong>Net Exports of goods and non-factor services</strong></td>
<td>-757.6</td>
<td>-551.5</td>
<td>-941.4</td>
<td>-1298.2</td>
<td>-1266.3</td>
</tr>
<tr>
<td><strong>Exports</strong></td>
<td>9711.9</td>
<td>10500.5</td>
<td>11783.5</td>
<td>13558.7</td>
<td>13400.2</td>
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<tr>
<td><strong>Imports</strong></td>
<td>10469.5</td>
<td>11052</td>
<td>12724.9</td>
<td>14856.9</td>
<td>14666.5</td>
</tr>
<tr>
<td><strong>GDP at market prices</strong></td>
<td>22560.8</td>
<td>24671.5</td>
<td>26685.3</td>
<td>28741.5</td>
<td>29890.1</td>
</tr>
</tbody>
</table>

(in millions of Tunisian dinars)

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Consumption</strong></td>
<td>76.4%</td>
<td>75.9%</td>
<td>76.2%</td>
<td>76.7%</td>
<td>79.0%</td>
</tr>
<tr>
<td><strong>Government</strong></td>
<td>15.6%</td>
<td>15.5%</td>
<td>15.6%</td>
<td>15.8%</td>
<td>16.5%</td>
</tr>
<tr>
<td><strong>Private</strong></td>
<td>60.8%</td>
<td>60.4%</td>
<td>60.6%</td>
<td>60.9%</td>
<td>62.6%</td>
</tr>
<tr>
<td><strong>Gross Domestic Investment</strong></td>
<td>26.9%</td>
<td>26.3%</td>
<td>27.3%</td>
<td>27.8%</td>
<td>25.2%</td>
</tr>
<tr>
<td><strong>Fixed Investment</strong></td>
<td>24.9%</td>
<td>25.4%</td>
<td>26.3%</td>
<td>26.2%</td>
<td>25.2%</td>
</tr>
<tr>
<td><strong>Changes in Stocks</strong></td>
<td>2.0%</td>
<td>0.8%</td>
<td>1.0%</td>
<td>1.7%</td>
<td>0.0%</td>
</tr>
<tr>
<td><strong>Gross Domestic Expenditure</strong></td>
<td>103.4%</td>
<td>102.2%</td>
<td>103.5%</td>
<td>104.5%</td>
<td>104.2%</td>
</tr>
<tr>
<td><strong>Net Exports of goods and non-factor services</strong></td>
<td>-3.4%</td>
<td>-2.2%</td>
<td>-3.5%</td>
<td>-4.5%</td>
<td>-4.2%</td>
</tr>
<tr>
<td><strong>Exports</strong></td>
<td>43.0%</td>
<td>42.6%</td>
<td>44.2%</td>
<td>47.2%</td>
<td>44.8%</td>
</tr>
<tr>
<td><strong>Imports</strong></td>
<td>46.4%</td>
<td>44.8%</td>
<td>47.7%</td>
<td>51.7%</td>
<td>49.1%</td>
</tr>
</tbody>
</table>

(in percent of GDP)

Source: National Statistics Office
### Tunisia: Table 3: Central Government Financial Operations, 1998 - 2002

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Revenue, Grants, and Privatization</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Revenue</td>
<td>5972.0</td>
<td>5984.0</td>
<td>6772.0</td>
<td>7097.0</td>
<td>7746.0</td>
</tr>
<tr>
<td>Tax Revenue</td>
<td>5465.0</td>
<td>5900.0</td>
<td>6396.0</td>
<td>7007.0</td>
<td>7289.0</td>
</tr>
<tr>
<td>Non-tax Revenue</td>
<td>4770.0</td>
<td>5208.0</td>
<td>5678.0</td>
<td>6222.0</td>
<td>6436.0</td>
</tr>
<tr>
<td><strong>Total Expenditure and Net Lending</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Expenditure</td>
<td>6147.0</td>
<td>6854.0</td>
<td>7423.0</td>
<td>8091.0</td>
<td>8330.0</td>
</tr>
<tr>
<td>Current Expenditure</td>
<td>6039.0</td>
<td>6786.0</td>
<td>7288.0</td>
<td>7930.0</td>
<td>8231.0</td>
</tr>
<tr>
<td>Capital Expenditure</td>
<td>1471.0</td>
<td>1707.0</td>
<td>1980.0</td>
<td>2340.0</td>
<td>2234.0</td>
</tr>
<tr>
<td>Net Lending</td>
<td>108.0</td>
<td>68.0</td>
<td>135.0</td>
<td>161.0</td>
<td>99.0</td>
</tr>
<tr>
<td><strong>Central Government deficit, excluding grants and privatization</strong></td>
<td>-683.0</td>
<td>-955.0</td>
<td>-1027.0</td>
<td>-1084.0</td>
<td>-1041.0</td>
</tr>
<tr>
<td>Grants</td>
<td>89.0</td>
<td>83.0</td>
<td>34.0</td>
<td>79.0</td>
<td>118.0</td>
</tr>
<tr>
<td>Privatization proceeds</td>
<td>418.0</td>
<td>1.0</td>
<td>342.0</td>
<td>11.0</td>
<td>339.0</td>
</tr>
<tr>
<td><strong>Central Government deficit, including grants and privatization</strong></td>
<td>-176.0</td>
<td>-871.0</td>
<td>-651.0</td>
<td>-994.0</td>
<td>-584.0</td>
</tr>
<tr>
<td>Financing</td>
<td>176.0</td>
<td>871.0</td>
<td>650.0</td>
<td>994.0</td>
<td>584.0</td>
</tr>
<tr>
<td>Foreign</td>
<td>4.0</td>
<td>350.0</td>
<td>-51.0</td>
<td>1089.0</td>
<td>683.0</td>
</tr>
<tr>
<td>Domestic</td>
<td>172.0</td>
<td>521.0</td>
<td>701.0</td>
<td>-95.0</td>
<td>-99.0</td>
</tr>
</tbody>
</table>

(in millions of Tunisian dinars)

(\(\text{in percent of GDP}\))

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Revenue, Grants, and Privatization</strong></td>
<td>26.5%</td>
<td>24.3%</td>
<td>25.4%</td>
<td>24.7%</td>
<td>25.9%</td>
</tr>
<tr>
<td><strong>Total Expenditure and Net Lending</strong></td>
<td>27.2%</td>
<td>27.8%</td>
<td>27.8%</td>
<td>28.2%</td>
<td>27.9%</td>
</tr>
<tr>
<td><strong>Central Government deficit, excluding grants and privatization</strong></td>
<td>-3.0%</td>
<td>-3.9%</td>
<td>-3.8%</td>
<td>-3.8%</td>
<td>-3.5%</td>
</tr>
<tr>
<td><strong>Central Government deficit, including grants and privatization</strong></td>
<td>-0.8%</td>
<td>-3.5%</td>
<td>-2.4%</td>
<td>-3.5%</td>
<td>-2.0%</td>
</tr>
<tr>
<td>Primary Balance (excl. grants and privatization)</td>
<td>0.0%</td>
<td>-0.5%</td>
<td>-0.5%</td>
<td>-0.7%</td>
<td>-0.4%</td>
</tr>
<tr>
<td>GDP at market prices (TD millions)</td>
<td>22560.8</td>
<td>24671.5</td>
<td>26685.3</td>
<td>28741.5</td>
<td>29890.1</td>
</tr>
</tbody>
</table>

Source: IMF
Tunisia: Table 4: Merchandise Trade, 1998 - 2002

<table>
<thead>
<tr>
<th>Year</th>
<th>Trade Balance</th>
<th>Total Merchandise Exports (fob)</th>
<th>Total Merchandise Imports (cif)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fuel</td>
<td>Fuel</td>
</tr>
<tr>
<td>1998</td>
<td>-2609.0</td>
<td>5724.6</td>
<td>366.8</td>
</tr>
<tr>
<td>1999</td>
<td>-2608.0</td>
<td>5873.3</td>
<td>419.8</td>
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<tr>
<td>2000</td>
<td>-2723.6</td>
<td>5839.9</td>
<td>705.8</td>
</tr>
<tr>
<td>2001</td>
<td>-2914.9</td>
<td>6605.8</td>
<td>610.1</td>
</tr>
<tr>
<td>2002</td>
<td>-2646.3</td>
<td>6856.8</td>
<td>641.4</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Agriculture</td>
<td>Agriculture</td>
</tr>
<tr>
<td></td>
<td></td>
<td>550.6</td>
<td>666.8</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1917.8</td>
<td>2232.8</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Phosphates</td>
<td>Phosphates</td>
</tr>
<tr>
<td></td>
<td></td>
<td>773.9</td>
<td>728.4</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3958.4</td>
<td>4981.4</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Other Exports</td>
<td>Other Exports</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4033.3</td>
<td>4058.3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Capital Goods</td>
<td>Capital Goods</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4058.3</td>
<td>3958.4</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Source: Central Bank</td>
<td>Source: Central Bank</td>
</tr>
</tbody>
</table>

(in millions of US dollars)
### Tunisia: Table 5: External Debt, 1998 - 2002

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Debt Stocks</strong></td>
<td>10850</td>
<td>11880</td>
<td>10626</td>
<td>10876</td>
<td>12625</td>
</tr>
<tr>
<td><strong>Medium and Long-term debt</strong></td>
<td>9680</td>
<td>10266</td>
<td>9685</td>
<td>10195</td>
<td>12027</td>
</tr>
<tr>
<td>Multilateral</td>
<td>3544</td>
<td>3646</td>
<td>3451</td>
<td>3616</td>
<td>4193</td>
</tr>
<tr>
<td>of which: <em>IBRD</em></td>
<td>1458</td>
<td>1323</td>
<td>1211</td>
<td>1297</td>
<td>1464</td>
</tr>
<tr>
<td>Bilateral</td>
<td>3515</td>
<td>2768</td>
<td>2596</td>
<td>2514</td>
<td>2707</td>
</tr>
<tr>
<td>Private Creditors</td>
<td>2440</td>
<td>3080</td>
<td>2838</td>
<td>2948</td>
<td>3742</td>
</tr>
<tr>
<td>Private Non-guaranteed</td>
<td>181</td>
<td>772</td>
<td>800</td>
<td>1118</td>
<td>1386</td>
</tr>
<tr>
<td>Use of IMF Credit</td>
<td>129</td>
<td>76</td>
<td>32</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Short-term debt</strong></td>
<td>1040</td>
<td>1538</td>
<td>909</td>
<td>681</td>
<td>598</td>
</tr>
</tbody>
</table>

*(in millions of US dollars)*

Source: World Bank, GDF
Table 6. Average Tariffs by processing level, International Comparison
Countries ranked according to the simple average tariff rate, from high to low rate

<table>
<thead>
<tr>
<th>Country</th>
<th>Raw materials</th>
<th>Intermediate goods</th>
<th>Consumer goods</th>
<th>Capital goods</th>
<th>Simple Average Tariff</th>
</tr>
</thead>
<tbody>
<tr>
<td>Morocco (2003)</td>
<td>31.7</td>
<td>29.2</td>
<td>37.9</td>
<td>13.8</td>
<td>28.6</td>
</tr>
<tr>
<td>Tunisia (2003)</td>
<td>37.6</td>
<td>22.7</td>
<td>34.9</td>
<td>15.8</td>
<td>25.7</td>
</tr>
<tr>
<td>Egypt (2002)</td>
<td>14.1</td>
<td>18.7</td>
<td>26.9</td>
<td>11.8</td>
<td>19.0</td>
</tr>
<tr>
<td>Algeria (2003)</td>
<td>14.5</td>
<td>15.9</td>
<td>24.7</td>
<td>11.0</td>
<td>17.4</td>
</tr>
<tr>
<td>Syria (2002)</td>
<td>13.6</td>
<td>8.3</td>
<td>27.4</td>
<td>13.7</td>
<td>14.7</td>
</tr>
<tr>
<td>Jordan (2003)</td>
<td>15.5</td>
<td>7.0</td>
<td>21.8</td>
<td>11.3</td>
<td>14.5</td>
</tr>
<tr>
<td>Romania (2001)</td>
<td>16.1</td>
<td>10.6</td>
<td>14.8</td>
<td>7.5</td>
<td>11.6</td>
</tr>
<tr>
<td>Belarus (2002)</td>
<td>8.8</td>
<td>9.7</td>
<td>14.6</td>
<td>9.7</td>
<td>11.5</td>
</tr>
<tr>
<td>Bulgaria (2003)</td>
<td>9.8</td>
<td>9.6</td>
<td>14.2</td>
<td>5.2</td>
<td>10.2</td>
</tr>
<tr>
<td>Azerbaijan (2002)</td>
<td>11.0</td>
<td>8.6</td>
<td>13.6</td>
<td>5.7</td>
<td>10.1</td>
</tr>
<tr>
<td>Georgia (1999)</td>
<td>12.0</td>
<td>11.5</td>
<td>11.1</td>
<td>6.0</td>
<td>9.9</td>
</tr>
<tr>
<td>Russia (2002)</td>
<td>10.4</td>
<td>8.3</td>
<td>9.7</td>
<td>13.2</td>
<td>8.2</td>
</tr>
<tr>
<td>Ukraine (2002)</td>
<td>5.7</td>
<td>5.7</td>
<td>11.2</td>
<td>5.2</td>
<td>7.9</td>
</tr>
<tr>
<td>Croatia (2001)</td>
<td>7.5</td>
<td>4.8</td>
<td>10.6</td>
<td>5.5</td>
<td>7.7</td>
</tr>
<tr>
<td>Lebanon (2002)</td>
<td>13.3</td>
<td>3.1</td>
<td>9.5</td>
<td>4.4</td>
<td>6.8</td>
</tr>
<tr>
<td>Moldova (2001)</td>
<td>7.2</td>
<td>3.5</td>
<td>7.4</td>
<td>1.6</td>
<td>5.1</td>
</tr>
<tr>
<td>Armenia (2001)</td>
<td>3.8</td>
<td>1.7</td>
<td>4.9</td>
<td>1.0</td>
<td>3.3</td>
</tr>
<tr>
<td>Turkey (2003)</td>
<td>9.8</td>
<td>2.4</td>
<td>3.5</td>
<td>0.7</td>
<td>2.6</td>
</tr>
<tr>
<td></td>
<td>CNRPS</td>
<td>RSNA</td>
<td>RSAA</td>
<td>CNSS</td>
<td>RNS</td>
</tr>
<tr>
<td>-----------------------</td>
<td>-------</td>
<td>------</td>
<td>------</td>
<td>------</td>
<td>----------------------</td>
</tr>
<tr>
<td><strong>Targeted population</strong></td>
<td>Civil servants &amp; local authorities</td>
<td>Non-agriculture workers in formal sector</td>
<td>Agriculture workers in cooperatives</td>
<td>Agriculture workers employed at least 45 days/quarter by the same employer</td>
<td>Self-employed in agriculture and non-agriculture sectors</td>
</tr>
<tr>
<td><strong>Benefits</strong></td>
<td>Health care, retirement, invalidity, survivorship</td>
<td>Health care, retirement, invalidity, survivorship, family allowances</td>
<td>Health care, retirement, invalidity, survivorship, family allowances</td>
<td>Health care, retirement</td>
<td>Health care, retirement</td>
</tr>
<tr>
<td><strong>Nb. Affiliates</strong></td>
<td>551,519</td>
<td>1,055,000</td>
<td>60,350</td>
<td>14,760</td>
<td>318,600</td>
</tr>
<tr>
<td><strong>Nb. Pensioners</strong></td>
<td>172,363</td>
<td>248,000</td>
<td>5,827</td>
<td>16,380</td>
<td>61,900</td>
</tr>
<tr>
<td><strong>Coverage of eligible population</strong></td>
<td>100.0%</td>
<td>97.4%</td>
<td>57.8%</td>
<td>28.3%</td>
<td>58.0%</td>
</tr>
<tr>
<td><strong>Contribution rates for pension benefits</strong></td>
<td>16.7% of gross wage bill (9.7% for employer, 7% for employee)</td>
<td>12.5% of gross wage bill (9.75% for employer, 2.75% for employee)</td>
<td>7.5% of gross wage bill (5% for employer, 2.5% for employee)</td>
<td>5.25% of gross wage bill (3.5% for employer, 1.75% for employee)</td>
<td>7% of gross income for self-employed</td>
</tr>
<tr>
<td><strong>Total expenditures</strong></td>
<td>696.1 MTD (2.31% GDP)</td>
<td>560.9 MTD (1.86% GDP)</td>
<td>2.8 MTD (0.01% GDP)</td>
<td>10.8 MTD (0.036% GDP)</td>
<td>71.5 MTD (0.24% GDP)</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td>709.6 MTD</td>
<td>558.4 MTD</td>
<td>7.3 MTD</td>
<td>0.8 MTD</td>
<td>72.1 MTD</td>
</tr>
<tr>
<td><strong>Net financial balance</strong></td>
<td>13.5 MTD</td>
<td>-2.5 MTD</td>
<td>4.5 MTD</td>
<td>-10.0 MTD</td>
<td>0.6 MTD</td>
</tr>
</tbody>
</table>

Notes: the private sector covers: (i) scheme for non-agricultural employees (RSNA); (ii) improved scheme for employees in large agricultural sector exploitations (RSAA); (iii) scheme for agriculture wage-earners (RSA); (iv) scheme for self-employed in agriculture and non-agriculture sectors (RNS).

### Table 8: Social Indicators

<table>
<thead>
<tr>
<th></th>
<th>Latest single year</th>
<th>Same region/income group</th>
<th>Lower middle income</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>POPULATION</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total population, mid-year (millions)</td>
<td>5.6 7.3 9.8</td>
<td>306.2</td>
<td>2,410.7</td>
</tr>
<tr>
<td>Growth rate (% annual average for period)</td>
<td>1.8 2.6 1.2</td>
<td>1.9</td>
<td>1.0</td>
</tr>
<tr>
<td>Urban population (% of population)</td>
<td>49.8 53.8 66.8</td>
<td>58.0</td>
<td>49.4</td>
</tr>
<tr>
<td>Total fertility rate (births per woman)</td>
<td>5.9 4.3 2.1</td>
<td>3.2</td>
<td>2.1</td>
</tr>
<tr>
<td><strong>POVERTY</strong></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>National headcount index</td>
<td></td>
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</tr>
<tr>
<td>Urban headcount index</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rural headcount index</td>
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<td></td>
</tr>
<tr>
<td><strong>INCOME</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GNI per capita (US$)</td>
<td>770 1,160 1,990</td>
<td>2,070.0</td>
<td>1,390</td>
</tr>
<tr>
<td>Consumer price index (1995=100)</td>
<td>53 123</td>
<td>111</td>
<td>1.7</td>
</tr>
<tr>
<td>Food price index (1995=100)</td>
<td>54 111</td>
<td>111</td>
<td>1.7</td>
</tr>
<tr>
<td><strong>INCOME/CONSUMPTION DISTRIBUTION</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gini index</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Lowest quintile (% of income or consumption)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Highest quintile (% of income or consumption)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>SOCIAL INDICATORS</strong></td>
<td></td>
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</tr>
<tr>
<td>Public expenditure</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Health (% of GDP)</td>
<td></td>
<td>2.9</td>
<td>2.7</td>
</tr>
<tr>
<td>Education (% of GNI)</td>
<td></td>
<td>5.3</td>
<td>4.7</td>
</tr>
<tr>
<td>Social security and welfare (% of GDP)</td>
<td>4.4 3.7 6.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net primary school enrollment rate (% of age group)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>76 93 99</td>
<td>82.2</td>
<td>93</td>
</tr>
<tr>
<td>Male</td>
<td>89 99 100</td>
<td>84.9</td>
<td>93</td>
</tr>
<tr>
<td>Female</td>
<td>62 87 99</td>
<td>79.4</td>
<td>93</td>
</tr>
<tr>
<td>Access to an improved water source (% of population)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>88.2</td>
<td>81</td>
</tr>
<tr>
<td>Urban</td>
<td></td>
<td>95.5</td>
<td>95</td>
</tr>
<tr>
<td>Rural</td>
<td></td>
<td>77.6</td>
<td>70</td>
</tr>
<tr>
<td>Immunization rate (% under 12 months)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Measles</td>
<td></td>
<td>92.3</td>
<td>85</td>
</tr>
<tr>
<td>DPT</td>
<td></td>
<td>92.4</td>
<td>84</td>
</tr>
<tr>
<td>Child malnutrition (% under 5 years)</td>
<td>20 4</td>
<td></td>
<td>11</td>
</tr>
<tr>
<td>Life expectancy at birth (years)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>59 65 73</td>
<td>68.6</td>
<td>69</td>
</tr>
<tr>
<td>Male</td>
<td>58 64 71</td>
<td>67.2</td>
<td>67</td>
</tr>
<tr>
<td>Female</td>
<td>59 66 75</td>
<td>70.1</td>
<td>72</td>
</tr>
<tr>
<td>Mortality</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Infant (per thousand live births)</td>
<td>104 55 21</td>
<td>36.7</td>
<td>30</td>
</tr>
<tr>
<td>Under 5 (per thousand live births)</td>
<td>151 76 27</td>
<td>53.8</td>
<td>37</td>
</tr>
<tr>
<td>Adult (15-59)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Male (per 1,000 population)</td>
<td>276 232 169</td>
<td>192.8</td>
<td>212</td>
</tr>
<tr>
<td>Female (per 1,000 population)</td>
<td>249 214 99</td>
<td>143.3</td>
<td>131</td>
</tr>
<tr>
<td>Maternal (per 100,000 live births)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Births attended by skilled health staff (%)</td>
<td></td>
<td></td>
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</table>
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