OECD Economic Surveys
TUNISIA
ECONOMIC ASSESSMENT

MARCH 2018

OECD

OECD Economic Surveys: Tunisia 2018

ECONOMIC ASSESSMENT

OECD
BETTER POLICIES FOR BETTER LIVES

This document, as well as any data and map included herein, are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

Please cite this publication as:
OECD (2018), *OECD Economic Surveys: Tunisia 2018*, OECD Publishing, Paris.
http://dx.doi.org/10.1787/eco_surveys-tun-2018-en

ISBN 978-92-64-29174-4 (print)
ISBN 978-92-64-29175-1 (PDF)
ISBN 978-92-64-29176-8 (epub)

Series: OECD Economic Surveys
ISSN 0376-6438 (print)
ISSN 1609-7513 (online)

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Photo credits: Cover © Leonid Andronov/Shutterstock.com.

Corrigenda to OECD publications may be found on line at: *www.oecd.org/about/publishing/corrigenda.htm*.

Table of contents

Thematic chapters

Tables

Figures

This Survey was prepared in the Economics Department by Isabelle Joumard and Christine de La Maisonneuve under the supervision of Piritta Sorsa. The survey benefited from the substantial contributions of Manuel Betin, Alain de Serres, Souad Dhaoui, Raja Dridi, Jean-Marc Fournier, Said Kechida, Hedi Larbi and Paul O'Brien. Statistical research was carried out by Hermes Morgavi. Assa Fofana formatted the report and made the layout.

The Economic Survey of Tunisia was discussed at a meeting of the Economic and Development Review Committee on 15 January 2018, with the participation of Tunisian government representatives.

This Survey is published under the responsibility of the Secretary-General of the OECD.

This Survey is the first one dedicated to Tunisia.

BASIC STATISTICS OF TUNISIA, 2016

(Numbers in parentheses refer to the OECD average)*

LAND, PEOPLE AND ELECTORAL CYCLE

Population (million)	11.3		Population density per km^2	69.1	(37.2)
Under 15 (%)	24.4	(17.9)	Life expectancy (years, 2015)	75.1	(80.5)
Over 65 (%)	8.2	(16.6)	Men	74.5	(77.9)
			Women	77.8	(83.1)
Latest 5-year average growth (%)	1.2	(0.6)	Latest general election	October 2014	

ECONOMY

Gross domestic product (GDP)			Value added shares (%)		
In current prices (billion USD)	42.1		Primary sector	9.0	(2.5)
In current prices (billion TND)	90.4		Industry including construction	26.4	(26.7)
Latest 5-year average real growth (%)	2.4	(1.9)	Services	64.6	(70.8)
Per capita (000 USD PPP)	4.3	(42.1)			

GENERAL GOVERNMENT[1]

Per cent of GDP

Expenditure	32.4	(41.6)	Gross financial debt	61.9	(100.1)
Revenue	20.7	(38.7)			

EXTERNAL ACCOUNTS

Exchange rate (TND per USD)	2.339		Main exports (% of total merchandise exports)		
PPP exchange rate (USA = 1)	0.689		Electrical Machines and Apparatus	39.3	
In per cent of GDP			Textile	26.5	
Exports of goods and services	39.6	(53.6)	Crude Oil and Derived Products	8.0	
Imports of goods and services	50.4	(49.3)	Main imports (% of total merchandise imports)		
Current account balance	-8.8	(0.2)	Electrical Machines	18.4	
Net international investment position	-120.3		Machines and Mechanical Devices	14.2	
			Textiles	13.3	

LABOUR MARKET, SKILLS AND INNOVATION

Employment rate[2] (%)	39.8	(66.9)	Unemployment rate, Labour Force Survey (age 15 and over) (%)	15.5	(6.3)
Men	59.8	(74.7)	Youth (age 15-24, %)	37.6	(13.0)
Women	20.5	(59.3)	Long-term unemployed (1 year and over, %)	44.6	(2.0)
Participation rate[2] (%)	47.1	(71.7)	Tertiary educational attainment 25+ (%)	12.3	
			Gross domestic expenditure on R&D (% of GDP)	0.6	(2.4)

ENVIRONMENT

Total primary energy supply per capita (toe)	0.9	(4.1)	CO_2 emissions from fuel combustion per capita (tonnes, 2015)	2.3	(9.2)
Renewables (%)	11.1	(9.6)			
Exposure to air pollution (more than 10 µg/m^3 of PM2.5, % of population, 2015)	99.9	(75.2)			

SOCIETY

Income inequality (Gini coefficient[3], 2015)	0.358	(0.311)	Education outcomes (PISA score, 2015)		
Relative poverty rate[3] (%)	15.2	(11.3)	Reading	361	(493)
Public and private spending (% of GDP)			Mathematics	367	(490)
Health care	7.0	(9.0)	Science	386	(493)
			Share of women in parliament (%)	31.3	(28.7)
			Net official development assistance (% of GNI)[4]	-1.13	(0.39)

Better life index: *www.oecdbetterlifeindex.org*

* Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 29 member countries.

1. Data refer to central government for Tunisia.
2. Aged 15 years or more for Tunisia and aged 15-64 for the OECD countries.
3. The Gini index for Tunisia is based on consumption while for the OECD countries it is based on income. The two indicators are not strictly comparable.
4. Tunisia is net receiver of official development assistance.

Source: Calculations based on data extracted from the databases of the following organisations: OECD, International Energy Agency, World Bank, International Monetary Fund and Inter-Parliamentary Union.

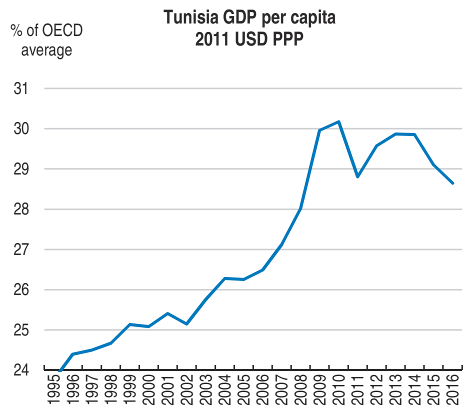
Acronyms

ALMP	Active labour market policies
AMC	Asset Management Company
APII	Industry and Innovation Promotion Agency
BCT	Central Bank of Tunisia
CAWTAR	Center of Arab Woman for Training and Research
CEPEX	Promotion and Export Center
CNSS	National Social Security Fund
CRES	Centre for economic and social studies and research
FDI	Foreign direct investment
FIPA	Foreign Investment Promotion Agency
FTC	Fixed-term contracts
GDP	Gross Domestic Product
GFCF	Gross fixed capital formation
IMF	International Monetary Fund
IACE	Arab Institute of business leaders
ITCEQ	Institute of Competitiveness and Quantitative Studies
INS	National institute of statistics
MENA	Middle East and North Africa
NPLs	Non-performing loans
ONTT	National office of the Tunisian Tourism
PISA	Programme for International Student Assessment
PMR	Produt Market Regulation
PPP	Public-private partnerships
SME	Small and medium-sized enterprise
SMIG	Interprofessional guaranteed minimum wage
SONEDE	National Water Distribution Utility
SOTUGAR	Tunisian Guarantee Company
VAT	Value-added tax
TFI	Trade facilitation indicators
TIVA	Trade in Value-added
TND	Tunisian Dinar
UGTT	Tunisian General Labour Union
UTICA	Tunisian Union of Industry, Trade and Handy crafts
UNDP	United Nations Development Programme
VET	Vocational education and training
WEF	World Economic Forum
WTO	World Trade Organization
WDI	World Development Indicators

Executive summary

- *The drivers of inclusive growth need to be rebalanced*
- *Reviving business investment is vital for relaunching the convergence process*
- *The creation of quality jobs will help reduce the gap in living standards*

The drivers of inclusive growth need to be rebalanced

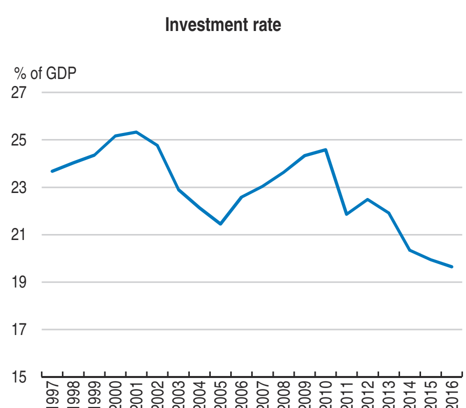


Source: World Bank World Development Indicators database.

StatLink http://dx.doi.org/10.1787/888933692807

The process of economic convergence slowed after 2010, reflecting specific factors and an exacerbation of structural constraints. Tourism and mining activities suffered from a downturn in security and the social climate. Private consumption was underpinned by a sharp increase in employment and public-sector salaries but economic activity and job creation in the private sector remained low. Increased demand has put pressure on prices and the current account. The ratios of public and external debt to GDP have risen sharply. In order to return public debt to a sustainable footing without stifling growth, fiscal stabilisation needs to be targeted over the medium-term and accompanied by structural reforms which will revive economic activity and job creation in the private sector. Public spending also needs to be refocused on supporting underprivileged populations and inclusive growth.

Reviving business investment is vital for relaunching the convergence process

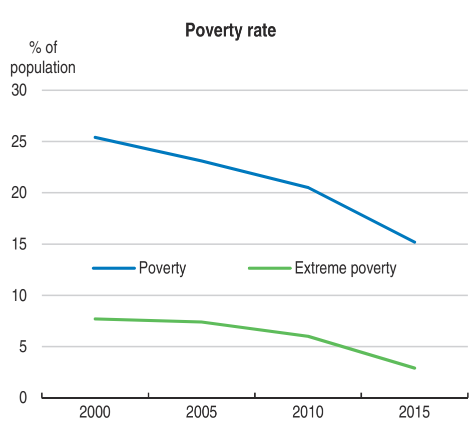


Source: INS.

StatLink http://dx.doi.org/10.1787/888933692826

The investment rate has been on a downward trend since the start of the century, and is currently low. To date, public investment has been for the most part preserved. On the other hand, business investment has suffered from excessive regulations on product markets, as well as complex administrative procedures which can encourage corruption, unpredictable taxation, increasing problems with customs clearance and the shipping of goods, and a financial system which does not particularly favour start-ups and growing companies. In order to revive business investments, these restrictions need to be lifted, which will also help revive productivity, job creation and the purchasing power of all Tunisians. Housing investment has been underpinned by financial and tax incentives which have moved savings away from more productive investments. The current reform process, kicked off by the new law on investment, needs to be continued.

The creation of quality jobs will help reduce the gap in living standards



Source: INS.

StatLink http://dx.doi.org/10.1787/888933692845

The average standard of living of Tunisians has improved in recent decades and there has been a substantial decline in poverty. Nevertheless, significant inequality still exists in the labour market, with high unemployment especially among young graduates, widespread informal employment, and many Tunisians in precarious working situations. Gender gaps are smaller than in other MENA countries but the employment rate is much lower for women than men, and women often have less skilled jobs. There are significant regional inequalities in terms of living standards and employment. A new regional development policy is required to leverage the specific strengths of each region.

MAIN FINDINGS	KEY RECOMMENDATIONS
Improve macroeconomic policies	
There has been a sharp increase in the fiscal deficit and government debt.	Accompany fiscal adjustment with structural reforms to set the ratio of government debt to GDP on a downward trend over the medium-term. Carry out spending reviews on the utility of public programmes, including infrastructure projects, in order to prioritise public spending.
Taxes are already high and weigh in particular on job creation in the formal sector and on private initiative. Tax incentives are eroding tax revenues and have not proved very effective.	Restore tax justice by facilitating the cross-check of information and increasing tax inspections in order to better combat tax evasion and fraud. Systematically assess the impact, costs and beneficiaries of tax incentives, especially for housing and business investment.
Public employment has risen sharply. Public servants' wages absorb half of public spending.	Gradually reduce public sector employment by maintaining the rule of partial replacement of persons leaving for retirement.
The pension regime is unsustainable, mainly as a result of the increase in life expectancy.	Gradually increase the legal age of retirement and undertake reforms to guarantee the financial sustainability of the pension regimes.
Subsidies mainly benefit wealthy households. They encourage fraud and excessive consumption, and are harmful to the environment.	Reform subsidies by implementing automatic adjustment rules for hydrocarbon products and, for other products, replace them by cash transfers to households.
Non-performing loans are high, especially in public banks.	Speed up the introduction of legislative changes allowing banks to reduce levels of non-performing loans. Continue to disengage the State from public banks and banks in which it has shareholding interests.
Revive business investment	
The fall in the rate of business investment steepened after 2010. Sector, regulatory and administrative restrictions are holding back private initiative. The new investment law introduces freedom of investment with a negative list which will gradually be applied.	Speed up the process for reducing the number of permissions to operate, and administrative authorisations, licences and permits. Further reduce restrictions on the presence of foreign executives.
Tunisia's ranking in terms of logistical performance and trade facilitation has deteriorated.	Simplify administrative and customs procedures for goods entering and exiting the country. Improve the management of port infrastructures, potentially through public-private partnerships.
Several sectors are dominated by public companies which are often in a precarious financial situation as employment has risen sharply since 2011 while the price and tariff adjustments were limited.	Improve the governance of public enterprises, by better enforcing performance contracts and with a level playing field for public and private companies.
Access to funding is difficult for start-ups and fast growing businesses.	Allow banks to set risk premiums by reconsidering the ceiling on lending rates. Speed up the adoption and application of the new code for collective investment funds.
Reduce inequalities in the labour market and across regions	
Unemployment is high, particularly among young graduates.	Ensure that systems for education, learning and training respond to the requirements of businesses.
Job creation is weak. Contributions remain high, pushing people towards the informal sector.	Diversify the funding sources for social security.
There is a gender gap in the labour market.	Encourage the recruitment of women through campaigns to raise awareness of the repercussions of educational choices on opportunities in terms of employment, entrepreneurship, career development and salaries.
Small enterprises and low-income households make little use of financial services.	Speed up the implementation of the financial inclusion strategy.
There are significant regional inequalities in terms of living standards and employment.	Modernise regional structures and institutions to take better advantage of investment opportunities and help investors in the regions.

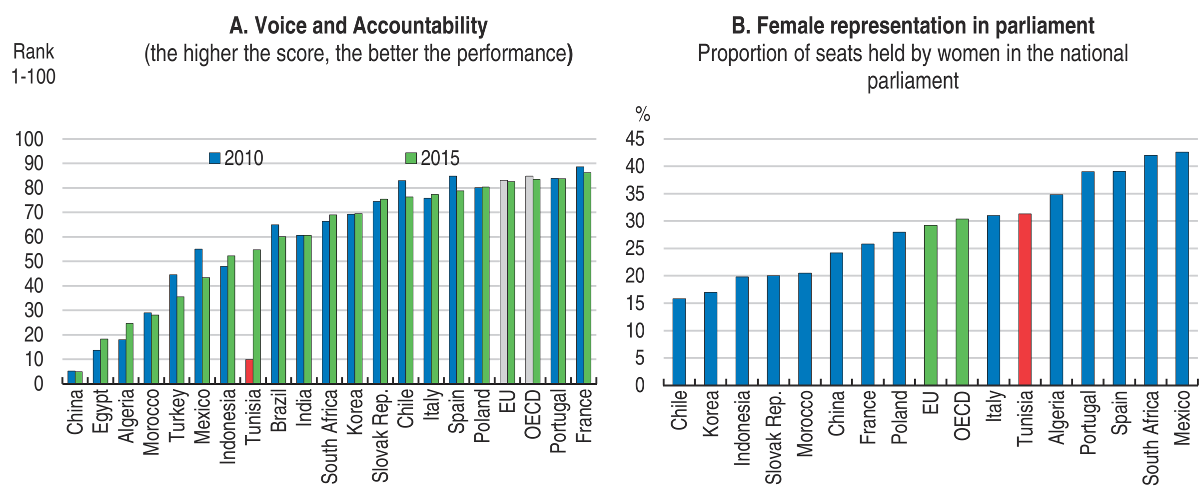
Assessment and recommendations

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

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

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

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



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

StatLink http://dx.doi.org/10.1787/888933692864

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

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

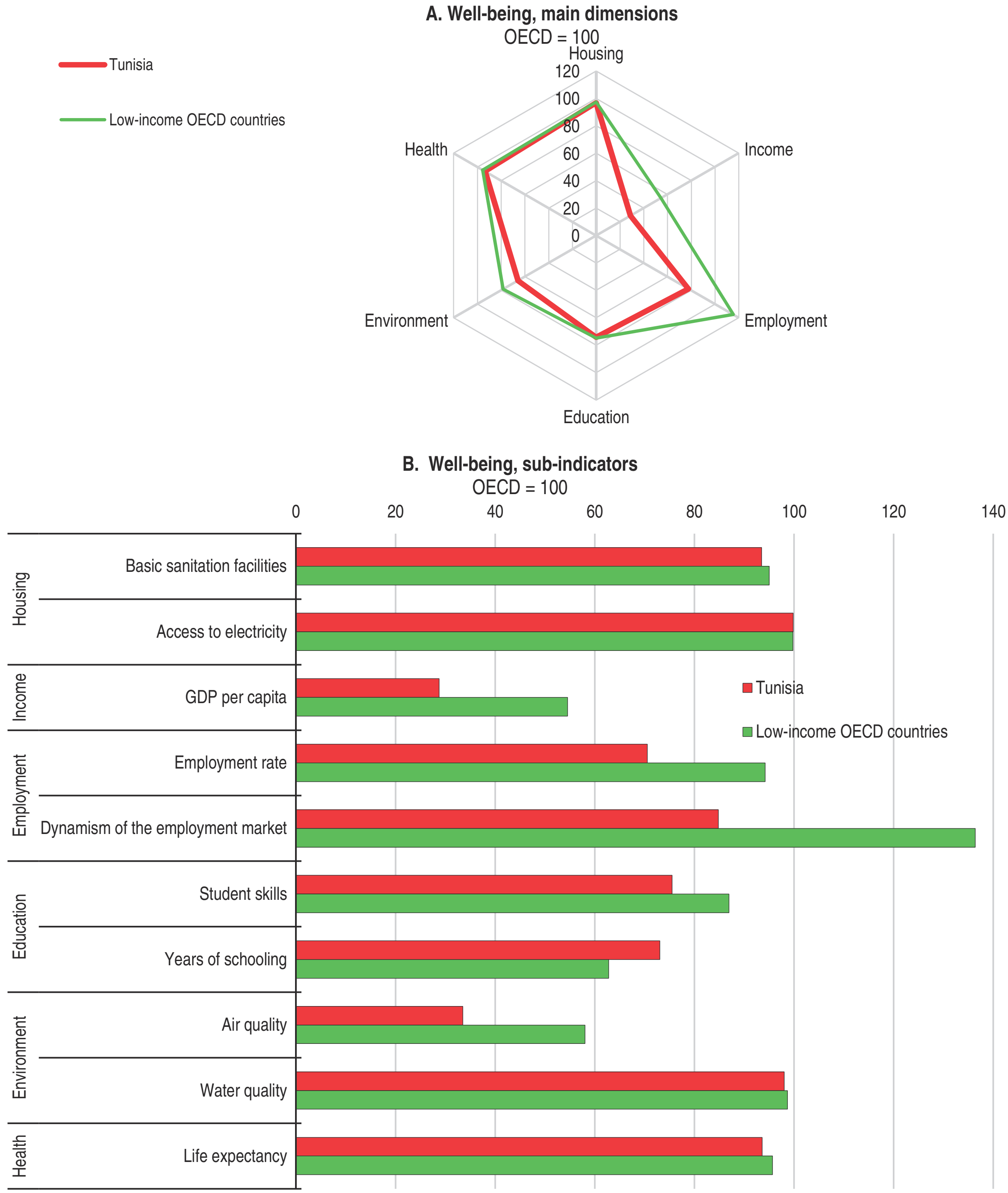
Inclusiveness has been a major concern in Tunisia since its independence. The Code of Personal Status, adopted in 1956, makes Tunisia the most progressive country in the Arab world in terms of women's rights. Schooling, in particular for girls, was also made a national priority much earlier than in the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

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

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

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

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

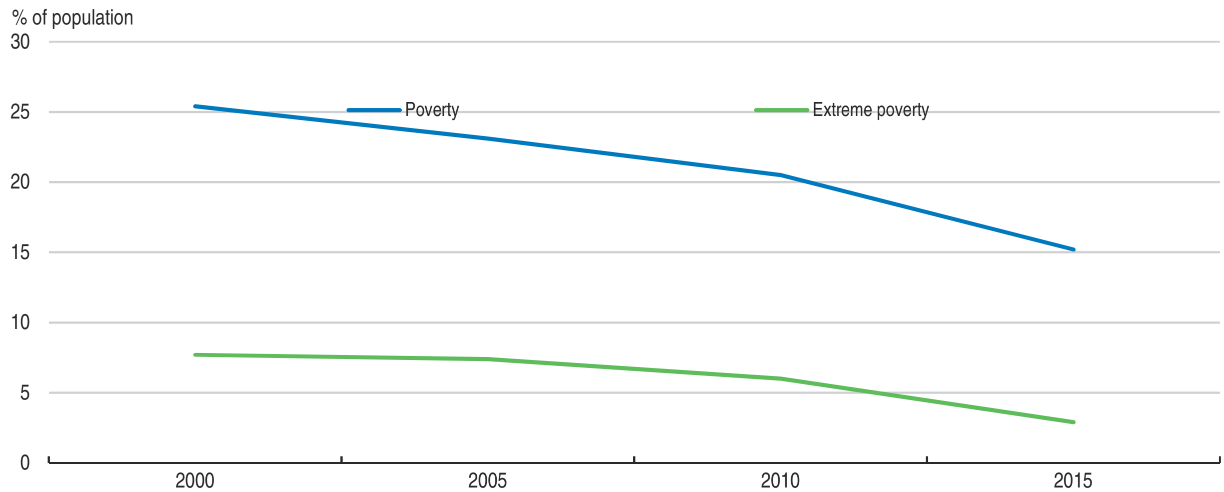


Note: The variables used for these dimensions are the following: i) Housing: share of population with access to improved sanitation and share of population with access to electricity; ii) Income: GDP per capita expressed in purchasing power parity; iii) Employment: employment rate and share of unemployed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

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

StatLink http://dx.doi.org/10.1787/888933692883

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



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

StatLink http://dx.doi.org/10.1787/888933692902

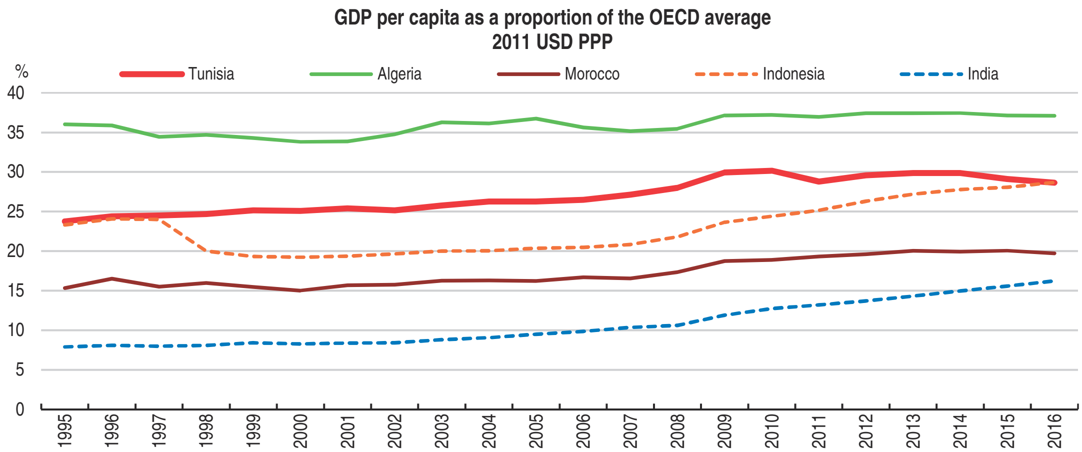
reforms have however been seen as smacking of cronyism, by reinforcing the control of important families over the economy (Rijkers et al., 2014).

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

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

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

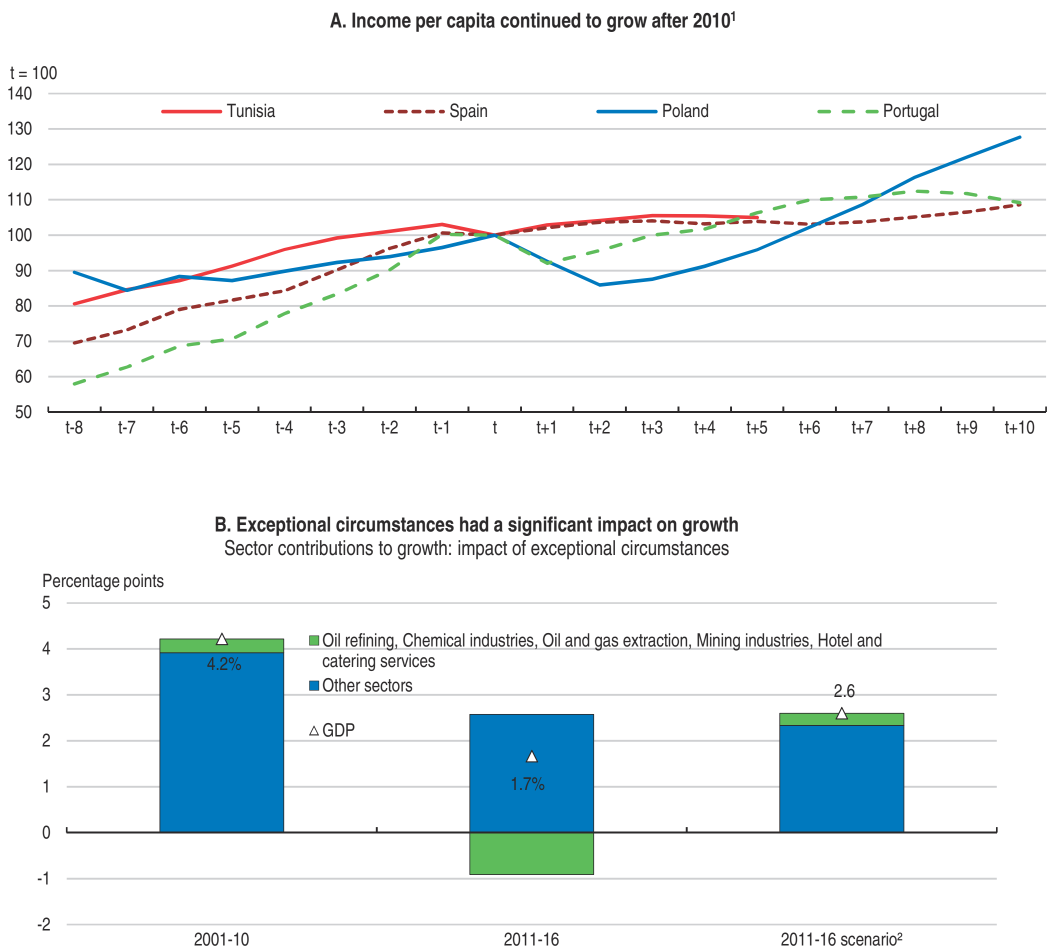
Figure 4. **The process of economic convergence has been gradual**



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

StatLink http://dx.doi.org/10.1787/888933692921

Figure 5. **The Tunisian economy has been resilient**



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

Source: OECD Economic Outlook 102 Database; OECD calculations.

StatLink http://dx.doi.org/10.1787/888933692940

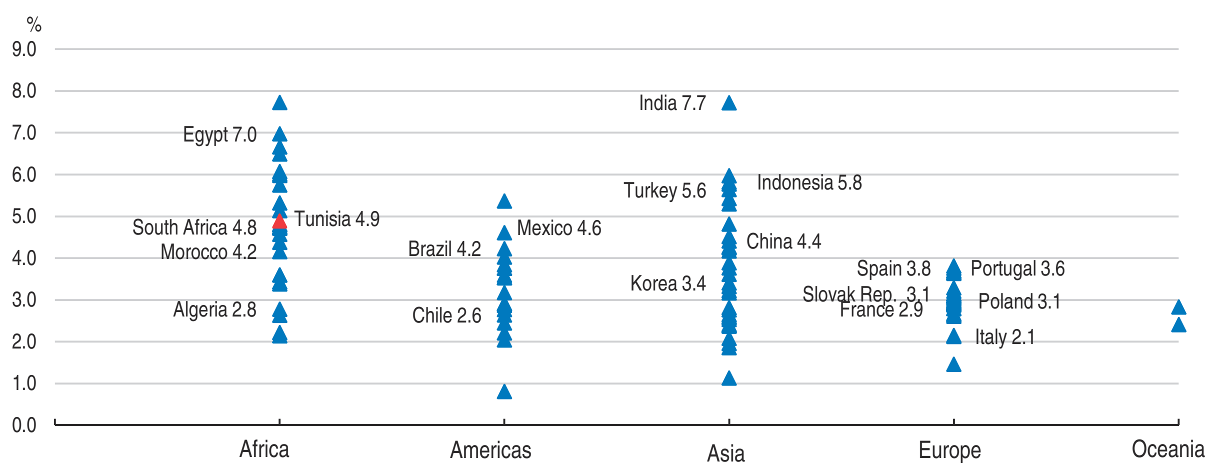
normalisation will however not be enough to spark a sustained pace of growth, to make a significant dent in unemployment (a key factor for inequality in Tunisia), and to return the public debt to a sustainable path.

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

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

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

Projected growth in 2025 by region



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

StatLink http://dx.doi.org/10.1787/888933692959

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

- To return public debt to a sustainable path will require a combination of gradual fiscal stabilisation and structural reforms capable of sustaining growth. As the tax-to-GDP ratio is already high, fiscal consolidation will have to focus on public spending and be enshrined in a medium-term horizon. Tax justice must be reinforced and the bias of subsidies in favour of wealthy households must be corrected. The governance of State-owned enterprises needs to be reinforced, and their financial performances significantly improved.

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

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

The economy is gaining strength

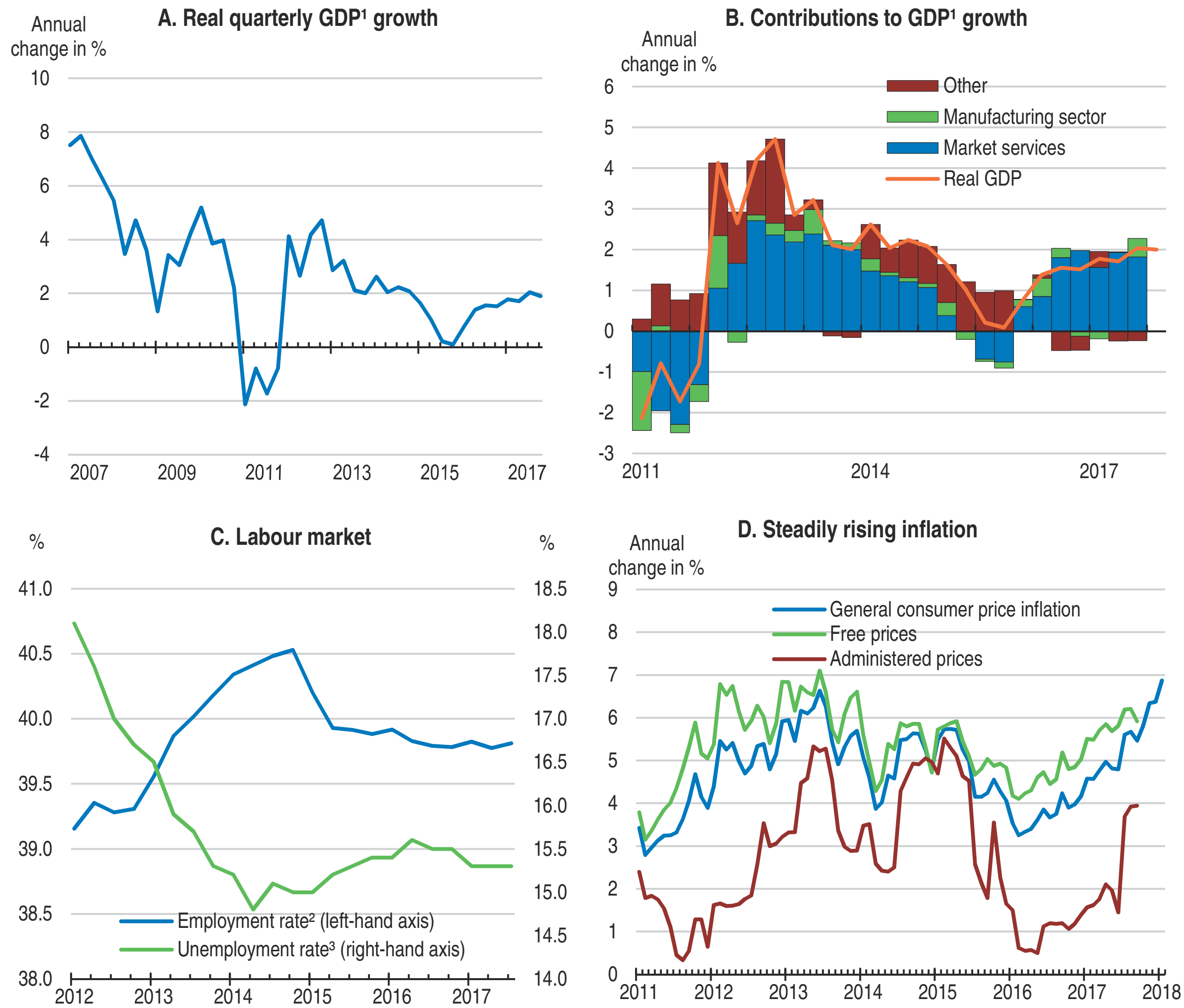
Economic activity has been recovering since 2016, driven by good harvests and the strong performance of the services sector, especially tourism and transport (Figure 7). In 2015, growth slowed as a result of temporary factors that were specific to certain sectors. Industrial performance was affected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

Job creation is weak and unemployment remains high

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

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

Figure 7. **Macroeconomic indicators**



1. GDP at factor cost.
2. The Employment rate is calculated as the labour force divided by the total working-age population (aged 15+).
3. The Unemployment rate is calculated as the number of unemployed people as a percentage of the active population. Unemployed people are persons of working age who are without work, available for work and that have taken active steps to find work. The active population is defined as the total number of unemployed people plus the employed civilian workforce.

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

StatLink http://dx.doi.org/10.1787/888933692978

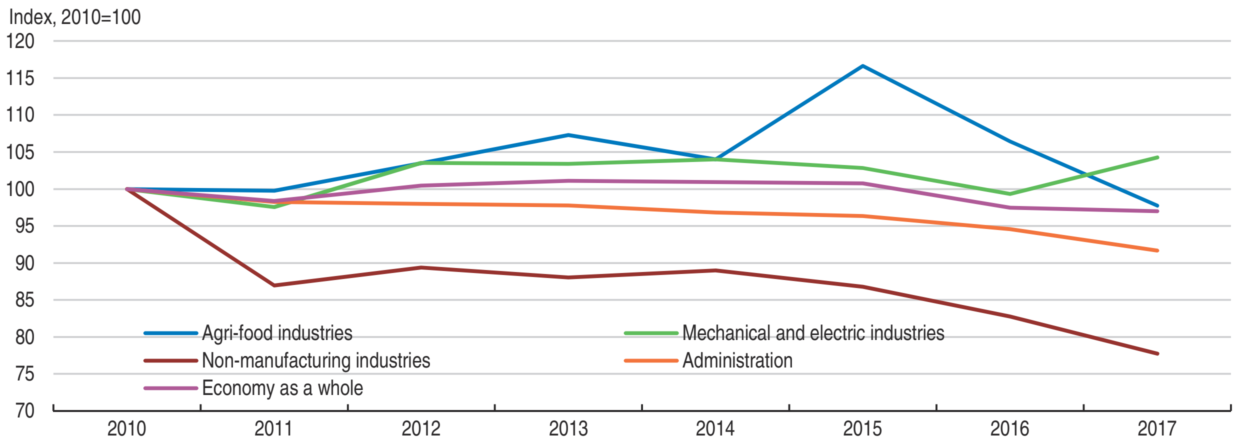
boosted consumption. In fact, real wages have risen faster than productivity in 2016 and 2017, especially in government, the agri-food industries, and hydrocarbons (Figure 8). The wage agreement signed in March 2017 foresees an increase of 6% for 2016 (with retroactive effect to August 2016) and a similar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

It is proving hard to reverse the current account deficit

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

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

Index of labour productivity/real wages



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

StatLink http://dx.doi.org/10.1787/888933692997

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

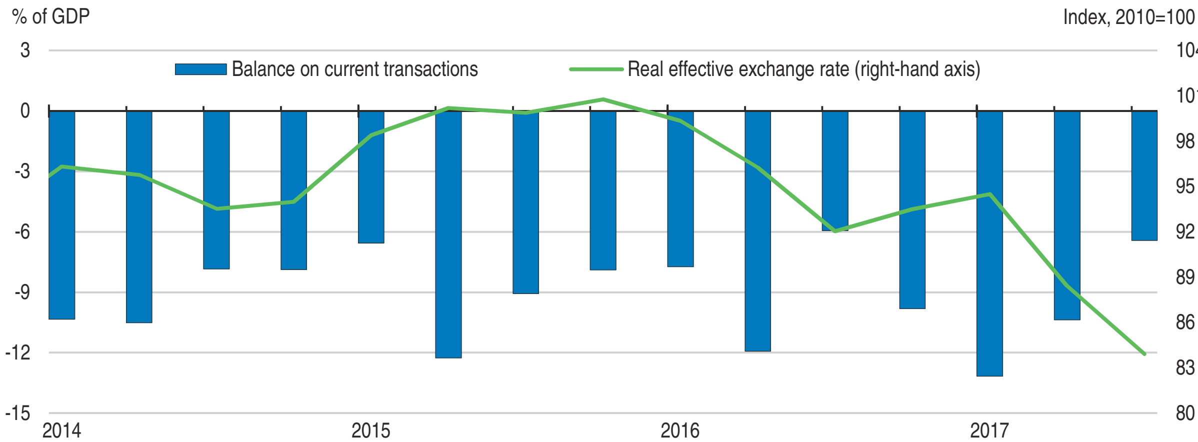
The energy balance has been largely in deficit in recent years as a result of declining volumes in domestic production, the increase in domestic consumption and the decrease in investment activity in the oil and gas exploration and development sectors. Export volumes of phosphates and derivatives have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

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

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

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

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



Note: A decline in the real effective exchange rate signifies an increase in competitiveness.
Source: Central Bank of Tunisia; and INS.

StatLink http://dx.doi.org/10.1787/888933693016

Growth will strengthen in 2018 and 2019, but risks persist

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

Table 1. **Recent developments and projections**

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

1. Contributions to changes in GDP in volume, effective amount for the first column.
Source: *OECD Economic Outlook No. 102 Database*, adjusted for the most recent available information.

Recent developments in agriculture and agri-food suggest that the farm sector could contribute more than expected to growth. On the other hand, social unrest could dampen growth. The lack of security in certain zones still poses a risk for investors and tourists. The continued increase in oil prices could adversely affect inflation, the public finances, and the balance of current payments. The Tunisian economy may also have to face shocks whose potential repercussions are difficult to integrate into forecasts (Table 2).

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

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

Policies to restore macroeconomic balances without halting growth

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

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

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

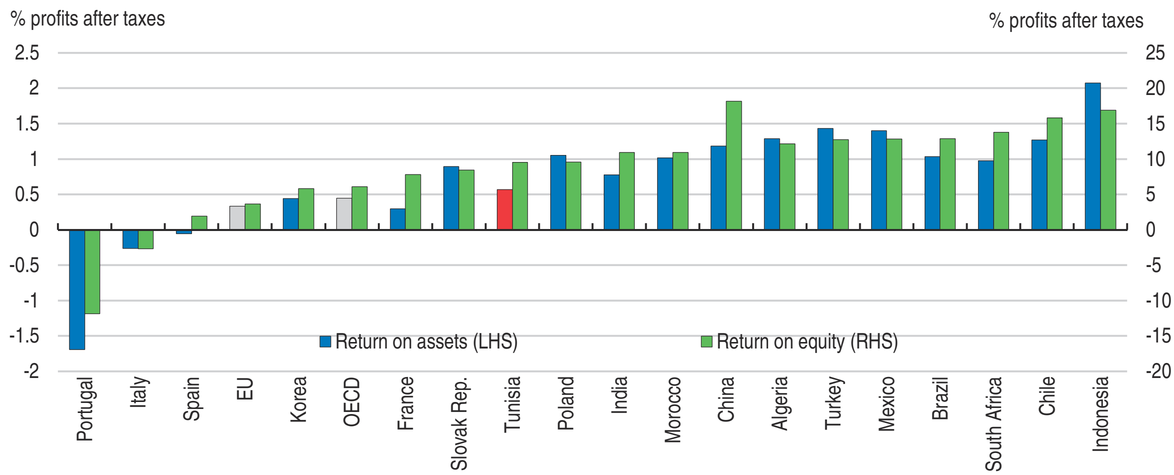
Since 2011, the central bank has made efforts to stimulate the interbank foreign exchange market and reduce its intervention as much as possible. To this end, a series of reforms were put in place, such as the removal of the obligation of the collateralisation of actual operations for foreign currency/dinar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

While current account operations are completely free, certain restrictions remain on the capital account. The planned simplification of procedures for transferring the assets of non-residents, boosting the thresholds for investments abroad by residents, and harmonising the operation of regulated accounts of resident individuals will allow further opening of the capital account (Central Bank, 2017b). Tunisia is aware that, before the capital account is fully opened, it must reinforce its macroeconomic stability, develop its financial institutions, and step up prudential surveillance (IMF, 2015).

Improving banks' health

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

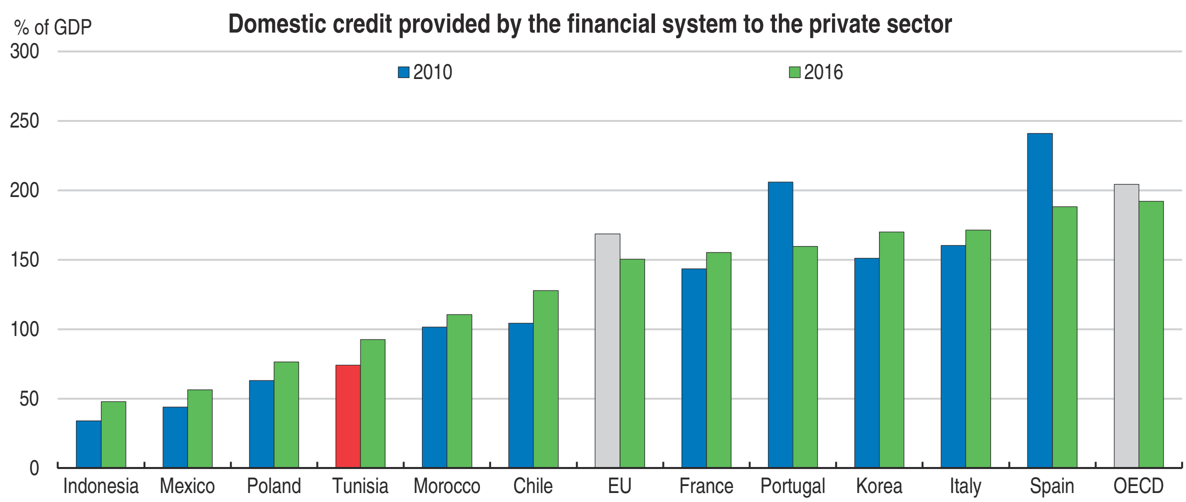
Figure 10. **Bank profits in international comparison, 2015 or latest year available**



Source: World Bank Global Financial Development database.

StatLink http://dx.doi.org/10.1787/888933693035

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

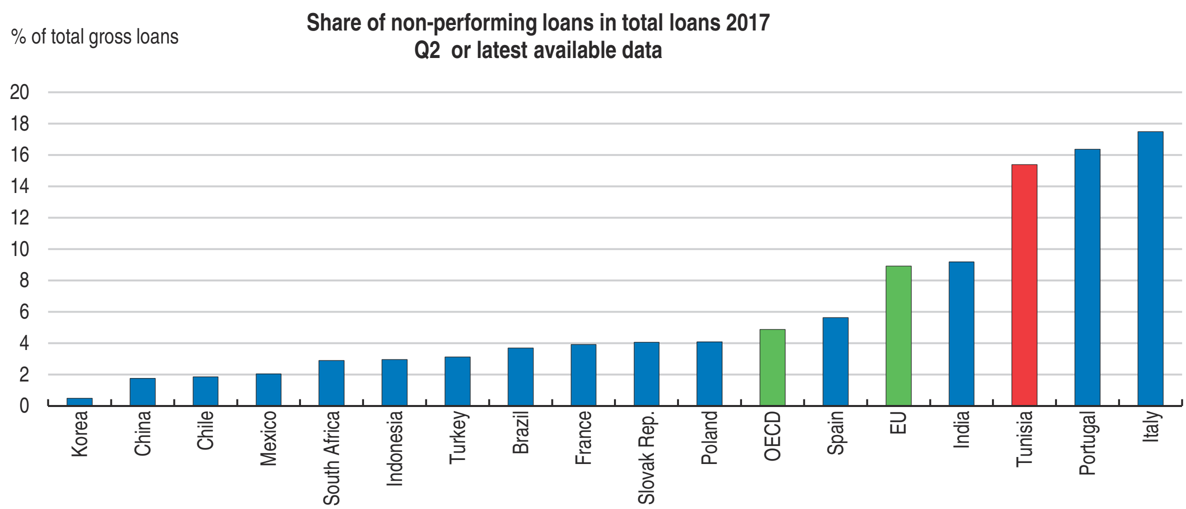


Source: World Bank, World Development Indicators (WDI).

StatLink http://dx.doi.org/10.1787/888933693054

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

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



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

StatLink http://dx.doi.org/10.1787/888933693073

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

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

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

Consolidating public finances while preserving growth and reinforcing social justice

Fiscal outcomes have deteriorated

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

Pressures on future spending: pensions, implicit liabilities and decentralisation

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

Table 3. **Fiscal outcomes:[1] principal data**

(% of GDP[2])

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

1. Central government. Social security income and expenditure do not feature.
2. GDP 2016 and 2017 figures from the Ministry of Finance.
3. Excluding grants, privatisations and confiscated revenues.
4. Budget Law for 2017.

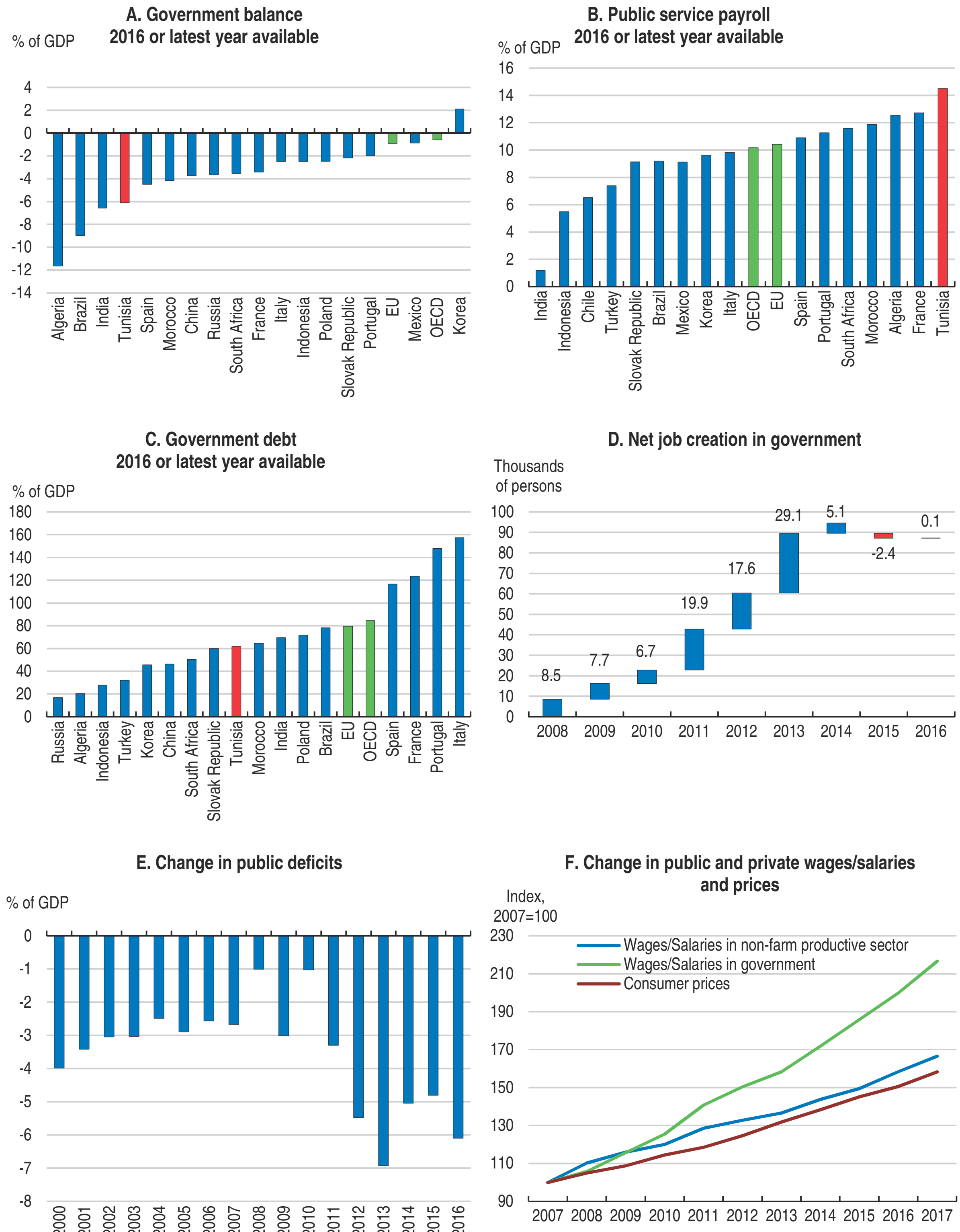
Source: Ministry of Finance.

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

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

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

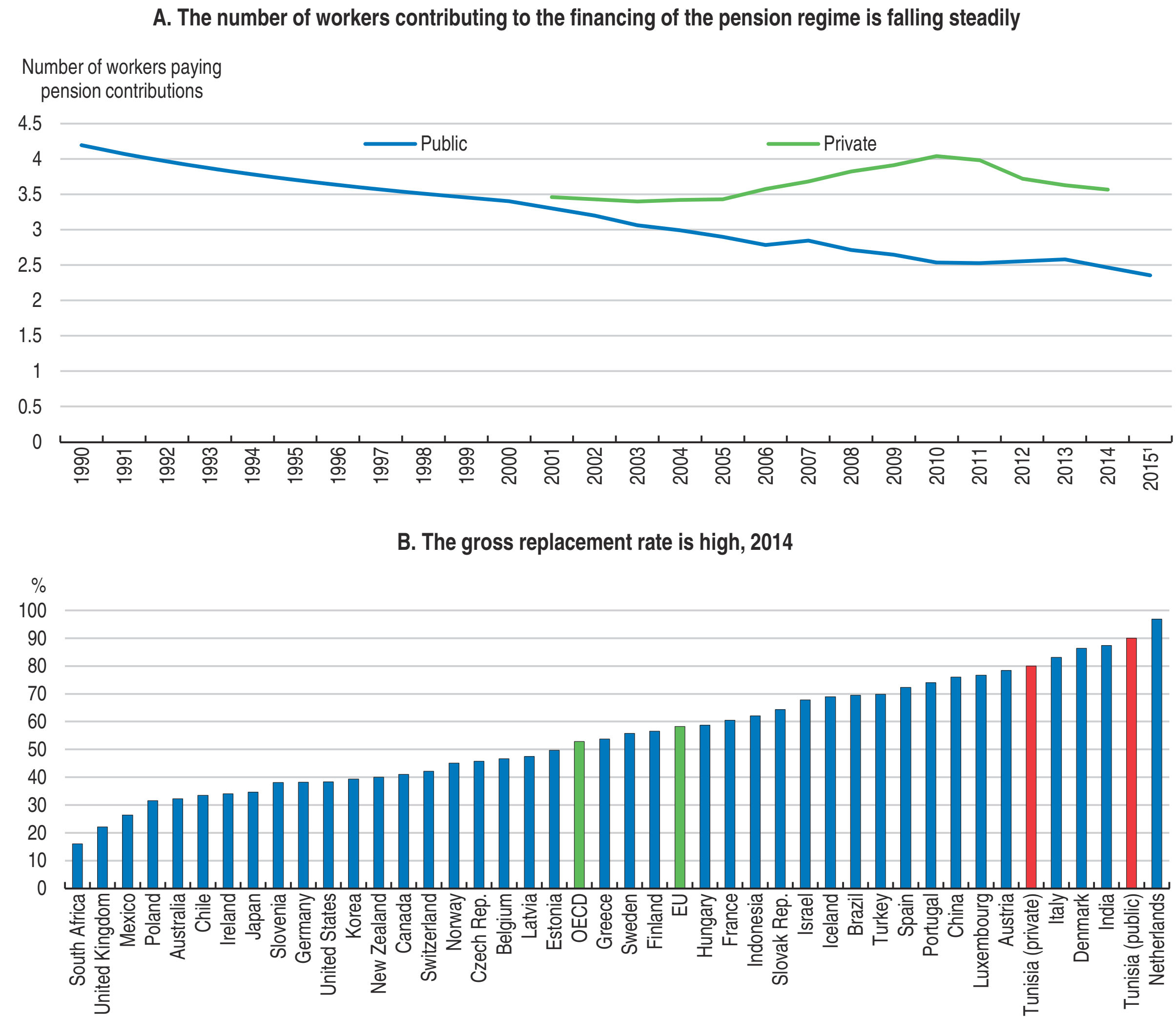
Figure 13. **Tunisia needs to return its public finances to a more sustainable path**



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

StatLink http://dx.doi.org/10.1787/888933693092

Figure 14. **The pension regime is generous but unsustainable**



1. The data for 2015 are projections by the Tunisian government.
Source: Government of Tunisia; *OECD Pensions Outlook 2015*; and *OECD Database on pensions*.

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

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

Restoring public finances to a sustainable path

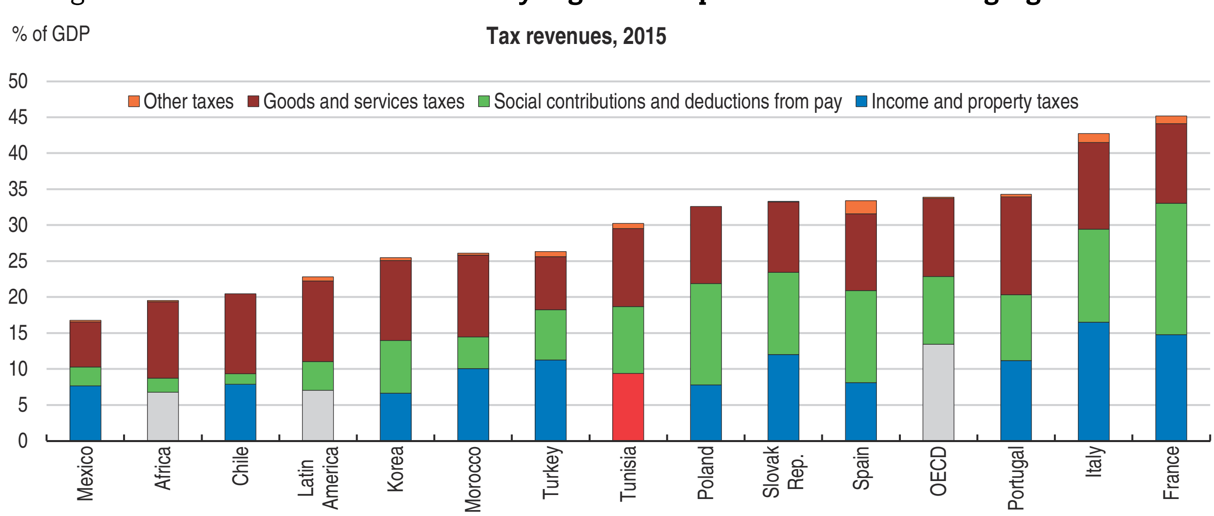
In the absence of reforms, the persistence of high fiscal deficits and weak economic growth will lead to a further increase in the public debt. The ratio of public debt to GDP rose from 41% in 2010 to 62% in 2016. Nearly 2/3 of this debt is financed by foreign currency loans, most of which are concessional, which reduces debt service but increases external vulnerability. The ratings agencies have downgraded Tunisian sovereign debt, which has not been "investment grade" at Fitch and Standard & Poor's since 2012, and since 2013 at Moody's. Moody's further downgraded the rating of Tunisian sovereign debt in August 2017. The government has undertaken to put in place reforms in order to, between now and 2020, i) reduce the deficit from 6.1% of GDP in 2016 to 3%; ii) maintain public debt at below 70% of GDP and, iii) reduce the payroll to 12.5% of GDP.

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

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

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

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



Source: *OECD Revenues Database.*

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

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

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

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

Improving the sustainability, equity and quality of public spending

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

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

Box 1. **Budget law for 2018**

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

Income tax and tax on corporations

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

Indirect taxes

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

Others

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

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

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

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

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

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

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

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

Replacing the current system with a cash transfer would improve both equity and efficiency. In Tunisia's case, a study (INS and CRES, 2013) found that a flat-rate cash transfer, equal in amount for all, would be more effective than subsidies in reducing income inequalities. The experience of India, which has taken this approach and combined it with a financial inclusion objective (Box 2), offers a model that Tunisia could usefully consider by introducing the principle of targeting at the earliest opportunity. The political risks involved in reforming the subsidy system are significant. It is essential to deploy a communication strategy that emphasises the advantages of the reform in terms of social fairness and macroeconomic stability. In the meantime, regular adjustment of product prices is needed to prevent further pressure on the budget.

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

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

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

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

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

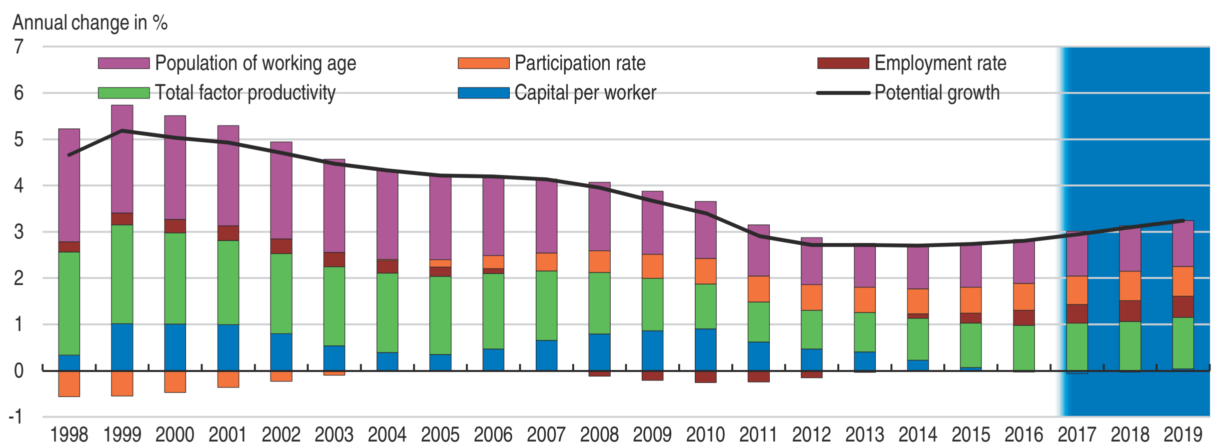
The introduction of a spending target should be based on the setting of priorities. To this end, several countries have put in place systematic spending reviews that make it possible to give priority to programmes with the highest economic and social impact. The role and resources of the Auditor General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

Returning Tunisia to a path of inclusive and robust growth

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

Figure 16. **Contributions to economic growth**

Breakdown of potential growth



Source: *OECD Economic Outlook 102 Database.*

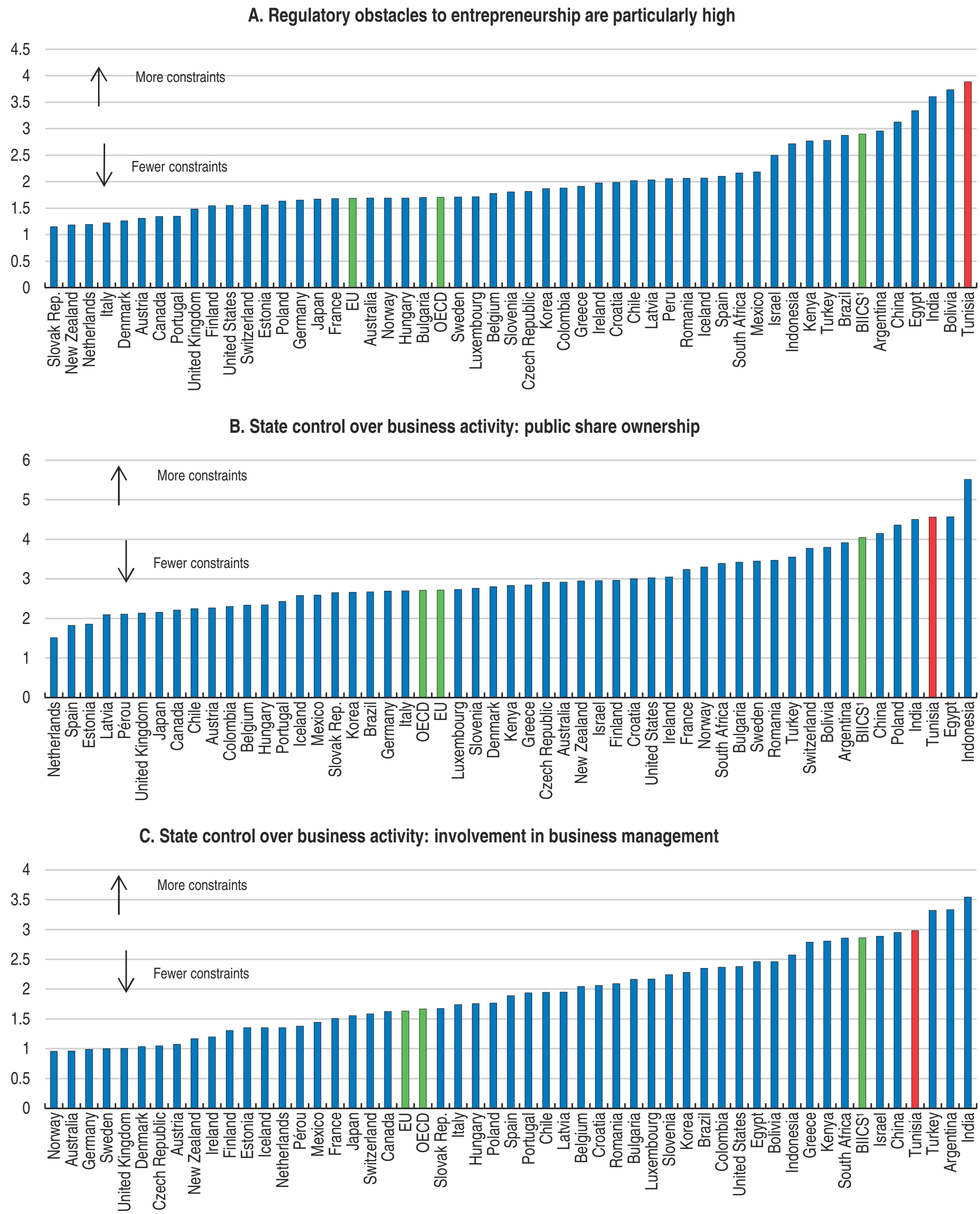
StatLink http://dx.doi.org/10.1787/888933693149

Promoting business investment by improving the regulatory and institutional framework

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

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

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



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

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

Source: OECD-World Bank Product Market Regulation Database.

StatLink http://dx.doi.org/10.1787/888933693168

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

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

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

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

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

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

In Tunisia, in addition to introducing performance contracts for state-owned enterprises, the government might also entrust some activities to the private sector, should it prove to be more effective, especially in network maintenance (electricity, water, etc.), the production of electricity, water desalinisation, and the construction and operation of wastewater treatment plants.

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

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

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

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

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

Regulatory reform to spur growth…

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

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

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

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

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

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

Estimated impacts on GDP and the main components of supply (compared to a no-reform scenario)[1]

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

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

Source: OECD Secretariat estimates.

… and put public debt back on a sustainable trajectory

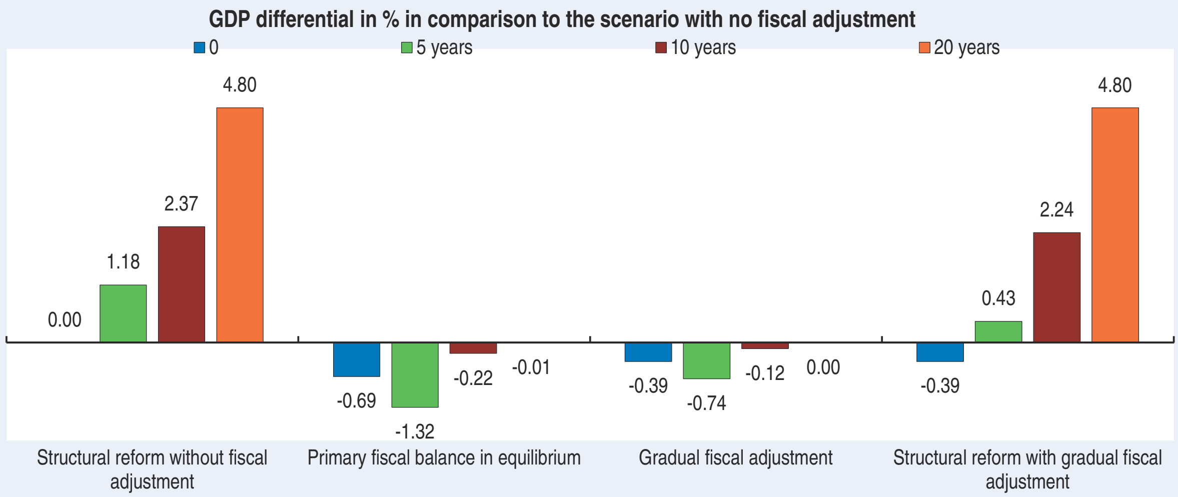
By supporting growth, these structural reforms would allow the country to restore its public debt to a sustainable trajectory. Debt sustainability depends on the rate of economic growth, inflation, the debt's interest rates and the budget deficit.

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

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

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

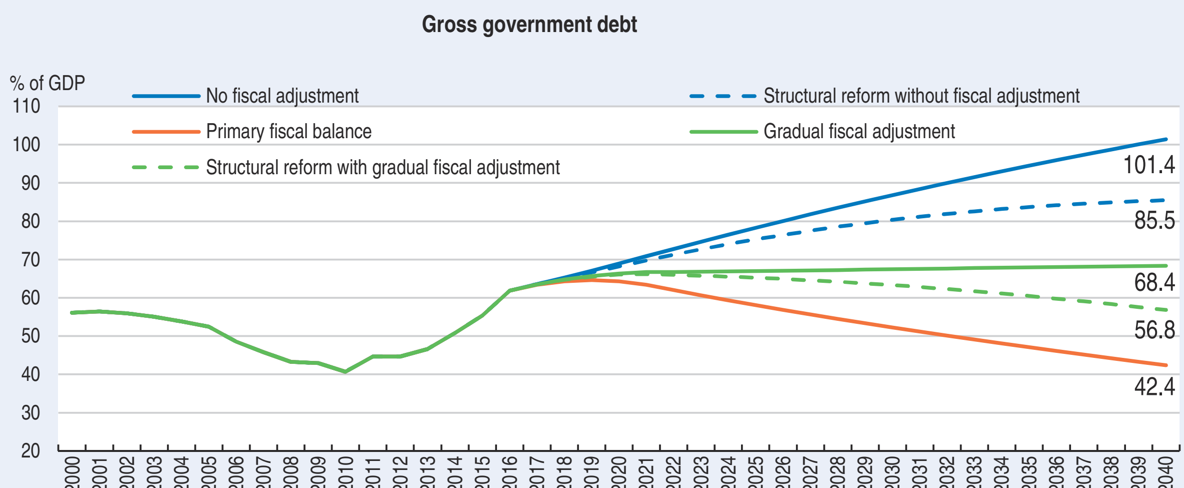
Figure 18. **Impact of the different reform scenarios on growth**



Source: OECD estimates.

StatLink http://dx.doi.org/10.1787/888933693187

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



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

StatLink http://dx.doi.org/10.1787/888933693206

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

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

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

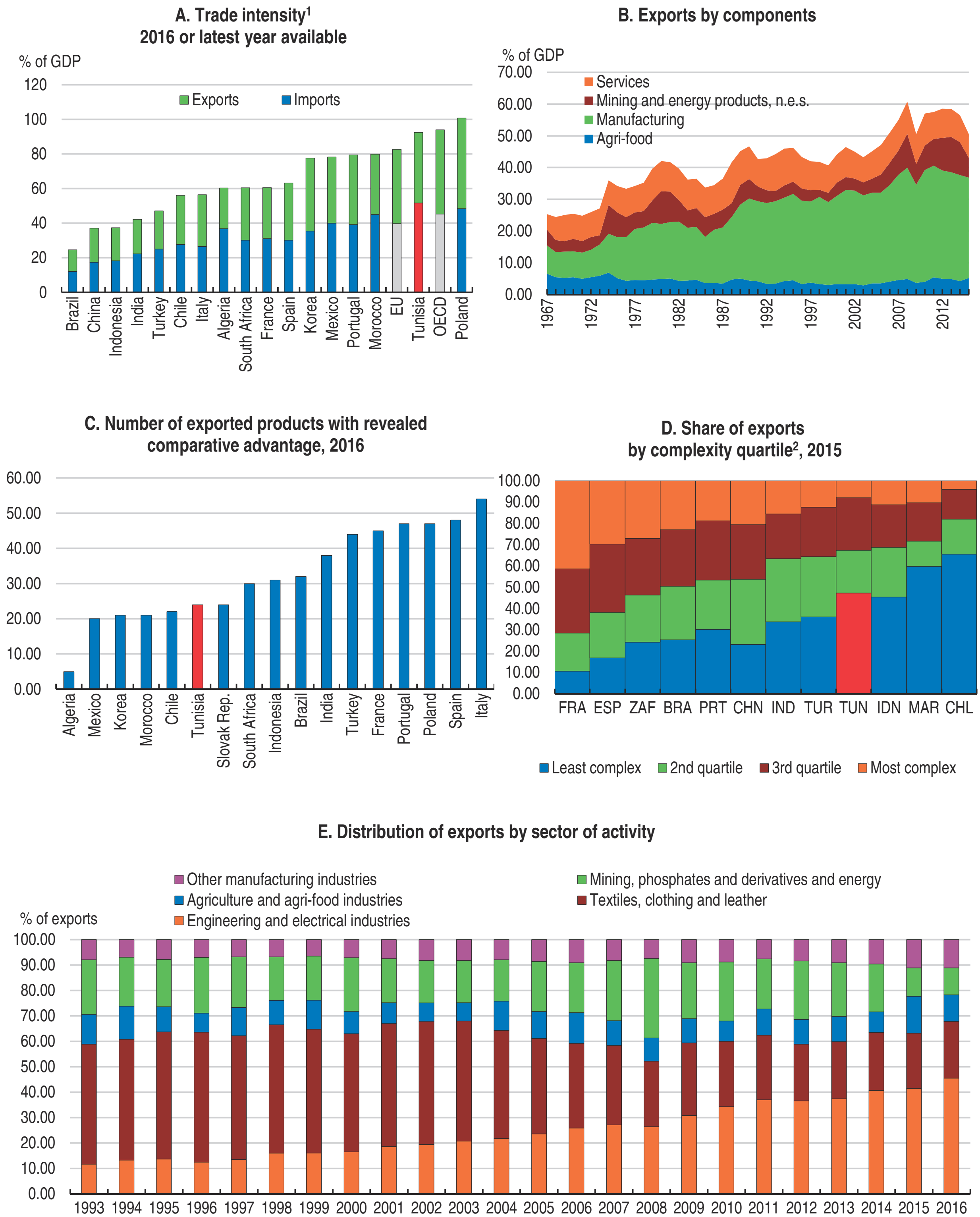
Trade openness has promoted growth and employment in offshore companies

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

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

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

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



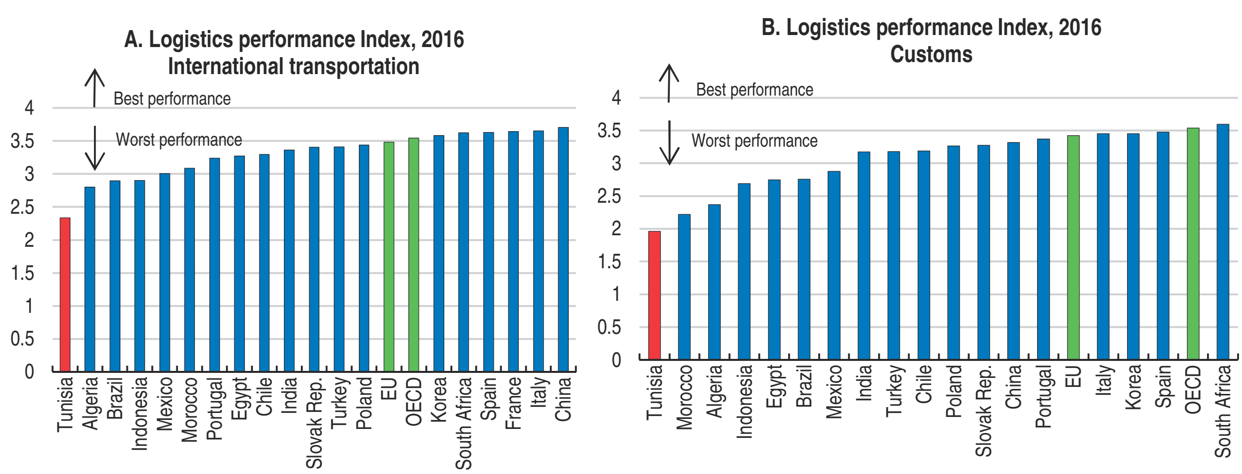
1. Trade intensity is measured by the total of imports and exports as a % of GDP.
2. The degree of complexity is defined in Hausmann et al. (2007), "What you export matters", *Journal of Economic Growth*, Springer, Vol. 12(1).
Source: National Statistics Institute; World Bank, World Development Indicators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

StatLink http://dx.doi.org/10.1787/888933693225

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

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

Figure 21. **Logistical performance has deteriorated**



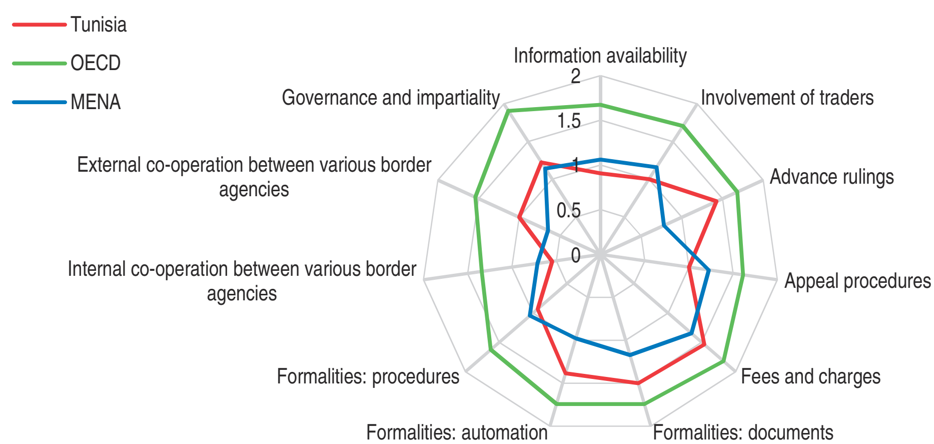
Note: The global score on the logistics performance index reflects perceptions of a country's logistics based on the efficiency of customs and border clearance, the quality of trade infrastructure and related transport infrastructure, the ease of arranging shipment at competitive prices, the quality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

Source: World Bank Logistics Performance Index database.

StatLink http://dx.doi.org/10.1787/888933693244

Figure 22. **Trade could be facilitated**

Trade facilitation indicators, 2017



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

StatLink http://dx.doi.org/10.1787/888933693263

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

Unemployment is high and informal employment is widespread

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

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

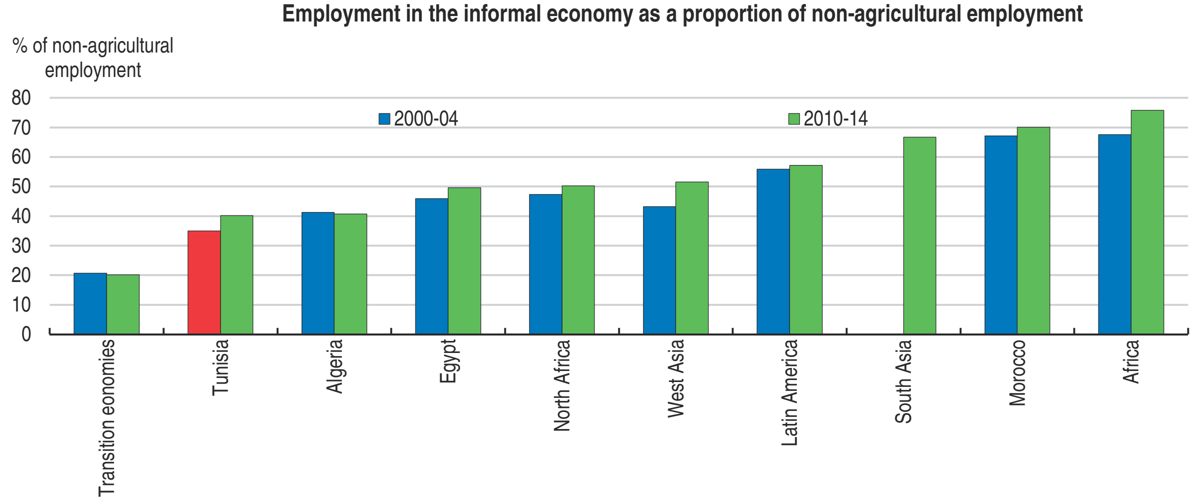
The public sector recruitment policy, which gave priority to the long-term unemployed, seems to have aggravated the problem of unemployment among graduates. This clearly represented an incentive to turn to the employment agency and await a job in the public sector, which offered a higher salary, job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

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

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

Figure 23. **Informal employment is widespread**

Employment in the informal economy as a proportion of non-agricultural employment



Source: World Bank Enterprise Survey.

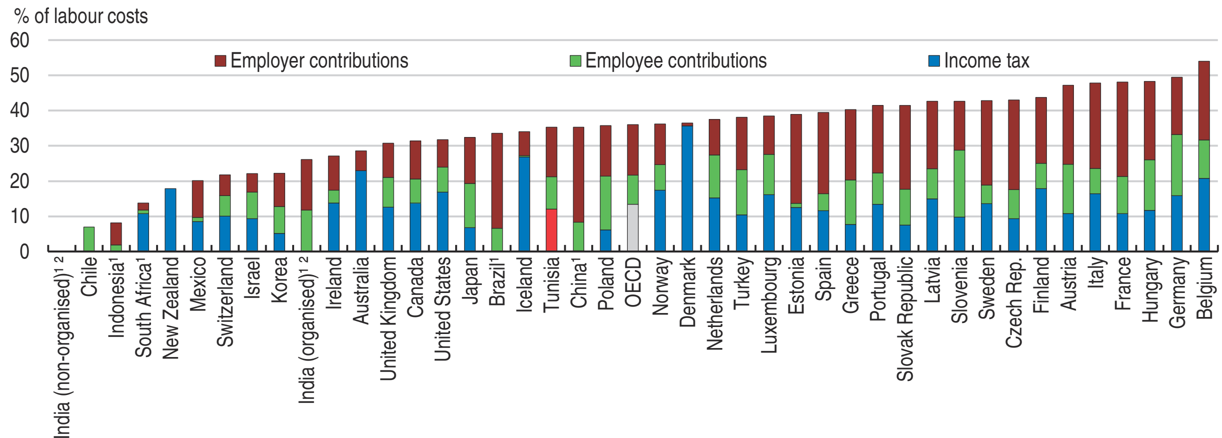
StatLink http://dx.doi.org/10.1787/888933693282

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

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

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

Taxation of income from work, 2016



1. Data refer to 2010 for Brazil, China, India and South Africa, and to 2009 for Indonesia.
2. The non-organised sector in India corresponds to companies with fewer than 20 employees. Companies with more than 20 employees have to comply with the law on pension funds for employees and other provisions, and to this end pay social security contributions.

Note: The scenario considers a single person with no children earning 100% of the average wage.
Source: OECD revenue statistics and Ministry of Finance.

StatLink http://dx.doi.org/10.1787/888933693301

Gender differences: a mixed record

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

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

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

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

A financial inclusion strategy is needed

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

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

Regional development: allowing each region to exploit its comparative advantages

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

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

Source: INS.

StatLink http://dx.doi.org/10.1787/888933693320

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

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

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

Bibliography

Araar, A. and P. Verme (2016), "A Comparative Analysis of Subsidy reforms in the Middle East and North African Region", *World Bank Policy Research Working Paper 7755 http://documents.worldbank.org/curated/en/965461469022650590/pdf/WPS7755.pdf*.

Bartolini, D., S. Stossberg and H. Blöchliger (2016), "Fiscal Decentralisation and Regional Disparities", *OECD Economics Department Working Papers*, No. 1330, OECD Publishing, Paris.

Baudino, P. and H. Yun (2017), "Resolution of non-performing loans – policy options", BIS FSI Insights on policy implementation, No. 3.

Ben Chaâben (2017), "La rémunération des salariés 2010-2017", *Notes et analyses de l'Institut Tunisien de la Compétitivité et des Etudes Quantitatives*, No. 60.

Central Bank of Tunisia (2016), "Rapport annuel sur la supervision bancaire".

Central Bank of Tunisia (2017a), Périodique de Conjoncture, No. 116.

Central Bank of Tunisia (2017b), Annual Report 2016.

Coady, D., M. Grosh and J. Hoddinott (2004), *Targeting of transfers in developing countries: Review of lessons and experience*, World Bank.

Conseil des Analyses économiques (2016), Programme National des Réformes Majeures, 2016-2020.

CRES (2016), "Protection sociale et économie informelle en Tunisie, Défis de la transition vers l'économie informelle".

Daghari, S. (2017), "Evolution du système éducatif tunisien", *Notes et analyses de l'Institut Tunisien de la Compétitivité et des Etudes Quantitatives (ITCEQ)*, No. 51.

Égert, B. and P. Gal (2017), "The Quantification of Structural Reforms in OECD Countries: A New Framework", *OECD Economics Department Working Papers*, No. 1354, OECD Publishing, Paris, *http://dx.doi.org/10.1787/2d887027-en*.

Fajgelbaum, P. and A. Kandhelwal (2016), "Measuring the unequal gains from trade", QJE, Vol. 131.

Gangopadhyay, S., R. Lensink and B. Yadav (2015), "Cash or In-kind Transfers? Evidence from a Randomised Controlled Trial in Delhi, India", *The Journal of Development Studies*, 51:6, 660-673.

Haddar, M. and M. Bouzaiene (2017), "Ancrage de la justice fiscale et mobilisation des ressources", *www.asectu.org/Documents/PDF/JF_Rapport.pdf*.

Hughes, J. and L. Mester (2013), "Who Said Large Banks Don't Experience Scale Economies? Evidence from a Risk-Return-Driven Cost Function", *Journal of Financial Intermediation*, Vol. 22, No. 4, October.

ILO (2011), *Tunisia: A New Social Contract for Fair and Equitable Growth – Studies on Growth with Equity*, ILO, Geneva.

IMF (2015), "Article IV Consultation, Sixth Review Under The Stand-By Arrangement, And Request For Rephasing – Press Release; Staff Report; And Statement By The Executive Director For Tunisia".

IMF (2017), "First Review Under The Extended Fund Facility, Request For Waivers Of Non observance Of Performance Criteria And Rephasing Of Access – Press Release; Staff Report; And Statement By The Executive Director For Tunisia".

Institut de la Méditerranée (2014), *Eléments Pour Une Stratégie de Développement Economique & Social à Moyen Terme en Tunisie*, *www.femise.org/wp-content/uploads/2015/03/Ouvrage_Tunisie_Final_V4.pdf*.

ITCEQ (2017), "Quelle stratégie de réforme de la subvention énergétique en Tunisie", *Tribune de l'ITCEQ* No. 19, May 2017, *www.itceq.tn/upload/files/tribune/tribune2017/tribune19.pdf*.

ITCEQ (2011), "Convertibilité totale du dinar: enjeux et défis".

Jamet, S. (2007), "Meeting the challenges of decentralisation in France", OECD *Economics Department Working Papers,* No. 571, OECD Publishing, Paris, http://dx.doi.org/10.1787/127050885680.

Johansson, Å. et al. (2008), "Taxation and Economic Growth", *OECD Economics Department Working Papers*, No. 620, OECD Publishing, Paris, *http://dx.doi.org/10.1787/241216205486*.

Joumard, I. and C. Giorno (2005), "Getting the most out of public sector decentralisation in Spain", *OECD Economics Department Working Papers,* No. 436, OECD Publishing, Paris, *http://dx.doi.org/10.1787/838564110008*.

Joumard, I. and J. Londoño Vélez (2013), "Income Inequality and Poverty in Colombia – Part 2. The Redistributive Impact of Taxes and Transfers", *OECD Economics Department Working Papers*, No. 1037, OECD Publishing, Paris.

Joussour (2016), "Commencer par cerner l'informel pour préparer son cantonnement : un enjeu de politique publique".

Minegishi, M. and B. Cournède (2009), "The Role of Transparency in the Conduct of Monetary Policy", *OECD Economics Department Working papers*, No. 724, OECD Publishing, Paris, *http://dx.doi.org/10.1787/221128317344*.

Moulay, S. (2012), "The role of monetary policies and macroeconomic convergence in the development of financial systems in south Mediterranean countries", *MEDPRO Technical Report*, No. 12.

OECD (2012), *Promoting Growth in All Regions*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264174634-en*.

OECD (2014), *OECD Integrity Review of Tunisias Audit System: Managing Risk in Public Institutions*.

OECD (2015a), *Economic Survey of Indonesia 2015*.

OECD (2015b), *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, 2015 edition.

OECD (2015c), *Investing in Youth: Tunisia – Strengthening the Employability of Youth during the Transition to a Green Economy*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264226470-en*.

OECD (2015d*), Open Government Review of Tunisia*.

OECD (2016a), *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Tunisia 2016*; Phase I: Legal and Regulatory Framework, *http://dx.doi.org/10.1787/9789264250697-en*.

OECD (2016b), *OECD Economic Survey of Indonesia 2016*.

OECD (2017a), *Une meilleure planification pour une meilleure gouvernance budgétaire en Tunisie : le cadre de dépenses à moyen terme*.

OECD (2017b), *Une meilleure performance pour une meilleure gouvernance publique en Tunisie : la gestion budgétaire par objectifs*.

OECD (2017c), "The effects of the tax mix on inequality and growth", *OECD Economics Department Working Papers*.

OECD (2017d), "How to make trade work for all", *OECD Economic Outlook*, June 2017, Chapter 2.

OECD (2017e), *Women's Economic Empowerment in Selected MENA Countries: The Impact of Legal Frameworks in Algeria, Egypt, Jordan, Libya, Morocco and Tunisia, Competitiveness and Private Sector Development*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264279322-en*.

OECD (2017f), "The quantification of structural reforms: Extending the framework to emerging market economies", *OECD Economics Department Working Papers*.

OECD (2017g), "Creating a Culture of Independence: Practical Guidance against Undue Influence", OECD Publishing, Paris", *http://dx.doi.org/10.1787/9789264287884-fr*.

Rijkers, B., C. Freund and A. Nucifora (2014), "All in the Family – State Capture in Tunisia", The World Bank WPS6810.

Statistiques Tunisie and CRES (2013), *Analyse de l'Impact des Subventions Alimentaires et des Programmes d'Assistance Sociale sur la Population Pauvre et Vulnérable*.

Tripathi, A., A.D. Sagar and K.R Smith (2015), "Promoting Clean and Affordable Cooking – Smarter Subsidies for LPG", Economic *and Political Weekly*, Vol. L, No. 48, 28 November 2015.

Vujanovic, P. (2017), "Decentralisation to promote regional development in Indonesia", OECD *Economics Department Working Papers,* No. 1380, OECD Publishing, Paris, *http://dx.doi.org/10.1787/d9cabd0a-en*.

World Bank (2014), "The Unfinished Revolution: Bringing Opportunity, Good jobs and Greater Wealth to all Tunisians".

World Bank (2015), "Snapshot: Financial inclusion in Tunisia – low-income households and micro-enterprises".

World Bank (2016), "Tunisia Poverty Assessment, 2015".

World Bank (2017), *Impact of Libya crisis on the Tunisian economy*.

World Economic Forum (2017a), "Global Competitiveness Report".

Thematic chapters

Chapter 1

Reviving investment

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

Introduction and main conclusions

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

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

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

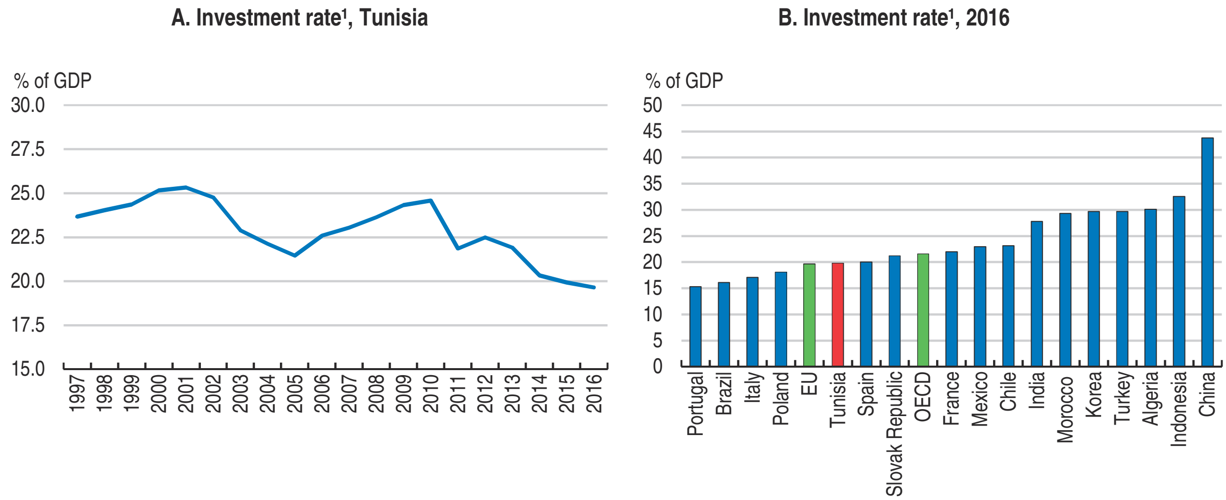
Fostering greater investment will also mean making Tunisia more competitive in global value chains, through measures to facilitate trade and make logistics services more efficient. Surveys of business leaders stress the importance of these constraints, and serve to highlight Tunisia's deteriorating position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

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

The investment rate has declined

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

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



1. Gross fixed capital formation.
Source: INS; *OECD Economic Outlook 102 Database*; IMF, World Economic Outlook Database; and Eurostat.

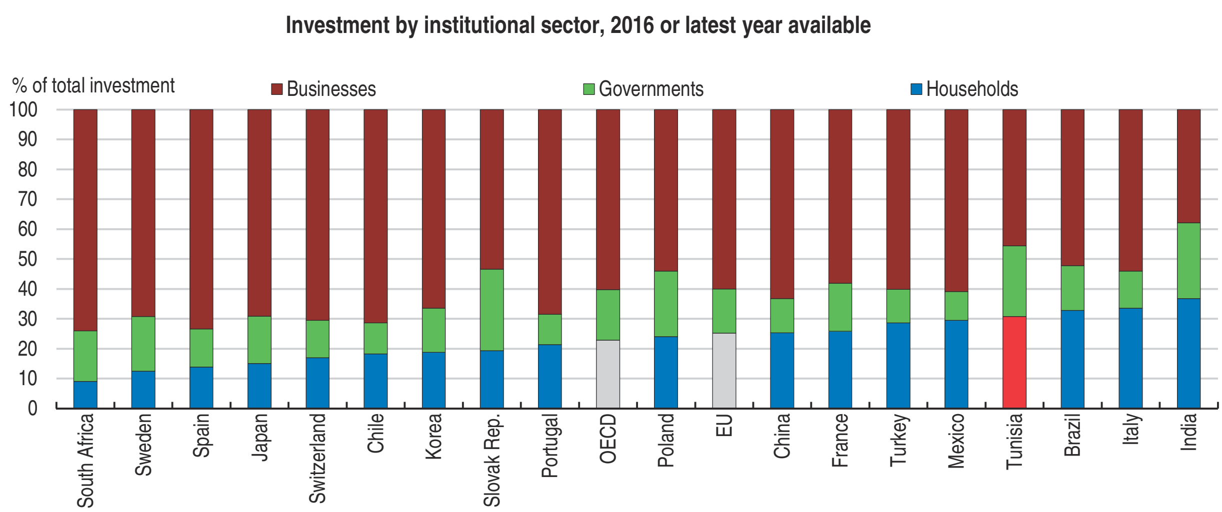
StatLink http://dx.doi.org/10.1787/888933693339

Investment by households and governments has remained vigorous

Housing dominates investment

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

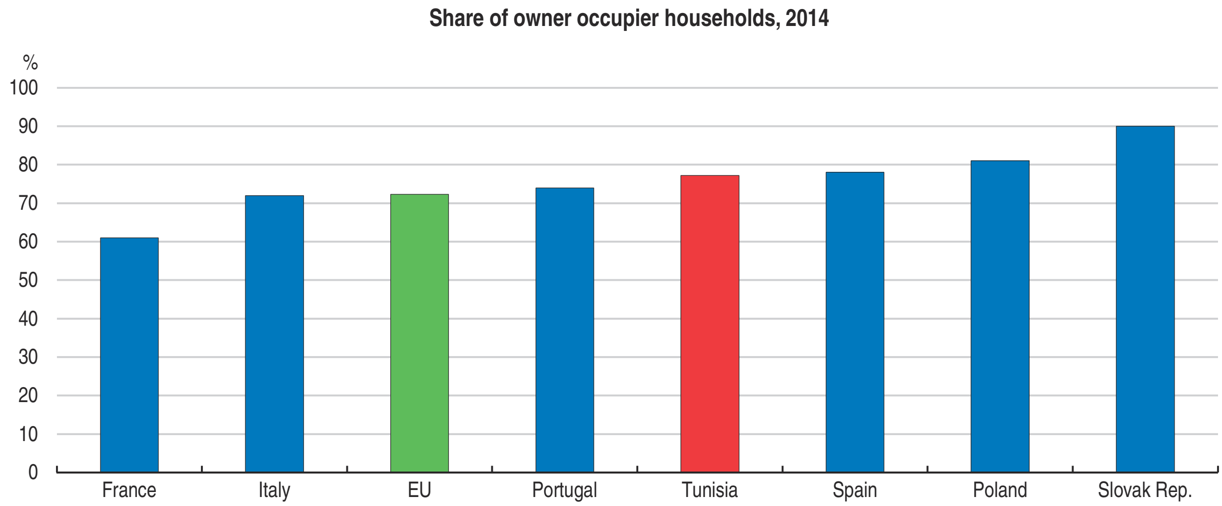
Figure 1.2. **Investment is dominated by households and governments**



Note: The "household" sector comprises households, individual businesses and non-profit institutions serving households. Household investment in housing represents around 18% of total gross fixed capital formation.
Source: INS; and *OECD Economic Outlook 102 Database*.

StatLink http://dx.doi.org/10.1787/888933693358

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



Source: Whitehead, C. and P. Williams (2017), "Changes in the regulation and control of mortgage markets and access to owner-occupation among younger households", *OECD Social, Employment and Migration Working Papers*, No. 196, OECD Publishing, Paris.

StatLink http://dx.doi.org/10.1787/888933693377

Home purchasing by households is promoted by various tax and financial incentives. In response to the rapid rural exodus that began in the early 1970s, the government instituted a policy that includes various tax and financial incentives to facilitate access to housing. Individuals are allowed to claim interest payments on loans granted to finance the purchase of a first home not exceeding 200 000 dinars in price as a deduction from taxable income. As well, interest earned on housing savings accounts as well as capital gains upon first transfer are fully tax exempt. Tunisia has been strengthening these measures in support of housing investment in recent years, even though mortgage interest adaptability tends to favour the better-off classes, recognising that the propensity to buy a home rises with income. Information on the budget cost and the beneficiaries of these incentives is unfortunately not available, but we do know that lending to households has in fact remained relatively vigorous in comparison to bank loans to business (see the Assessment and Recommendations chapter).

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

Government intervention in the housing market has not reduced the imbalances between housing supply and demand, which are in fact worsening. The scarce supply of social housing has pushed low-income families into the informal market on urban peripheries. A central feature of urban development is the proliferation of clandestine building lots or subdivisions with no collective infrastructure or facilities (Ministry of Equipment, Housing and Land Use Planning, 2015). These irregular subdivisions impose a high cost on government, as they are subsequently integrated into urban rehabilitation and outfitting programmes. Moreover, the stock of vacant housing is sizable (estimated at 600 000 units in 2016), representing in some cases a "passive" financial asset that the owner deliberately keeps empty, and in other cases newly built, but unsold, properties and secondary residences. At the same time, real estate prices are soaring (with prices for houses and apartments up by an average of more than 12% annually over the period 2012-15, according to the INS). This inflation can be laid in part to the scarcity of available building lots, resulting from cumbersome administrative procedures involved in the application and revision of urban development plans (Kamoun, 2017).

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

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

Government investment has remained strong

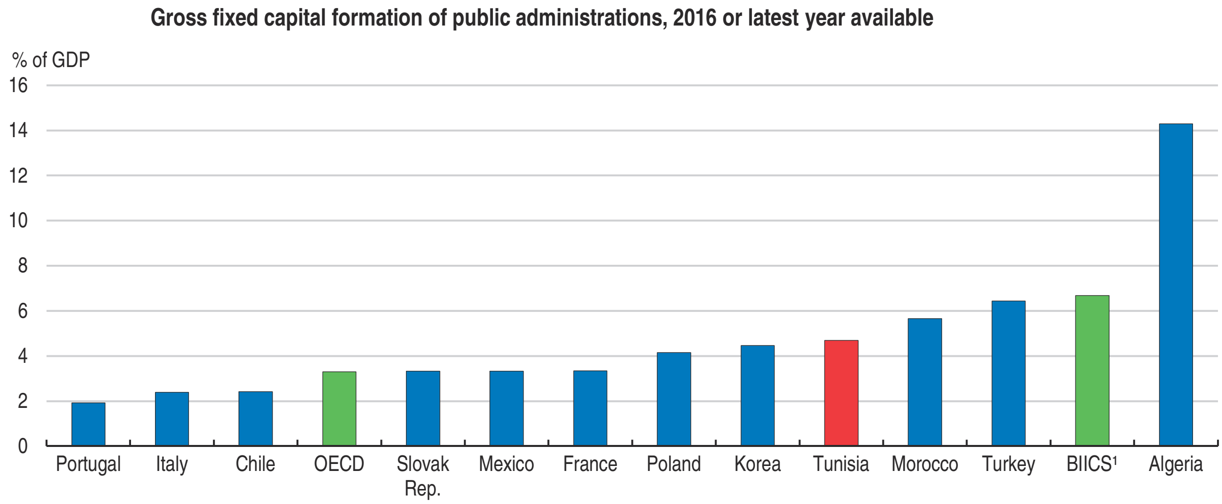
At 4.7% of GDP, government investment has been relatively high since 2011. It exceeds the level observed in OECD countries (Figure 1.4). Tunisians today enjoy nearly universal access to basic services – 99.8% of homes have electricity and 89% have drinking water, according to the 2014 census – even if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

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

Business investment has retreated, slowing growth and job creation

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

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



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

StatLink http://dx.doi.org/10.1787/888933693396

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

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

Source: World Bank Enterprise Survey.

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

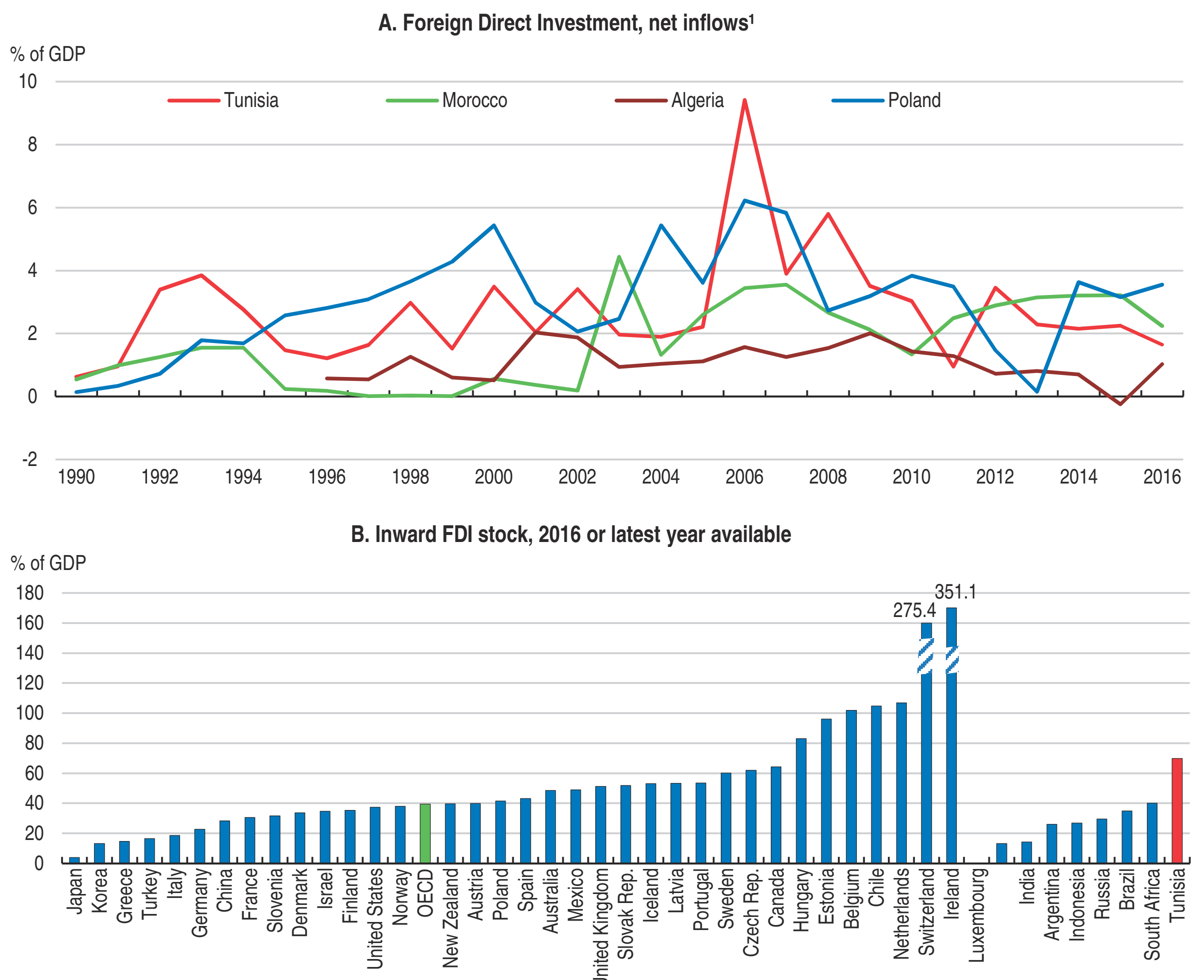
Gross fixed capital formation (GFCF)	2000 (% of GDP)	2010 (% of GDP)	2016[1] (% of GDP)	Gap 2000-16[1] (percentage points of GDP)	Gap 2010-16[1] (percentage points of GDP)
Total GFCF	25.2	24.6	19.2	-6.0	-5.4
GFCF of nonfinancial companies	14.0	12.2	8.8	-5.2	-3.4
Of which:					
Private	9.5	8.1	6.0	-3.5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

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

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

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

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



1. Three-year moving average.

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

StatLink http://dx.doi.org/10.1787/888933693415

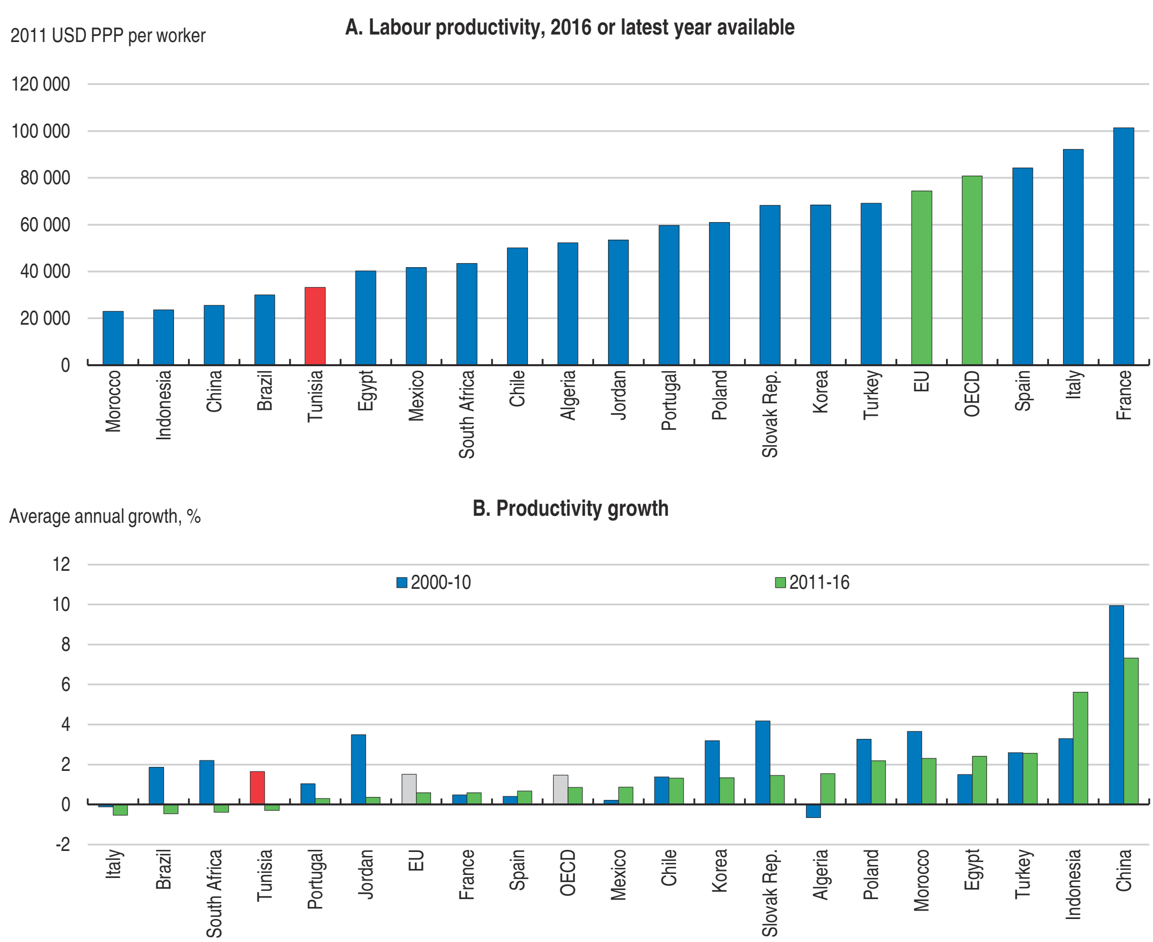
Because of its geographic position, it is a privileged point of entry for European countries into the countries of the Maghreb and sub-Saharan Africa. It is also a strategic base for the reconstruction of Libya. Foreign companies are attracted by competitive production costs and a relatively well-trained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

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

Productivity is respectable, but gains are shrinking

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

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



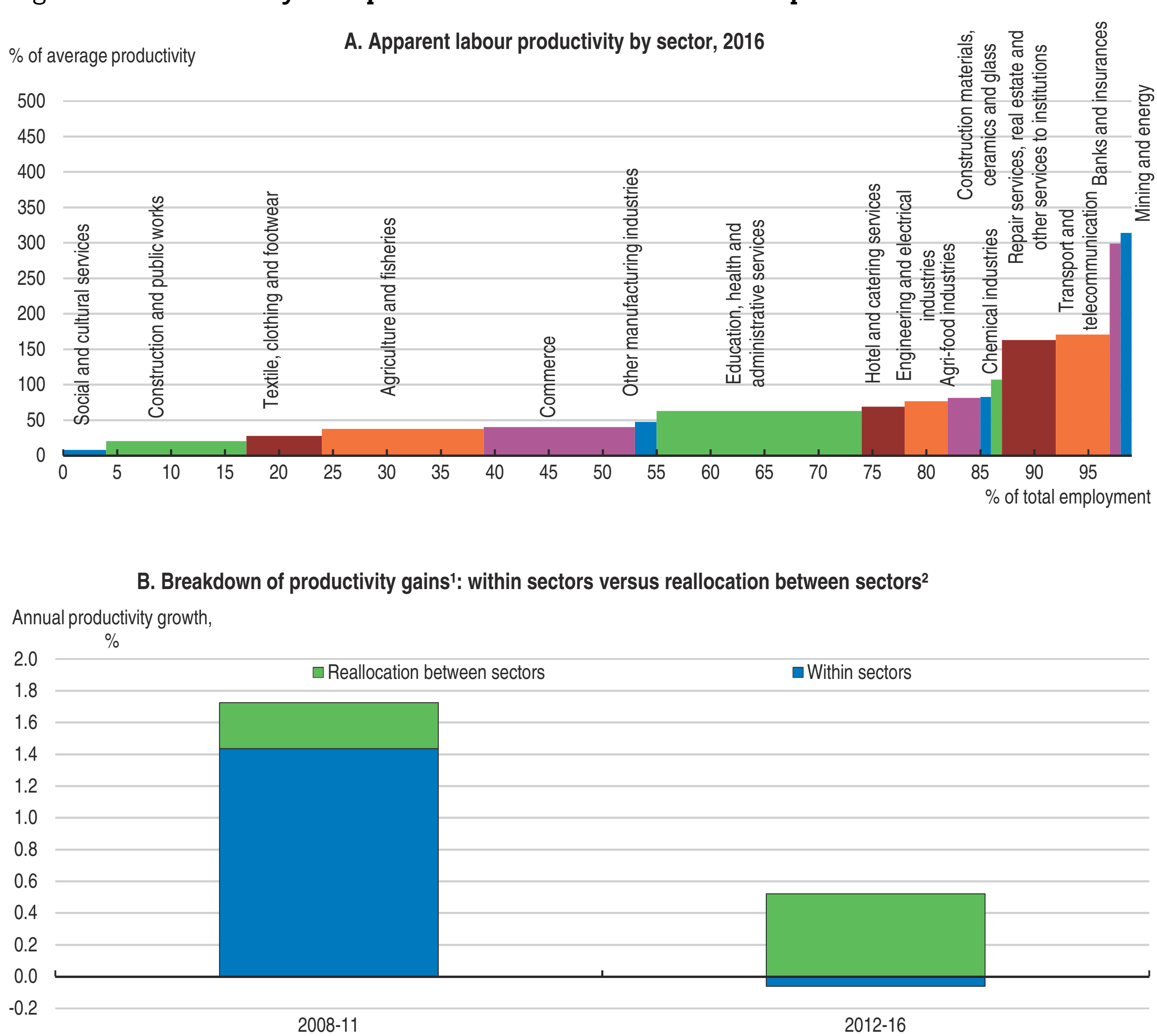
Source: IMF World Economic Outlook database; World Bank, World Development Indicators (WDI); and *OECD Economic Outlook 102 Database*.

StatLink http://dx.doi.org/10.1787/888933693434

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

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

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



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

Source: INS; and OECD calculations.

StatLink http://dx.doi.org/10.1787/888933693453

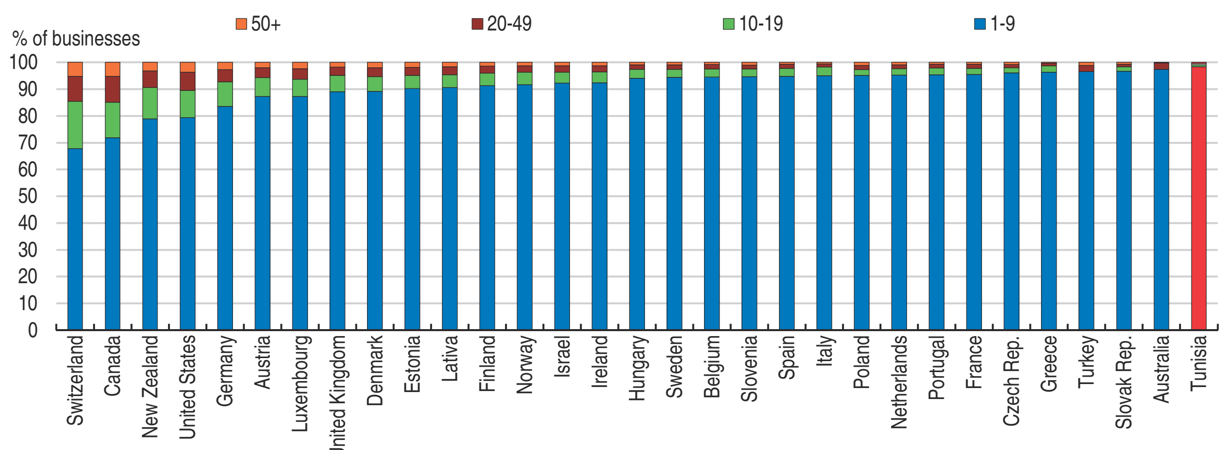
has been strong. The electromechanical industries, and more recently the electronic industries, have been particularly dynamic. They have developed in product niches of medium to high value-added. Their success can often be attributed to large groups geared essentially to the European market, which is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

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

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

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

Breakdown of businesses by number of employees



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

StatLink http://dx.doi.org/10.1787/888933693472

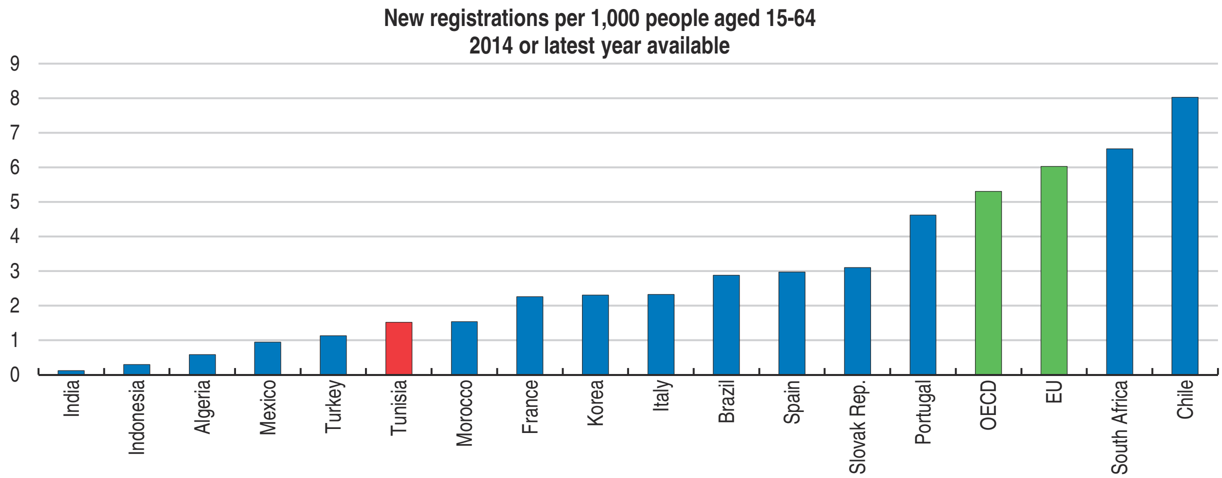
Improving the business climate in order to boost productivity and returns on investment

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

Barriers to business activity: progress is needed on several fronts

The business creation rate has risen since the year 2000. It now exceeds the rate recorded in other emerging countries, but it remains well below the average for OECD countries (Figure 1.9). Moreover, growth among Tunisian firms is weak, yet it is the younger and larger firms that create the most jobs (World Bank, 2014a). With some rare exceptions, new enterprises struggle along with one or two employees for years, whereas the big firms were created 20 or 30 years ago – a situation that testifies to the lack of dynamism among small and medium-sized firms.

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



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

StatLink http://dx.doi.org/10.1787/888933693491

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

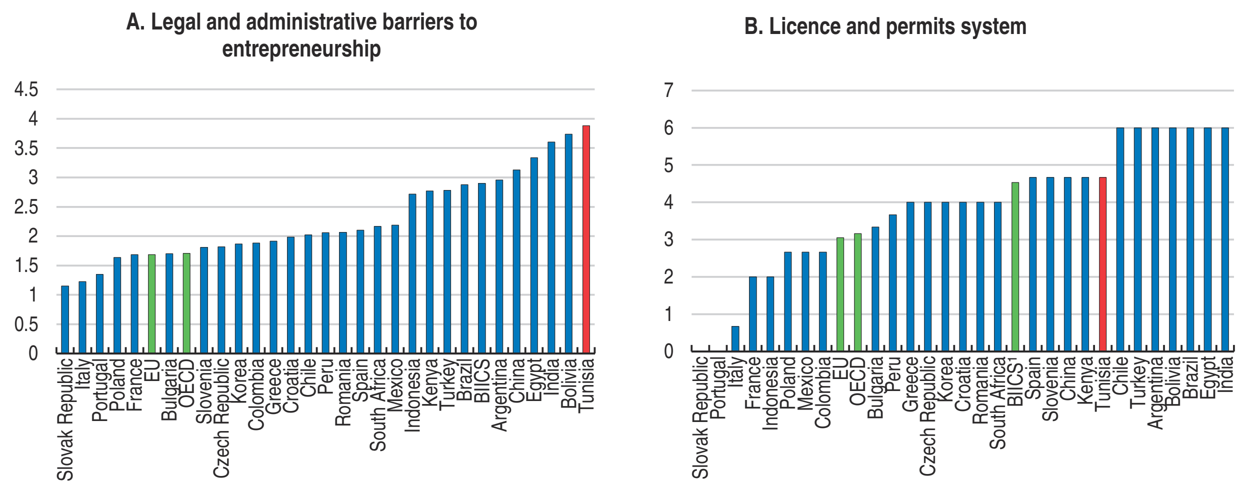
Table 1.3. **Business climate: the most problematic factors according to business leaders**

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

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

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

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



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

StatLink http://dx.doi.org/10.1787/888933693510

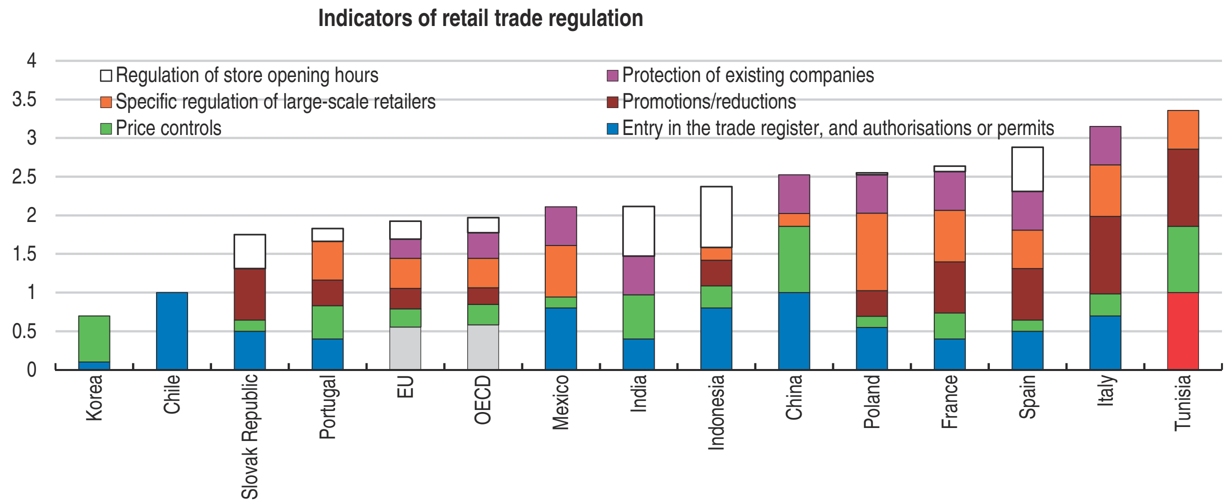
Regulations need to be simplified, especially as the complexity of the regulatory framework and the lack of transparency in the preparation and enforcement of regulations encourage corruption (OECD, 2013) and thereby undermine the legitimacy of government. In 2012 the authorities had already recognised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

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

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

Entry restrictions reduce incentives to modernise existing businesses and they hold back investment. The distribution sector is a case in point. It is heavily protected by significant restrictions on foreign direct investment and by a restrictive set of regulations on prices and authorisations (Figure 1.11).

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



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

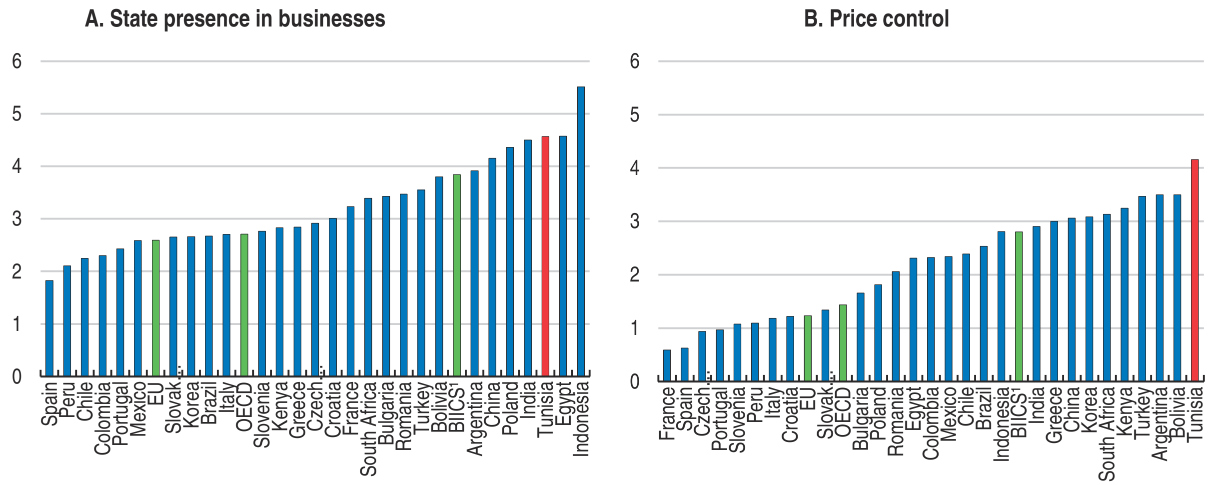
StatLink http://dx.doi.org/10.1787/888933693529

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

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

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

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



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

StatLink http://dx.doi.org/10.1787/888933693548

International trade facilitation: Tunisia's position has deteriorated

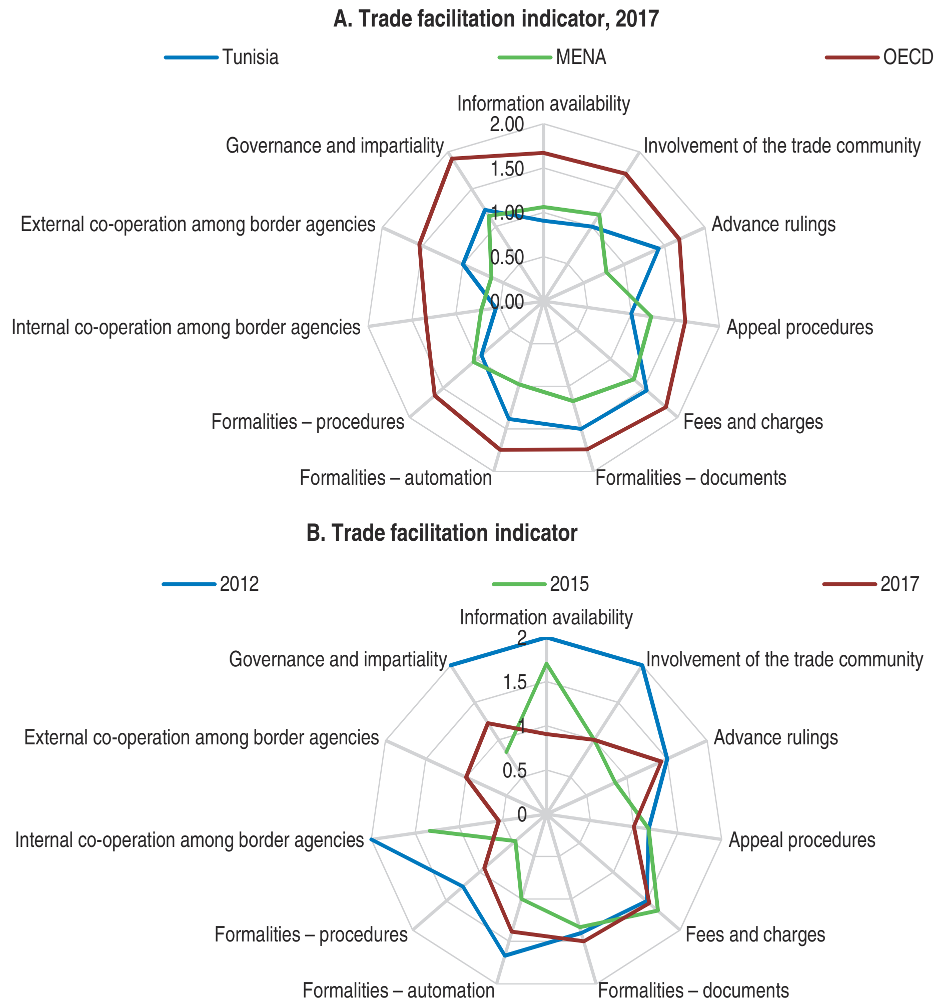
In global value chains, goods cross borders many times. The predictability and efficiency of border procedures is therefore especially important in maintaining competitiveness and conquering new export markets. The OECD trade facilitation indicator reflects the broad terms of the WTO agreement that was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

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

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

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

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



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

StatLink http://dx.doi.org/10.1787/888933693567

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

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

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

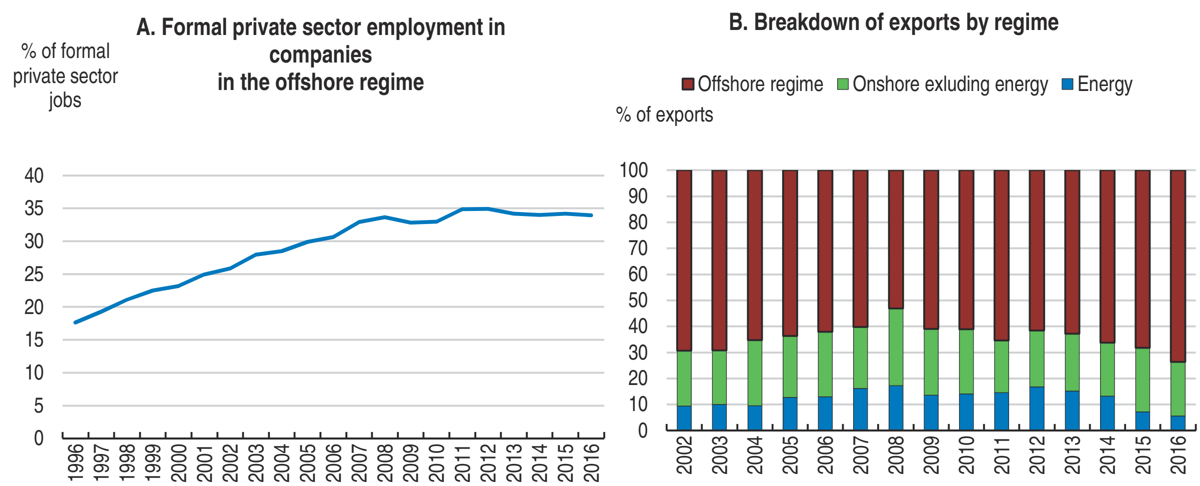
Definitions of the offshore sector. There are two definitions of the offshore regime. For the INS, these businesses are those that are wholly engaged in exporting, whether they are Tunisian or foreign. The Tunisian central bank adds another criterion: foreign ownership of at least 66% of the share capital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

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

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

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

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



Source: INS.

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

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

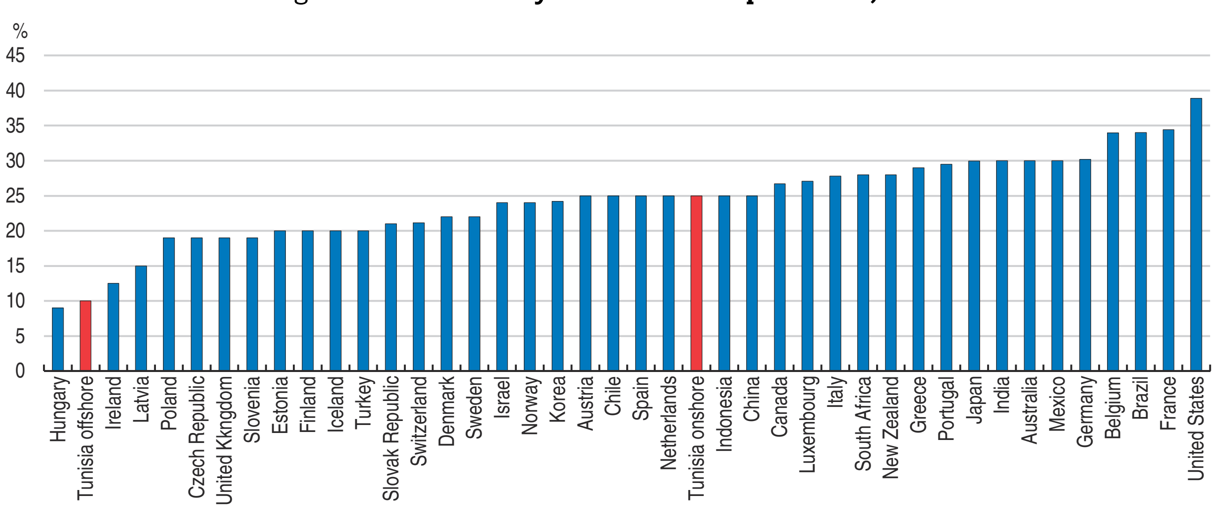
Firms in the two regimes trade little with each other. When they sell their output in Tunisia, export-only firms must therefore pay taxes and customs duties, and thereby enter into a relationship with the government. They may also supply themselves on the local market, in which instance they are exempt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

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

Taxation: remedying the lack of transparency and predictability

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

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



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

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

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

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

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

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

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

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

Box 1.2. **The new investment law**

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

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

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

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

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

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

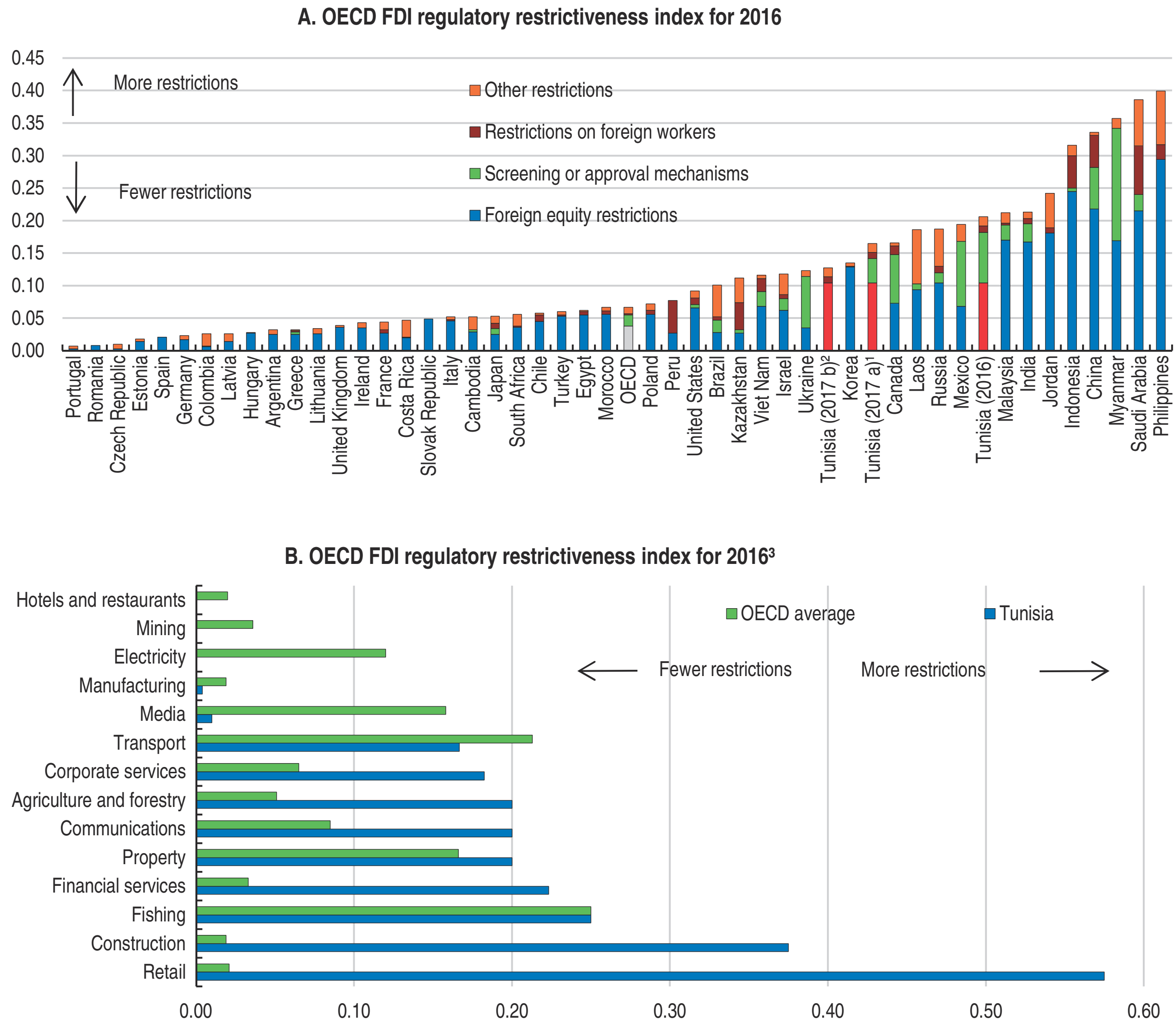
The institutional framework for implementing the new investment law is still complex. The law introduces a new institutional system, with the Tunisian Investment Authority (*Instance tunisienne de l'investissement*) acting alongside the pre-existing bodies that encourage investment: these include the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

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

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

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

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



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

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

Source: OECD Foreign direct investment regulatory restrictiveness index.

StatLink http://dx.doi.org/10.1787/888933693624

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

Improving infrastructure

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

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

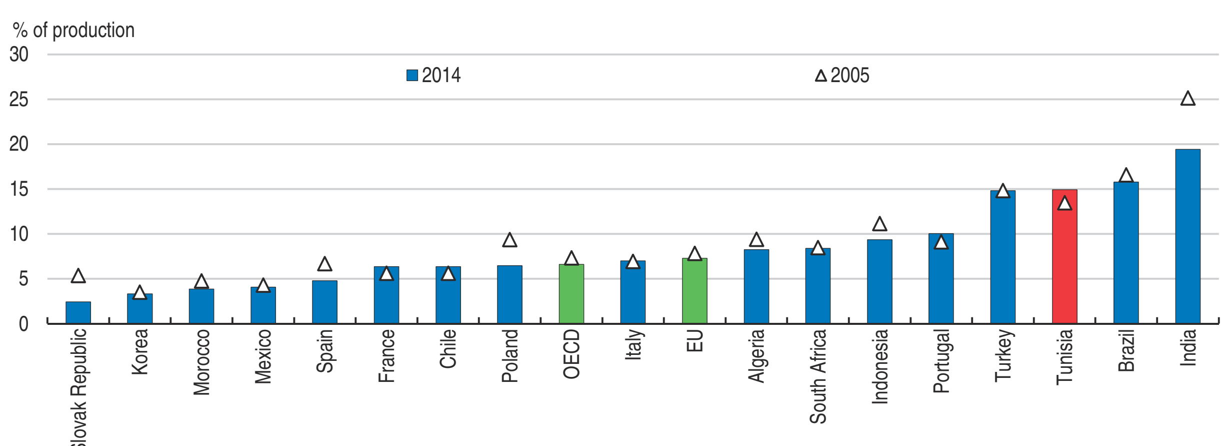
Rationalising the choice of public investments

Better maintenance and operation of existing infrastructure

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

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

Electric power transmission and distribution losses



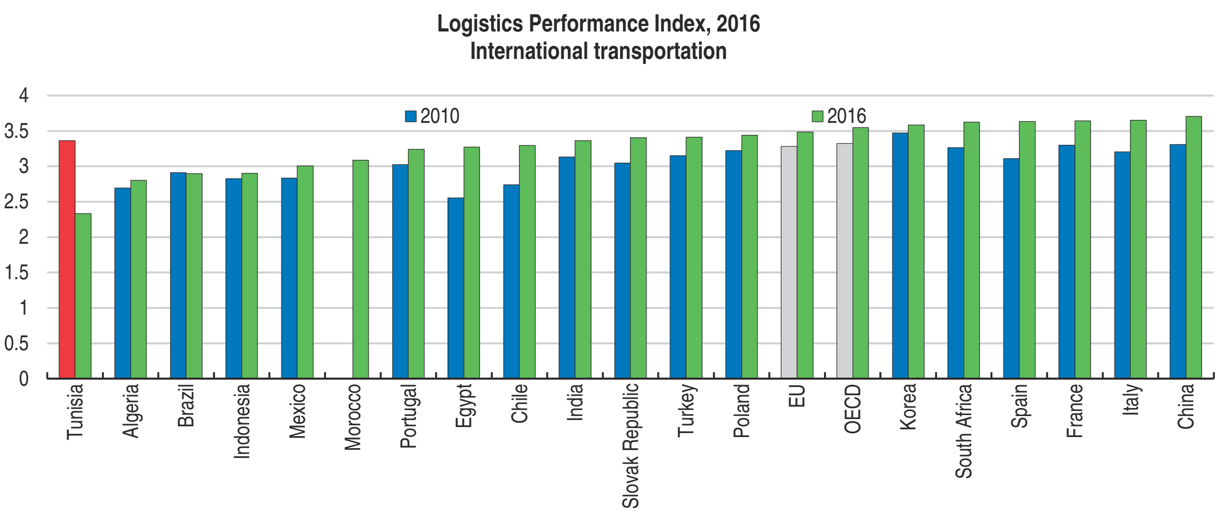
Source: World Bank, World Development Indicators (WDI).

StatLink http://dx.doi.org/10.1787/888933693643

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

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

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



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

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

Selecting future projects more carefully

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

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

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

Establishing a pricing structure favourable to sound management of infrastructure

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

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

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

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

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

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

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

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

Facilitating private sector participation in the financing and management of infrastructure

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

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

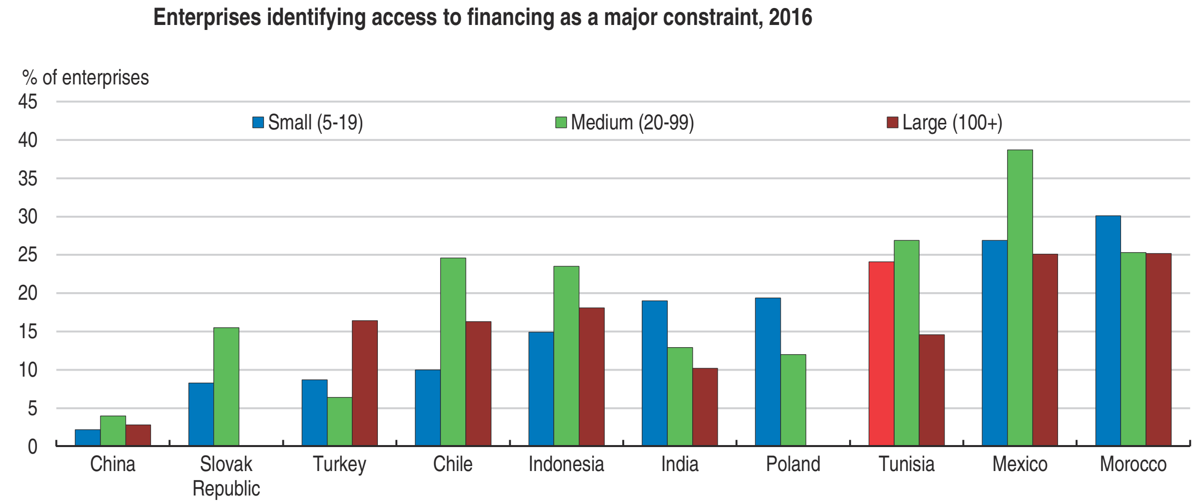
Other measures will be needed to encourage the private sector to contribute to infrastructure. For example, the government objective of raising the share of renewable energy from 12% to 30% of power production in 2030 is ambitious but achievable with private sector participation. Yet increasing private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

Removing constraints on the financing of investment

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

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

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

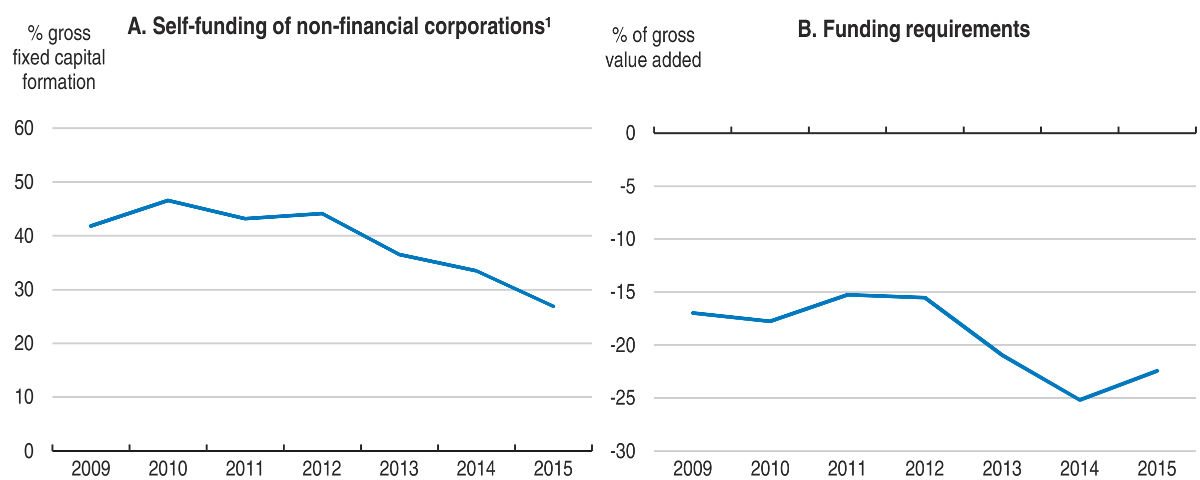


Source: World Bank Enterprise Survey.

StatLink http://dx.doi.org/10.1787/888933693681

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

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



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

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

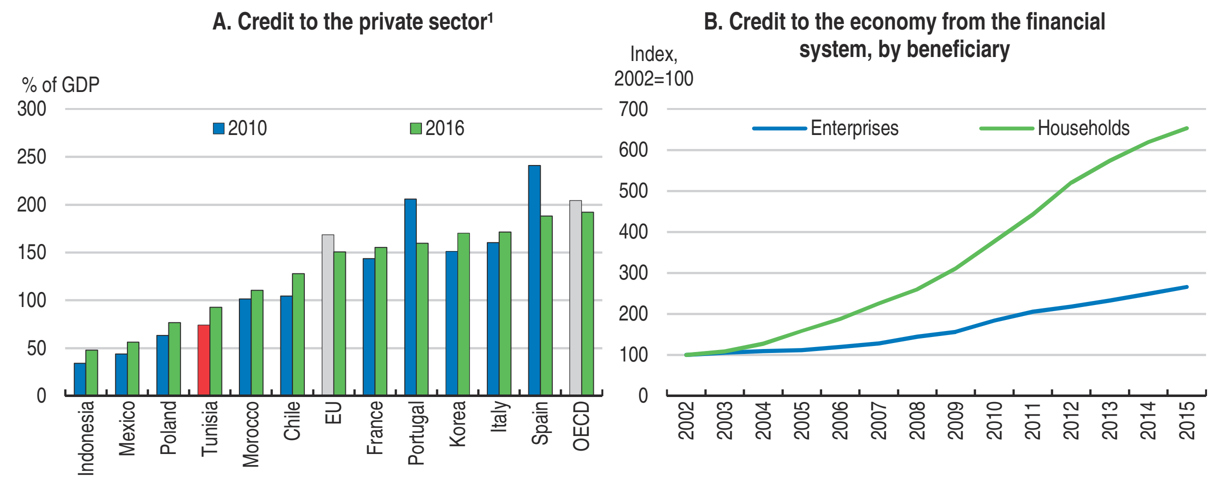
StatLink http://dx.doi.org/10.1787/888933693700

Resolving the shortcomings in banking intermediation

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

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

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

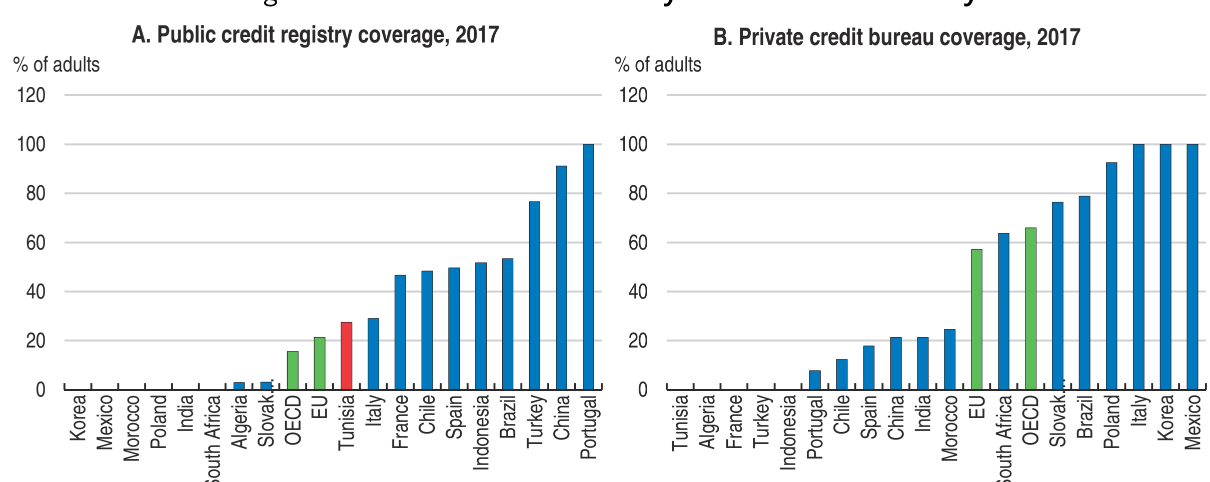


1. The lending rate is equal to domestic credit granted by the financial system as a percentage of GDP.
Source: Central Bank of Tunisia; World Bank, World Development Indicators (WDI).

StatLink http://dx.doi.org/10.1787/888933693719

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

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



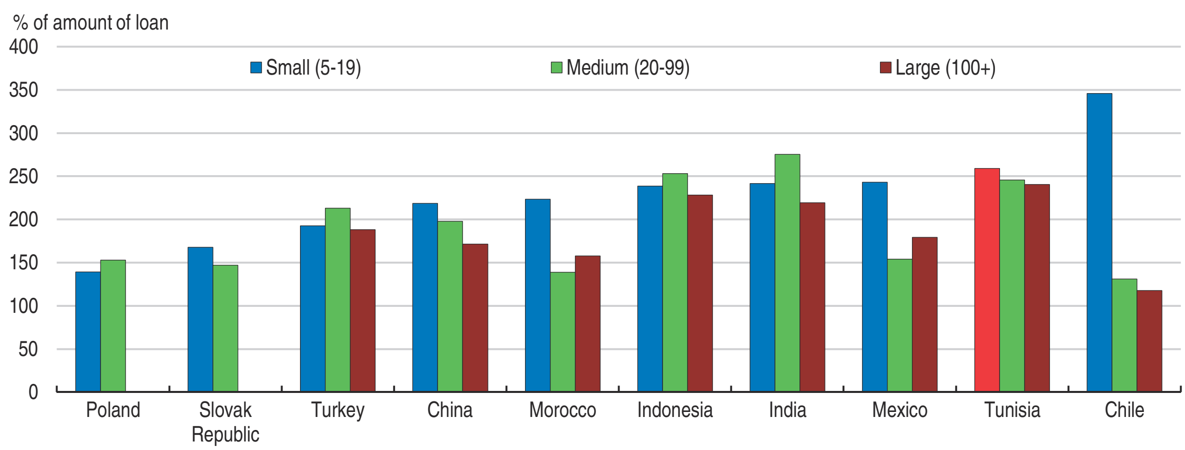
Source: World Bank, Doing Business 2017.

StatLink http://dx.doi.org/10.1787/888933693738

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

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

Average value of collateral demanded for a loan



Source: World Bank Enterprise Survey.

StatLink http://dx.doi.org/10.1787/888933693757

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

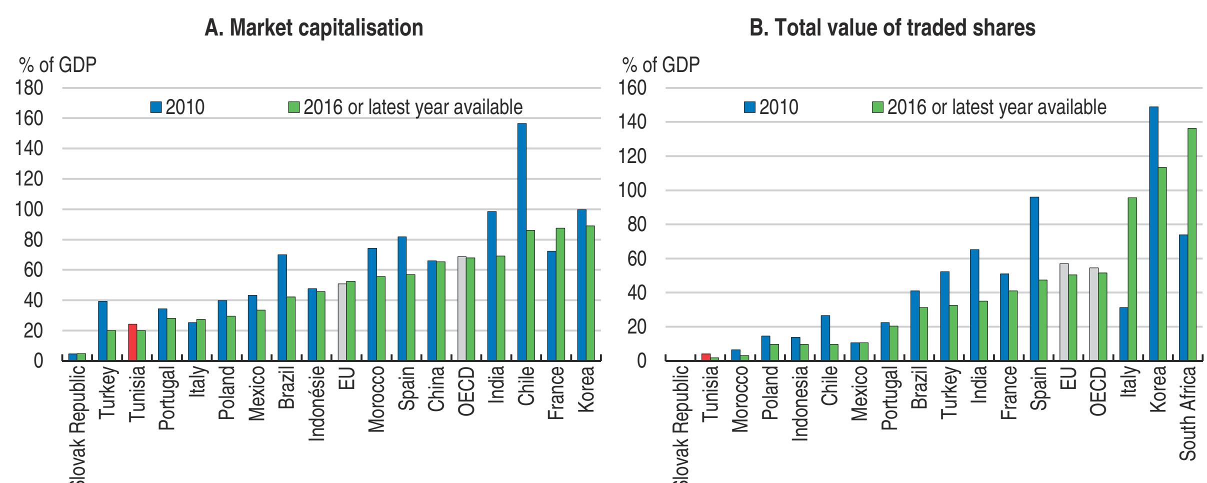
The reforms undertaken should be implemented promptly in order to improve bank financing for enterprises. Application of the new Bankruptcy Law ("law on collective procedures"), adopted by Parliament in 2016, would serve to modernise, simplify and speed the process of amicable settlement or judicial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

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

Revitalising the financial market

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

Figure 1.24. **Stock market performance**



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

StatLink http://dx.doi.org/10.1787/888933693776

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

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

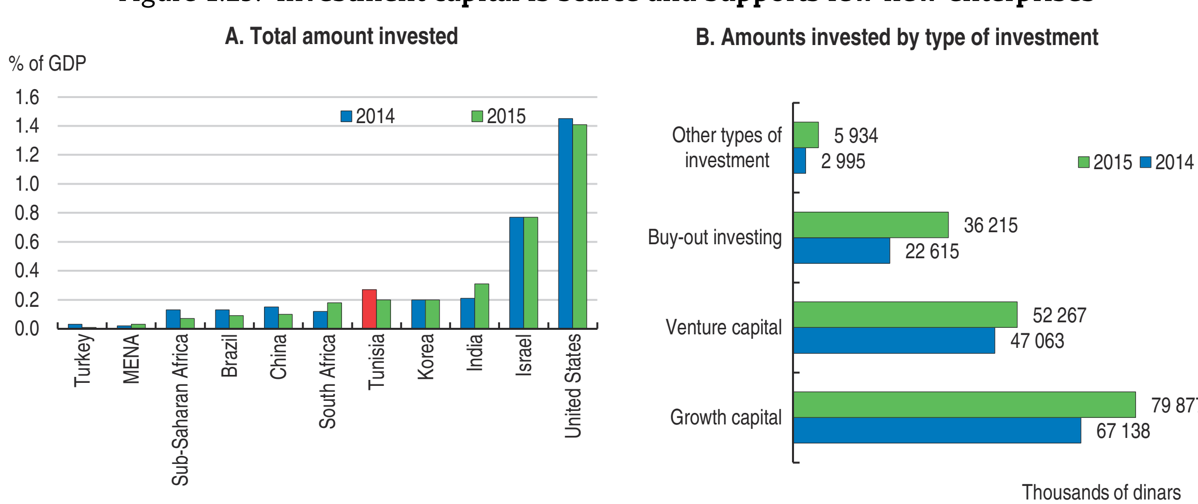
Expanding the supply of securities would seem crucial for development of the financial market. Stock market flotations of certain confiscated enterprises and public enterprises in key industrial sectors could be a first step in this direction, in anticipation of longer-term options for expanding the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

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

Developing investment capital

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

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



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

StatLink http://dx.doi.org/10.1787/888933693795

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

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

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

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

Main recommendations

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

Other recommendations

Improve the efficiency of public measures in favour of housing

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

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

Improve the business climate

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

Improve the quality of infrastructure

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

Remove restrictions on investment financing

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

Bibliography

Adalet McGowan, M., D. Andrews and V. Millot (2017), “The Walking Dead? Zombie Firms and Productivity Performance in OECD Countries”, *OECD Economics Department Working Papers* No. 1372.

AHK (2017), “Les entreprises allemandes en Tunisie : situation et perspectives 2016/17”, *http://tunesien.ahk.de/fileadmin/ahk_tunesien/04_PR_Service/Umfrage_L_P/Enquete_AHK_2016-2017.pdf*.

APII (2017), “Les problématiques de création et de pérennisation des entreprises en Tunisie”, June 2017.

BVMT (2017), Annual report 2016.

Dhaoui, S. (2016), “Les déterminants de l’investissement privé”, *Notes et analyses de l’ITCEQ* No. 37.

Dhaoui, S. and I. Samoud (2016), “Investissement direct étranger et transfert de technologie”, *Notes et Analyses de l’ITCEQ* No. 35, *www.itceq.tn/upload/files/notes2016/investissementDE-transfert-technologie.pdf*.

Haddar, M. and M. Bouzaiene (2017), "Ancrage de la justice fiscale et mobilisation des ressources", *www.asectu.org/Documents/PDF/JF_Rapport.pdf*.

IACE (2016), *Évaluation des politiques publiques*.

ITCEQ (2012), "Climat des affaires et compétitivité des entreprises".

ITCEQ (2017), Tribune de l'ITCEQ, No. 21.

ITES (2009), *Problématique de l'eau dans le monde, dans la région méditerranée et en Tunisie*.

ITES (2011), *Eau 2050 en Tunisie*.

Kamoun, M. (2017), "L'immobilier en Tunisie : un secteur en souffrance", *Kapitalis*, February 2017, *http://kapitalis.com/tunisie/2017/02/13/limmobilier-en-tunisie-un-secteur-en-souffrance/*.

Larbi, H. and A. Marrakchi (2016), "La productivité en Tunisie : Évolution, participation à la croissance, comparaisons", Mimeo.

Marouani, M.A. and R. Mouelhi (2016), "Contribution of Structural Change to Productivity Growth: Evidence from Tunisia", *Journal of African Economies*, 2016, Vol. 25, No. 1, 110-132.

Ministère de l'équipement, de l'habitat et de l'aménagement du territoire (2015), "Vers une nouvelle stratégie de l'habitat en Tunisie", *www.mehat.gov.tn/fileadmin/user1/doc/Contenus/FR/ProjetStrategieHabitatTunisie15092015.pdf*.

Nestpick (2017), "Startup Cities Index", *www.nestpick.com/best-cities-for-startup-employees/*.

OECD (2017a), *OECD Economic Survey of India*.

OECD (2017b), *Promouvoir l'investissement dans la chaine logistique en Tunisie : le rôle des politiques publiques*.

OECD (2016), *Opérationnaliser les partenariats public-privé en Tunisie*.

OECD (2015a), "La Tunisie dans les chaînes de valeur mondiales", December 2015.

OECD (2015), "Policy Framework for Investment", *www.oecd-ilibrary.org/docserver/download/2014041e.pdf?expires=1499180294&id=id&accname=guest&checksum=8873D3D3E6B9EEAC5C0B18527B231D29*.

OECD (2014), "Water Governance in Tunisia – Overcoming the Challenges to Private Sector Participation", *OECD Studies on Water.*

OECD (2013), "Policy framework for investment user's toolkit", Chapter 5 on taxation.

OECD (2012), *OECD Investment Policy Reviews: Tunisia 2012*, *www.oecd-ilibrary.org/docserver/download/2012062e.pdf*.

OECD (2011), "Housing and the Economy: Policies for renovation", *Economic Policy Reforms: Going for Growth 2011*.

Rao, K.R., S. Tandon and S. Mukherjee (2016), "Corporate Tax: A brief assessment of some exemptions", *NIPFP Working Paper* No. 165.

Samoud, I. (2017), "Chaines des valeur et intégration de la Tunisie dans l'économie mondiale", *Notes et analyses de l'Institut Tunisien de la Compétitivité et des Etudes Quantitatives (ITCEQ)*, No. 50. *www.itceq.tn/upload/files/notes2017/chaine-des-valeurs-et-integration-de-la-tunisie.pdf* .

Whitehead, C. and P. Williams (2017), "Changes in the regulation and control of mortgage markets and access to owner-occupation among younger households", *OECD Social, Employment and Migration Working Papers,* No. 196, OECD Publishing, Paris.

World Bank (2014), "Investment Climate Assessment: Enterprises' Perception in Post Post-Revolution Tunisia", *https://openknowledge.worldbank.org/bitstream/handle/10986/19323/890380ESW0P1280385264B00PUBLIC00ACS.pdf?sequence=1*.

World Bank (2014), *Doing Business in Tunisia*, *www.doingbusiness.org/data/exploreeconomies/tunisia/~/media/giawb/doing%20business/documents/profiles/country/TUN.pdf?ver=2*.

World Bank (2017), *Beyond Scarcity: Water Security in the Middle East and North Africa*.

World Economic Forum (2017), *The Travel & Tourism Competitiveness Report 2017 – Paving the way for a more sustainable and inclusive future*, *www3.weforum.org/docs/WEF_TTCR_2017_web_0401.pdf*.

Zribi, Y., S. Dhaoui and N. Faydi (2016), "Investissement privé en Tunisie : bilan et perspectives", *ITCEQ Study* No. 3/2016, *www.itceq.tn/upload/files/etudes/investissement-prive.pdf*.

Chapter 2

Toward more inclusive growth: reducing inequalities through quality job creation

The average standard of living of the Tunisians has been steadily increasing for several decades, while poverty and inequality have been greatly reduced by the implementation of many social programs. Access to basic infrastructure such as drinking water or electricity has also been developed. However, the employment rate remains low, especially for women; about a third of young people are unemployed and informal work is widespread. There is an urgent need to promote training that meet the employers' needs and to encourage women employment. The reduction of social security contributions on salaried employment will allow the creation of quality jobs. The implementation of the financial inclusion strategy will facilitate access to finance. Regional disparities in terms of unemployment and standard of living between coastal and inland regions are important. A new regional development policy, emphasising the specific assets of each region around the development of urban centers, is needed. The 2014 Constitution, which provides for increased autonomy and power of local authorities, represents an opportunity to achieve this goal.

Introduction and main findings

Tunisians have seen a steady rise in their average standard of living for several decades now, together with a sharp decline in poverty. Since independence, Tunisia has developed the welfare state through a social policy that offers universal and free access to education and health, special services for needy families, and low prices for basic food products thanks to subsidies paid directly to producers or indirectly to consumers. Access to basic infrastructure such as drinking water or electricity has also progressed. The prices of basic public services are subsidised. With the adoption in 1956 of the Personal Status Code, Tunisia has recognised the principle of gender equality on the socioeconomic, cultural and political fronts.

Nevertheless, despite all these efforts and the level of growth seen in the 1990s and 2000s, the employment rate remains low, especially for women. Around a third of the youth population is unemployed, and workers – around 30% of whom work in the informal sector – face insecure working conditions. Achieving quality job creation and participation by a bigger majority of Tunisians in the workforce should be made priorities in order to provide the opportunity for the population as a whole to contribute to the development of the country and to improve their living conditions.

Rising living standards have not been enough to ensure fair and balanced development across regions or between men and women. Income inequality in Tunisia, as in OECD countries and emerging economies, derives in part from a dysfunctional labour market (Hoeller et al., 2012). A strong, growing economy will be necessary but not sufficient to create quality jobs. Consequently, the Tunisian authorities will have to implement a set of coherent socio-economic policies to address the labour market but also the quality of education, product market regulation, the business climate, and the tax system.

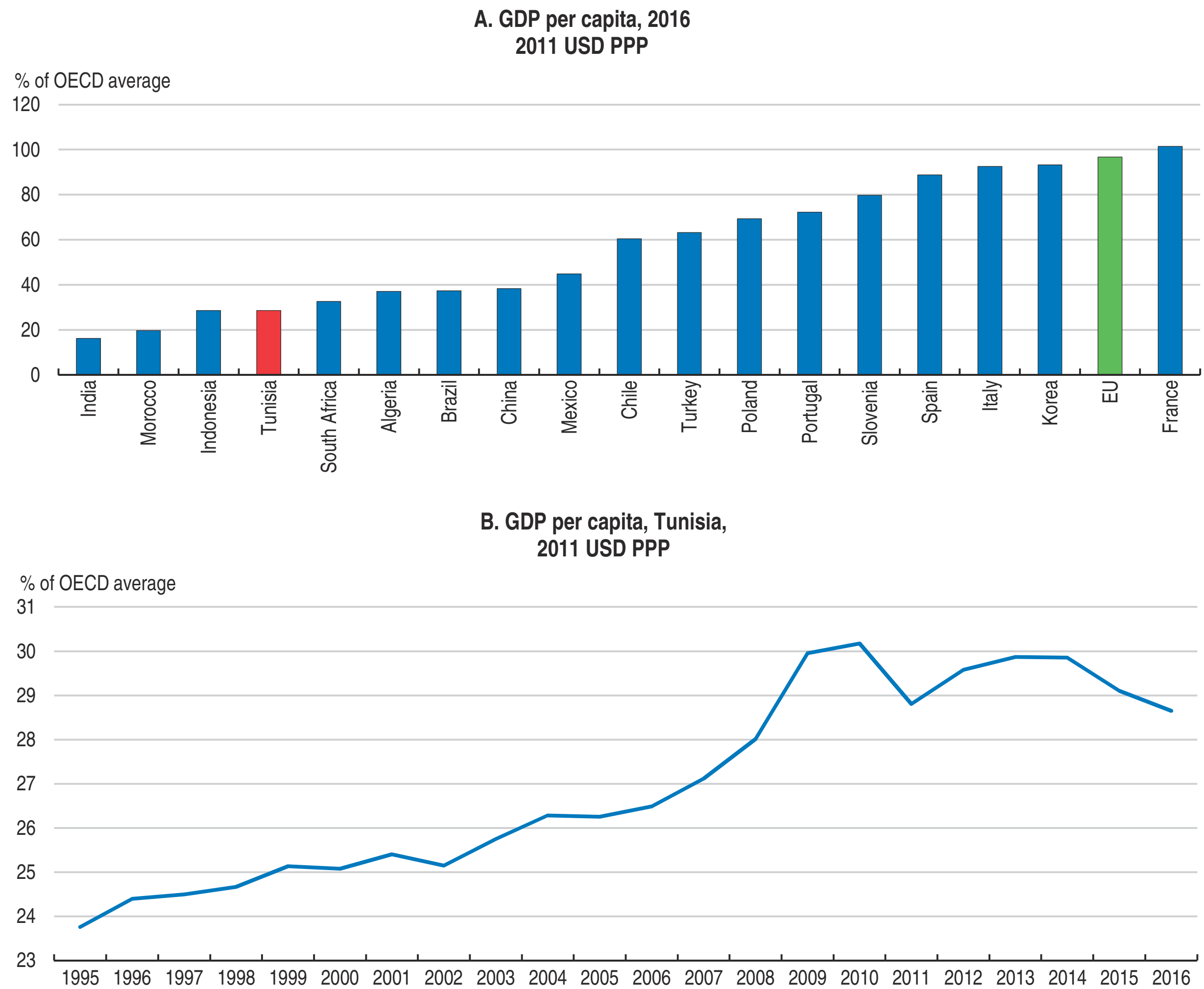
Job creation is particularly weak in certain regions. There are significant regional disparities in terms of unemployment and living standards between the coastal areas and the interior of the country (North-West, Centre and South-West). The coastal regions have slightly better access to public services such as health, education and drinking water. Moreover, the majority of industries and services are located in these regions, which are more urbanised and offer better conditions for private investment such as infrastructure and market proximity. Regional development policy needs to be rethought, drawing on the assets of each region in order to integrate them into the national value chain while ensuring effective co-ordination between the State and local governments. The 2014 Constitution, which provides for both increased autonomy and competences in regional government, and deep-seated change in the relationship between central and local government, represents an opportunity for Tunisia to meet this objective.

Promoting quality job creation

GDP per capita has risen while poverty has diminished

Tunisia has enjoyed sustained growth for several decades, and this has served to reduce poverty. GDP per capita rose from 24% of the OECD average in 1995 to 30% in 2015, an improvement that is comparable to Morocco but much weaker than in Asian countries. The impact on living standards of the January 2011 revolution was such that Tunisia was unable to benefit from the slowdown in OECD countries due to the financial crisis and thereby accelerate its convergence. GDP per capita remains well below that of OECD countries and of many emerging countries (Figure 2.1). It should be noted that this gap can be explained by differences in productivity and in the employment rate. Tunisia's productivity level is relatively high in comparison to other emerging countries, but has fallen rapidly since 2011. On the other hand, the employment rate is much weaker than that of OECD countries and emerging economies.

Figure 2.1. **GDP per capita has risen but still falls short of OECD countries**

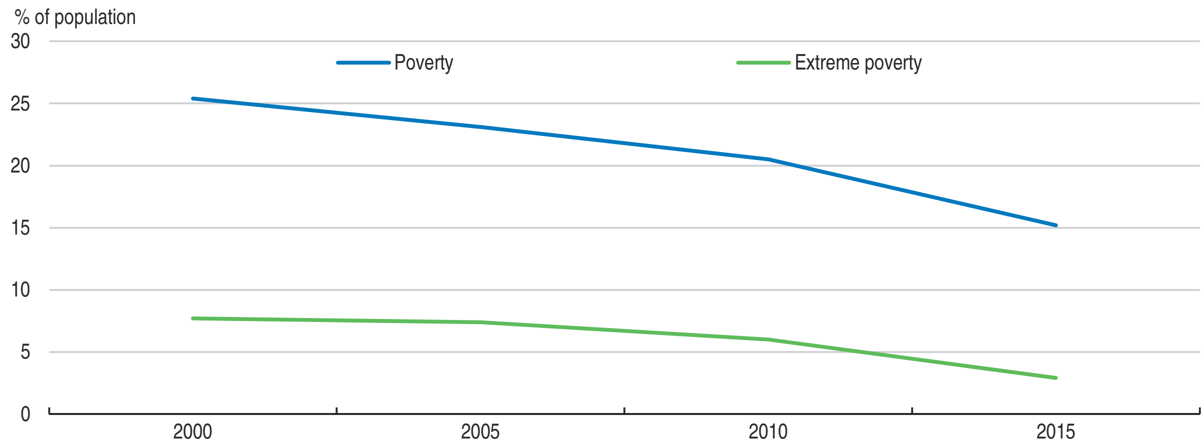


Source: World Bank, World Development Indicators (WDI).

StatLink http://dx.doi.org/10.1787/888933693814

The decline in the poverty rate (measured as the percentage of persons earning less than TND 1 706 or USD 712 a year, with the extreme poverty line set at TND 1 032 or USD 431 a year, a national poverty line based on calorie intake requirements) has been particularly significant, dropping in just 15 years from 25% of the total population in 2000 to 15% in 2015. The extreme poverty rate has followed the same trend (Figure 2.2). The fall has been

Figure 2.2. **The poverty rate has declined**



Note: The poverty rate is measured as the percentage of persons earning less than TND 1 706 or USD 712 a year in 2015, with the extreme poverty line set at TND 1 032 or USD 431 a year.
Source: INS.

StatLink http://dx.doi.org/10.1787/888933692902

particularly impressive in comparison with countries in the MENA region. The ratio of individuals living on less than USD 5.50 a day fell by 28 percentage points in Tunisia between 1995 and 2010 compared to a 16.5 percentage point decline across the MENA region as a whole over the same period (WB, WDI database). Numerous social programmes implemented since the 1970s have helped to reduce poverty. Moreover, generous energy subsidies, efforts to develop rural infrastructure (roads, water and electricity access, irrigated perimeters etc.), steep increases in the minimum wage, investment in education and microcredit programmes have all been targeted at the poorest population. Thus, economic growth has benefited most Tunisian households, including the poorest ones, who have seen their consumption rise at a pace faster than that of the wealthier segments (World Bank, 2016), thereby reducing consumption inequality.

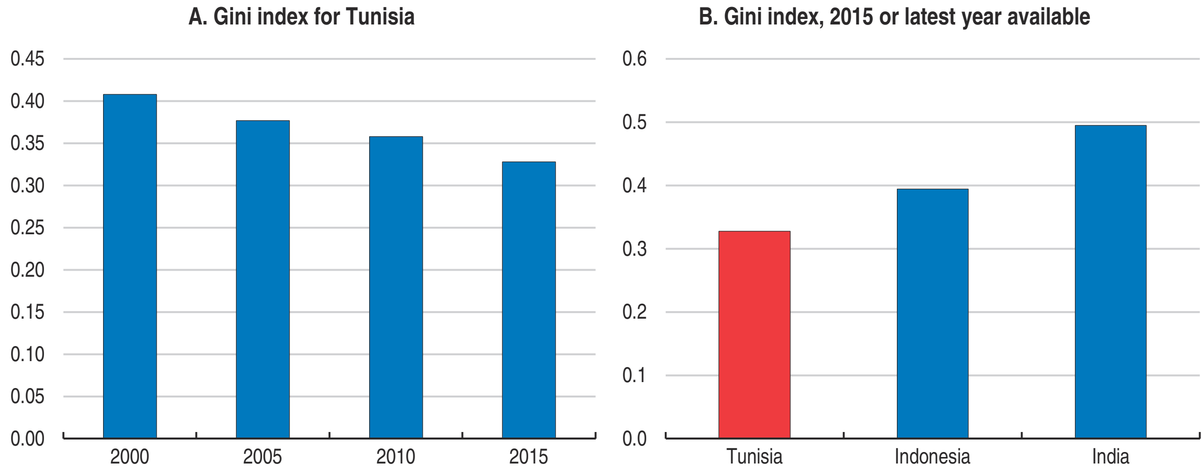
Income inequalities have diminished but still persist

Since independence in 1956, Tunisia has made the issue of inequality the centrepiece of its development model. Adoption of the Personal Status Code, the introduction of social protection mechanisms including the pension and health systems and direct support to low-income households, and the goal of education for all, and especially for women, are examples of this approach.

This avowed determination of the authorities, associated with strong growth until 2010, has indeed reduced inequalities (as measured by the Gini index based on consumption) (Figure 2.3). Yet this improvement at the national level is not so obvious at the regional level, where there are still glaring disparities of development and income between regions. In fact, although inequalities (calculated on the basis of household consumption) within regions have declined, inequalities between regions have been increasing, although to a lesser extent more recently (INS, 2012 and Amara and Jemmali, 2017). In addition, Tunisia faces disparities between men and women, and between young people and older persons (see below).

As the Gini Index is calculated on the basis of consumption and not income, it is impossible to determine the extent to which the tax and benefits system reduces income inequalities through redistribution. Nevertheless, in many emerging countries, for

Figure 2.3. **Living standard inequalities have diminished**



Note: The Gini index for Tunisia, India and Indonesia is calculated on a consumption basis.
Source: Ministry of Development, Investment and International Cooperation and *OECD Database on income distribution.*

StatLink http://dx.doi.org/10.1787/888933693833

example Mexico and Turkey, taxes and benefits only play a minor part in the redistribution of income.

Labour demand and supply, skills and job quality

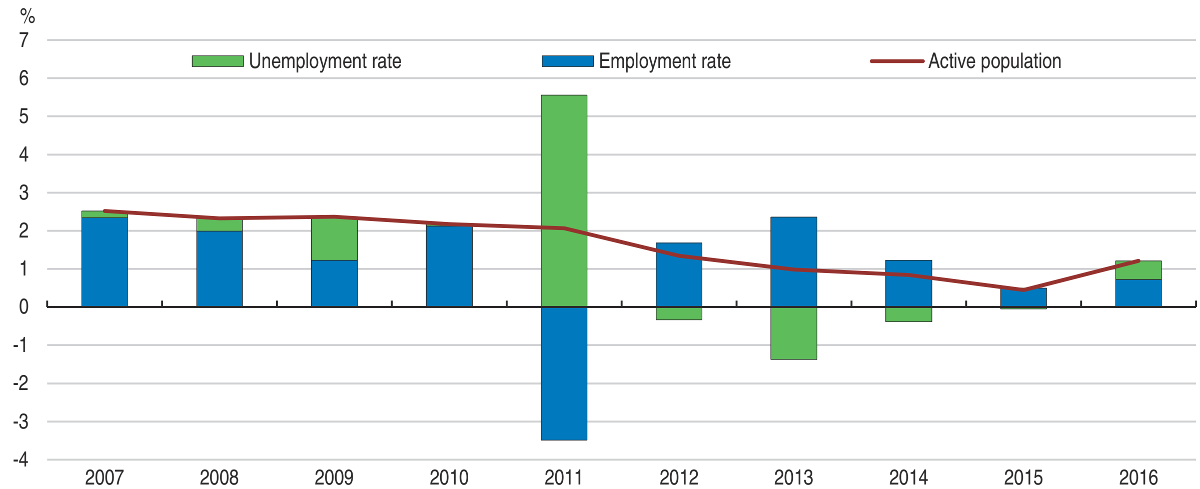
The employment rate (defined as the number of people in employment divided by the working-age population of 15 to 64 year-olds) is low, especially for women, while the unemployment rate is high: around one third of the young population is looking for a job. This section analyses trends and characteristics of the labour market and proposes solutions for making that market more dynamic and inclusive. Given the extent of the informal sector, employment quality is also a major problem in Tunisia.

Employment has risen but the labour market faces many challenges

The active population (defined as the employed plus the unemployed) has grown over the last decade, although the pace has slowed since 2011 (Figure 2.4). Public sector recruitment helped employment to recover after 2011, but the increase in the active population. The upturn observed in 2016 was largely due to an increase in employment as well as, to a large extent, an increase in the number of unemployed. For a decade now, employment has risen on average in all sectors of the economy except for agriculture (Figure 2.5). Nevertheless, on average, annually, the increase in total employment was fairly modest between 2006 and 2016, when it was around 1.2%, well below the growth of the active population, which explains the persistently high unemployment of the last decades. Job creation has been much more robust in the offshore sector, testifying to the greater dynamism of that sector (see Chapter 1). According to the National Business Registry, formal paid employment in the offshore sector represented around 30% of total formal paid employment, and had risen annually by 3% per year between 2006 and 2015, whereas employment in the onshore sector increased by only 1.1% per year.

The total employment rate (formal and informal) (defined as the employed population divided by the population of working age) of persons aged 15 to 64 years is well below that of OECD countries and of many emerging countries. In 2016, it amounted to around 45% in

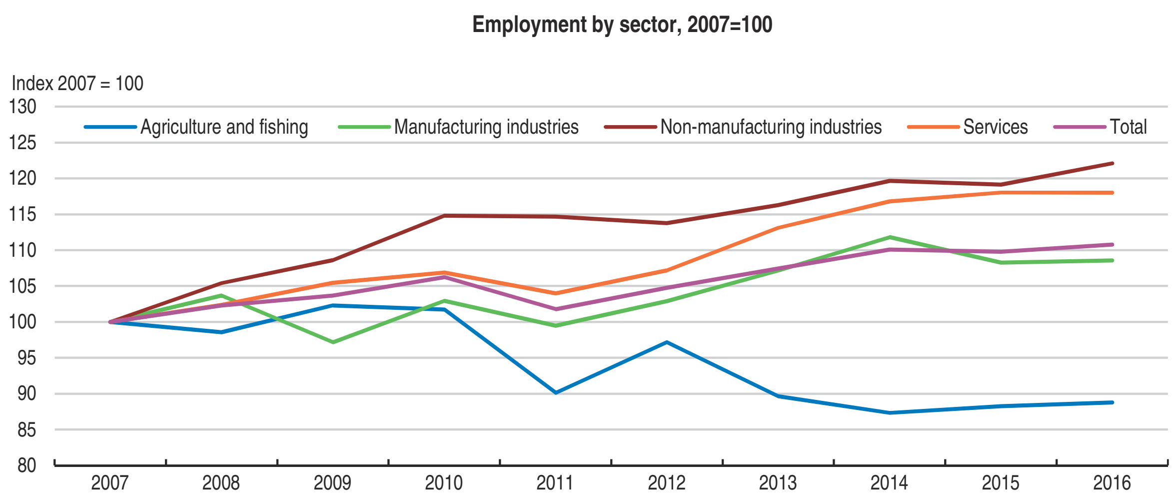
Figure 2.4. **Contribution of employment and unemployment to growth of the active population**



Source: INS.

StatLink http://dx.doi.org/10.1787/888933693852

Figure 2.5. **Breakdown of the active employed population by sector of activity**



Source: INS.

StatLink http://dx.doi.org/10.1787/888933693871

Tunisia, compared to almost 70% in OECD countries on average (Figure 2.6). This is particularly true for the female employment rate which, at around 23%, is weak, compared to an average of just over 60% on average in OECD countries. The majority of jobs created are moreover of poor quality in terms of qualifications and income. Informal employment is widespread, fixed term contracts are frequent, and working conditions are very often insecure. The situation for young people, especially young graduates, is of particular concern.

Aware of the problem, the authorities have since 2011 launched a series of active employment support programmes for youth, such as the "Amal" programme in 2011, or the more recent "Forsati" and "Dignité". In addition, a programme for "jobs of public utility" was initiated in 2011 in nearly all regions of the country. The effectiveness of these programmes is hard to judge in the absence of any systematic evaluation of their implementation. In

Figure 2.6. **The employment rate is low, especially for women**

Source: INS; and ILOSTAT.

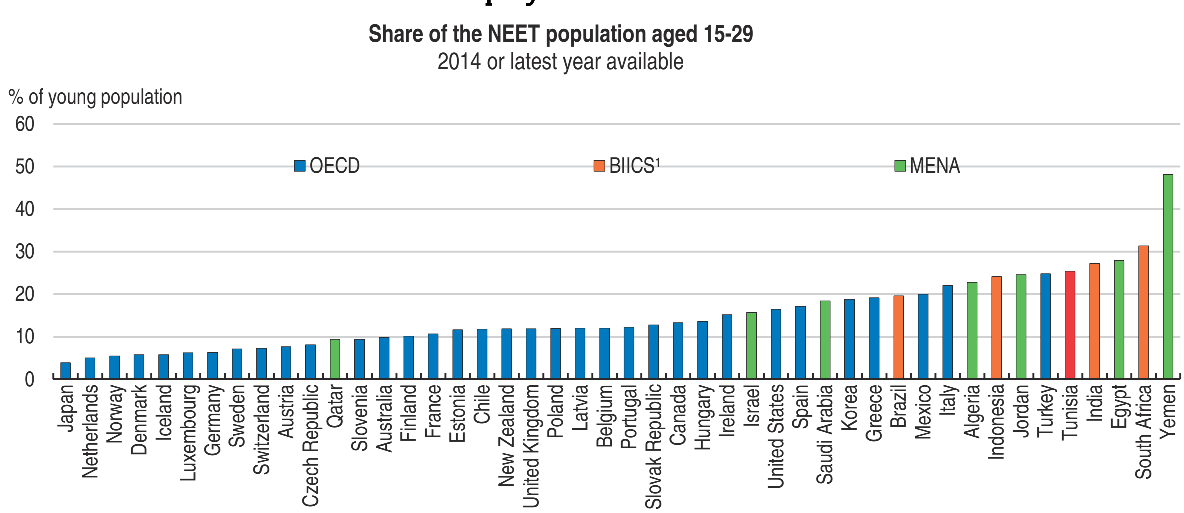
StatLink http://dx.doi.org/10.1787/888933693890

August 2017, the government launched a new national employment strategy to address the problem of unemployment and informal employment. It is supposed to be implemented within a year at most. This strategy seeks to reduce disparities between regions and between social categories and to exploit existing employment opportunities by capitalising on Tunisia's natural wealth and its human resources. The main component of this strategy is to encourage local entrepreneurship, especially among young people, who will receive technical and financial support for carrying out small scale projects. It is too soon to assess this initiative, but the priority that the authorities are giving to employment through this strategy represents an encouraging sign. The Employment Minister's announcement at the end of 2017 that a certain number of active employment support programmes were to be discontinued indicates the need to carry out systematic assessments before and during the deployment of this kind of programme, which has turned out in other countries to be very costly and rather ineffective.

One of the goals of the strategy is to strengthen the social and solidarity economy, which is a concept that refers to "enterprises and organizations, in particular cooperatives, mutual benefit societies, associations, foundations and social enterprises, which specifically produce goods, services and knowledge while pursuing economic and social aims and fostering solidarity" (UNDP, 2017). To date, this sector only represents 0.6% of employment and 1% of GDP in Tunisia. The purpose of the sector is to create added value and employment (1.5% of the active population in 2020) while ensuring social cohesion and solidarity. To this end, it requires an institutional framework and a legal framework to promote and protect it, including the set-up of sources of adequate financing, and an information system to monitor and assess it.

The unemployment rate is high, especially among young graduates. The unemployment rate is high, especially among youth, and remains one of the major problems in Tunisia. In 2016, the unemployment rate stood at 15.6% of the active population, while the average in the OECD zone was only 6.3%, rising to 11.1% in the MENA countries (World Bank WDI database). Some groups are particularly affected, notably women, youth and persons living in the interior (see below). At around 35%, the unemployment rate among youth (ages 15 to 24 years) is higher than in most OECD countries and emerging economies. As well, the number of young people who are neither in education or employment is high (Figure 2.7). It is striking to note that the unemployment rate among higher-education graduates exceeds that of persons who have only primary or secondary schooling. The unemployment rate for the former group was 30.5% in 2016: 40.4% for women and 19.4% for men (see Figure 2.8). This high unemployment rate for graduates reflects the mismatch between the supply of an increasingly qualified workforce and the demand for unskilled labour (World Bank, 2014), testifying both to the economy's inability to create enough jobs, and to the slow progress made by the structural transformation of the Tunisian economy, insofar as most economic activity is still limited to activities with low added value, which have less need for skilled labour.

Figure 2.7. **A large portion of the youth population aged15 to 29 is neither in employment or education**

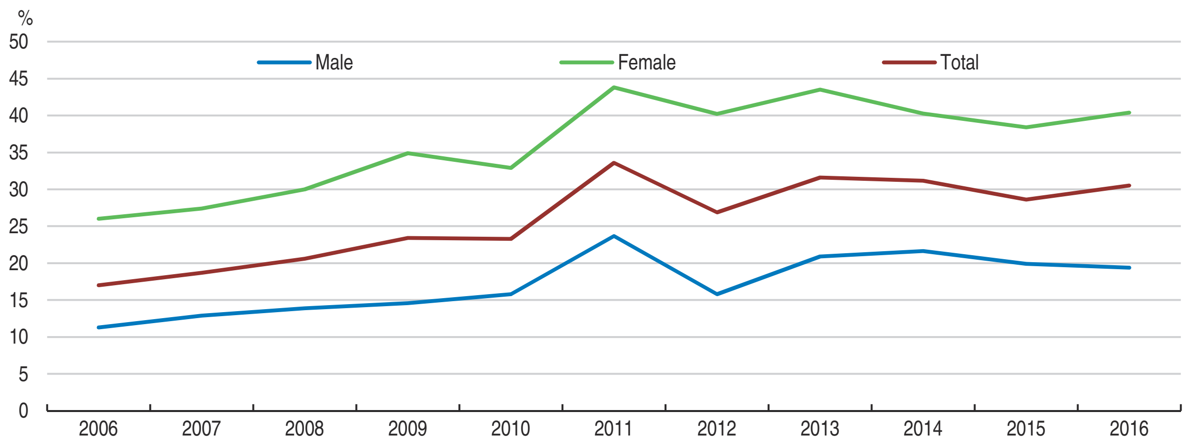


1. Data represent simple averages for the following countries: Brazil, India, Indonesia, China and South Africa.
Source: World Bank, World Development Indicators (WDI).

StatLink http://dx.doi.org/10.1787/888933693909

Figure 2.8. **The unemployment rate among higher education graduates is higher for women**

Unemployment rate of higher education graduates, by gender



Source: INS.

StatLink http://dx.doi.org/10.1787/888933693928

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

Public-sector recruitment policy also seems to have worsened the problem of unemployment among graduates. That policy gives priority to hiring the unemployed, and in particular the long-term unemployed. This represented a clear incentive to register with the employment agency and to wait for a job in the public sector, one that would offer the worker a higher salary, job security, and better social benefits (OECD, 2015b). Overemployment and the size of the public sector payroll (over 14% of GDP in 2016) now show that this policy has reached its limit. Jobs must now be created in the private sector, and future public policies should therefore focus on promoting entrepreneurship among young people and improving the business climate in order to galvanise private investment.

Unemployment among young people in general, and among young graduates in particular, reflects a combination of several factors. Modest economic performances in terms of growth and of structural transformation toward higher value-added activities, attributable to a business climate that does little to promote private investment and entrepreneurship, have failed to stimulate private investment and impeded job creation. Labour market institutions are ineffective in providing information on needed skills and qualifications, in ensuring co-ordination among training institutions and employers in order to match labour supply and demand, and in providing advice, coaching and support for young people to improve their employability and facilitate their placement. Labour legislation is relatively rigid and costly for businesses, especially when it comes to dismissals, including layoff for economic reasons. In accordance with the main lines of the Social Contract signed between the government and business and labour representatives in January 2013, a reform is to be introduced for the purpose of balancing worker protection against the viability of the economic enterprise, within the framework of the National Council for Social Dialogue, established in July 2017. A consultation process will be launched in 2018 for the creation of a tripartite fund to cover the loss of employment for workers made redundant for economic reasons.

Youth unemployment is also a result of shortcomings in the education system: the poor quality of instruction at all levels, including vocational training; a very elitist-oriented postgraduate system that select the best candidates and leaves the majority of young graduates to pursue studies in fields that offer scant employment opportunities (law, literature, history, management, economics etc.); the lack of attractive, high-quality technical education that will train technicians, who are in great demand on the labour market, instead of turning out university graduates in branches with limited vocational prospects; and the absence of a postgraduate skills upgrading system that would allow young unemployed graduates to retrain in skills and/or fields sought by the labour market; and poor guidance outside school for young people attending youth centres (OECD 2017a, OECD 2017b).

It is a paradox of the Tunisian labour market that, despite the scope of unemployment, many job openings go unfilled. A recent survey places such vacant jobs at slightly over 145 000 (IACE, 2016a). These positions are to be found most frequently in the processing industries, maintenance and commerce. This study shows that the skills of Tunisian workers are not fully adapted to the needs of businesses in many regions.

In order to create jobs for young graduates, the government undertook a series of programmes between 2006 and 2015. Just over 820 000 contracts were signed under this programme, but only 484 000 were pursued to completion, for a dropout rate of 41% (ITCEQ, 2017). Moreover, many of these contracts do not result in definitive employment when government support comes to an end, as the quality of candidates' skills does not always meet employers' expectations. An initial evaluation of these programmes in November 2017 resulted in five of them being discontinued. The government has undertaken to continue its evaluation of these programmes in order to keep only the most relevant ones.

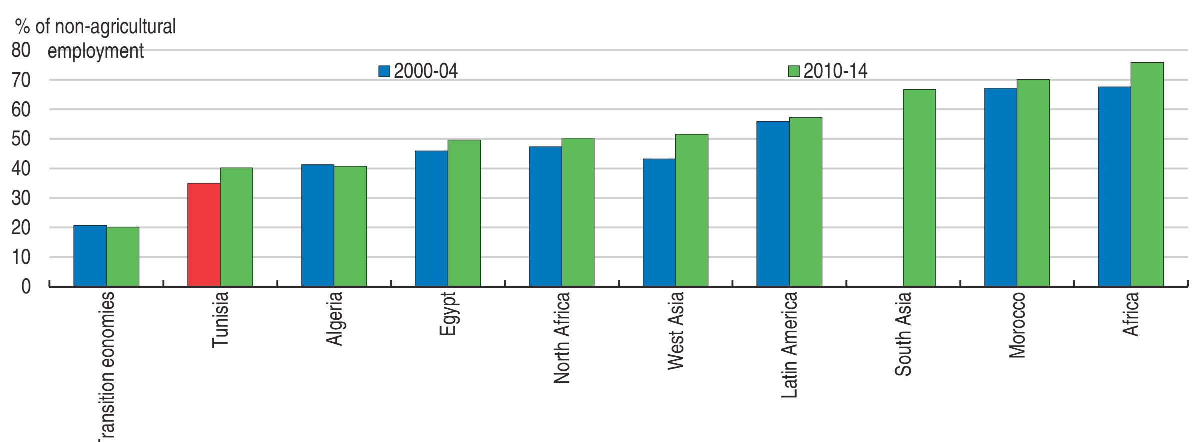
In March 2017, the "Dignity Contract" (*Contrat de dignité*) was launched for university graduates who have spent more than two years looking for their first job. The government covers employers' social security contributions and two-thirds of wage costs (wage of 600 dinars or around USD 250). This measure is intended to create 25 000 jobs in 2017, and the same number in 2018. Each *gouvernorat* (district government) is allocated 1 042 positions. As the majority of the population and businesses is concentrated in the coastal regions, the 1 042 positions allocated to these regions could prove inadequate, while in the Centre regions, businesses could have difficulty in coming up with so many positions, given their number and their size. This new programme will have to be monitored and assessed in order to maximise its impact on youth employment. Over the medium term, it could be useful to take a portion of the resources dedicated to these programmes and devote them to training to bring candidates skills into line with employer demands. Over the longer term, Tunisia will have to overhaul its education and vocational training system completely (see below).

Informal employment is widespread and many workers are on fixed term contracts. Informal employment is widespread and, depending on source and definition, could represent between 30% and 65% of total employment (World Bank, 2014; CRES, 2016; and

Joussour, 2016). Although this rate is lower than the average for Latin American or Asian countries, it is nevertheless higher than in OECD countries or countries in transition (Figure 2.9). Informal employment is defined here as persons working in small or micro-enterprises or those who do not contribute to social security. The illegal economy – smuggling, essentially – is not included: it is largely a result of distortions caused by price controls, which apply to approximately one price in three. A high rate of informality tends to generate inequalities, as persons working in this sector often receive lower wages (Dickens and Lang, 1985; Bargain and Kwenda, 2010; Daza and Gamboa, 2013) – they are not subject to the minimum wage, and they have less bargaining power because they are not covered by collective agreements – and in addition they face insecure working conditions and have little or no access to the financial system. The informal sector, moreover, generally consists of activities which typically have low added value and labour productivity and which contribute very little to the competitiveness of national economies and public finances, as they remain marginal to national and international value chains.

Figure 2.9. **Informal employment is widespread**

Employment in the informal economy as a proportion of non-agricultural employment



Note: The transition economies are Eastern Europe, Russia and Central Asia.

Source: Centre de Recherches et d'Études Sociales and African Development Bank (2016), "Protection sociale et économie Informelle en Tunisie – Défis de la transition vers l'économie formelle".

StatLink http://dx.doi.org/10.1787/888933693282

The informal economy affects women in particular, as well as unskilled workers and young people. It is estimated that, in Tunisia, 50% of young people hold informal jobs (OECD, 2015b). Lacking appropriate skills and adequate information, few workers make the move from the informal to the formal sector. For example, in a given year in Tunisia only 11% of salaried workers in the informal sector and 8% of the self-employed will migrate to the formal sector (Angel-Urdinola et al., 2015).

In the formal sector as well, there are many Tunisians working under precarious conditions as most workers are hired on fixed term contracts (FTC), given the rigidity of regulations on restrictions on terminating open-ended or permanent contracts. Under the Labour Code, an FTC is not supposed to last for more than four years, and should then be transformed into a permanent contract. Given the complexity and the cost of dismissal procedures, employers often prefer not to convert their workers to permanent employees at the end of this term, but rather to let them go and hire new ones (Angel-Urdinola et al., 2015).

While this system allows employers to adapt more swiftly to fluctuations in labour market, it is a source of insecurity for workers, who often earn lower wages, receive smaller pay increases, and must work under more difficult conditions (OECD, 2015c; Hijzen and Menyhert, 2016). Moreover, workers on fixed term contracts are not entitled to the benefits associated with redundancy for economic and technical reasons unemployment insurance or layoff allowances if their contract is terminated early. Young workers, in particular, find themselves locked into precarious jobs, diminishing their career prospects and devaluing their skills, with severe consequences both for the quality of employment and for productivity. It is estimated that 50% of young people working in the formal sector have a temporary contract, compared to an average of slightly over one-third in OECD countries (OECD, 2015b).

Implementing a set of coherent policies to stimulate employment

Increasing women's participation in the labour market. Although Tunisia is a leader among the countries of the MENA region when it comes to gender equality, the authorities face a number of challenges. Since 1956, Tunisia's Personal Status Code has enshrined the principle of women's rights and of equality between men and women on the socioeconomic, cultural and political fronts. Since that time, successive reforms have reinforced the rights and status of women, and supplementary mechanisms and measures have been adopted to give them effect. In August 2017, the President of the Republic opened debate on a proposal to introduce gender equality with respect to inheritance. Currently, women inherit only half of what men inherit. It is important to act fast to remove differences in the legal treatment of men and women.

These policies have certainly borne fruit. For example, the proportion of female parliamentarians is close to the average for OECD countries. It may be noted that women represented more than 40% of public sector employees in 2010, and held 45% of management positions in the public service, a situation comparable to the best-ranking OECD countries on this score. Moreover, the proportion of women holding managerial positions in the public and private sectors is higher than in MENA countries (14.8%), even if it is lower than in the majority of OECD countries (OECD, 2017c). Nevertheless, some important disparities in the labour market remain between men and women. The employment rate for women is one of the highest in the MENA region. Yet while the employment rate for men is slightly below the average for OECD countries (68% versus 74% in 2016 for persons between the ages of 15 and 64 years), the rate for women is much lower (23% versus 63%).

Women's education level has been rising sharply for several decades. For example, while the enrolment rate (persons enrolled at all levels as a percentage of the total population) for men rose from 51% to 61% between 1975 and 2016, that for women jumped from 32% to 71% (Daghari, 2017). Nevertheless, although the enrolment rate for women at all levels is today 10 points higher than that for men, the unemployment rate for women exceeds that for men (22% versus 12% in 2015), even if the gap between the two sexes is on the decline. Overall, women hold less-skilled jobs than men with the same level of education (Stampini and Verdier-Chouchane, 2011). This gap between male and female employment is the result of the inability of the economy to create enough jobs, the confinement of a large proportion of girls to educational pathways that are not prized by the labour market or that lead to public sector jobs at a time when the public sector is almost saturated, socio-cultural resistance, especially in the private sector, and in the provinces, women's relatively low mobility. Female entrepreneurs face many obstacles in Tunisia, the most significant being: i) cultural barriers to starting a business; ii) a lack of collateral for bank loans, since women own little property in their own right; iii) the general scarcity of women in the working population and in executive posts (OECD, 2017c5c). The introduction of a policy for the promotion of female employment should be a priority for the authorities in order to offset the continuing decline in the active population in the medium and long term caused by plunging fertility rates.

In OECD countries, policies designed to reduce gender inequalities on the labour market consist mainly of publicising the laws against discrimination, promoting wage transparency, and enforcing equal-pay laws more effectively. It is also possible to introduce temporary quotas to ensure a female presence on company boards of directors and in management positions, but a thorough analysis of the economic impact of such regulation would have to be carried out in advance (OECD, 2012). Moreover, to facilitate the balancing of family and working life, firms are encouraged to offer their employees a degree of flexibility as to the place of work and working time slots, and to allow working from home.

The supply of female labour could also be stimulated by policies targeted at early childhood. In Tunisia, as in many emerging and OECD countries, responsibility for household tasks and the care of children and the elderly falls for the most part upon women. A more equitable sharing of household tasks would improve the work-family balance for women, and for men as well (OECD, 2012a). Due to lack of resources, the number of public day care centres has declined greatly since the 1980s, although some have been rehabilitated since 2015 leaving the field to unlicensed private facilities or kindergartens. Since 2015, a number of these private facilities have been closed, and the public structures have been rehabilitated. Nevertheless, staff are poorly trained and have weak skills. There is a need to train a greater number of persons devoted to early childhood and to institute regular controls over reception facilities and services. The government is currently working to improve the nationwide provision of nursery schools and is hoping to increase coverage to 53% in 2020 from 35% in 2015, which could help to boost female employment to the target of 35% in 2020 compared to 28% in 2015.

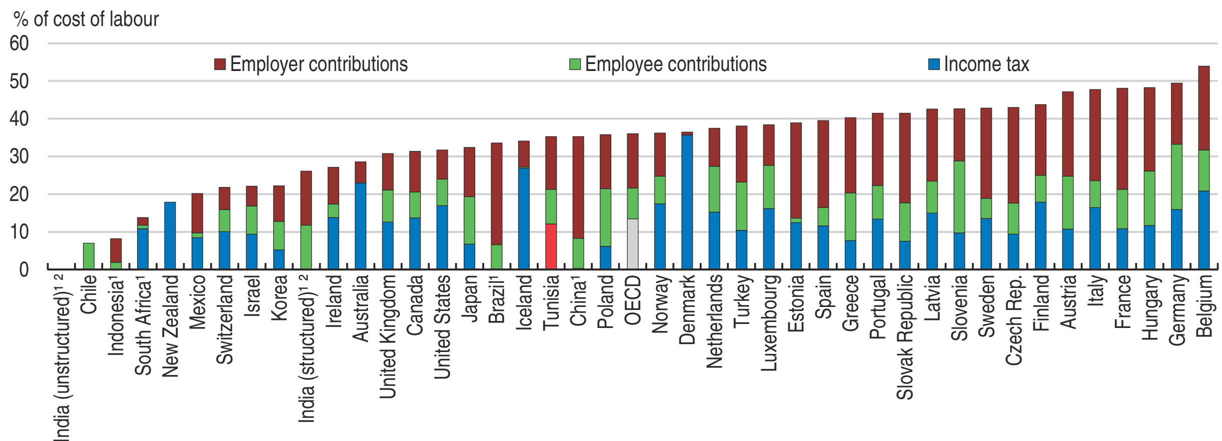
Childcare costs, which are especially high in Tunisia, should be set at levels that make it profitable for women to pursue full-time work. Affordable access to early childhood facilities would increase labour market participation by parents (Bauernschuster and Schlotter, 2015 and Thévenon, 2015). Policies geared to early childhood are also important for the well-being of children themselves, in terms of cognitive development and scholastic outcomes, socialisation, health and income, as investments at this stage translate into lifelong benefits (OECD, 2011; OECD, 2012ba). It is essential that this work is continued to ensure that the poorest households can access quality childcare at an affordable cost.

Several programmes and initiatives have been launched with the goal of driving women's social, economic and political empowerment, with a special focus on women in rural areas. Most involve encouraging women into work and to set up their own businesses, attracting more women to public office and political careers, reducing drop-out rates among girls in rural areas and fighting violence against women.

High taxes on labour keep a great many Tunisians in the informal sector. An important determinant of informal work in Tunisia is the high level of the tax wedge, i.e. the burden represented by social security contributions (both by employers and employees) and income tax. A heavy tax burden limits hiring incentives for employers and, for workers, reduces incentives to enter the formal labour market (Figure 2.10).

Figure 2.10. **Social contributions are a burden on formal employment**

Taxation of income from work, 2016



1. Data refer to 2010 for Brazil, China, India and South Africa, and to 2009 for Indonesia.
2. The non-organised sector in India corresponds to companies with fewer than 20 employees. Companies with more than 20 employees have to comply with the law on pension funds for employees and other provisions, and to this end pay social security contributions.

Source: OECD revenue statistics; and Tunisian Ministry of Finance.

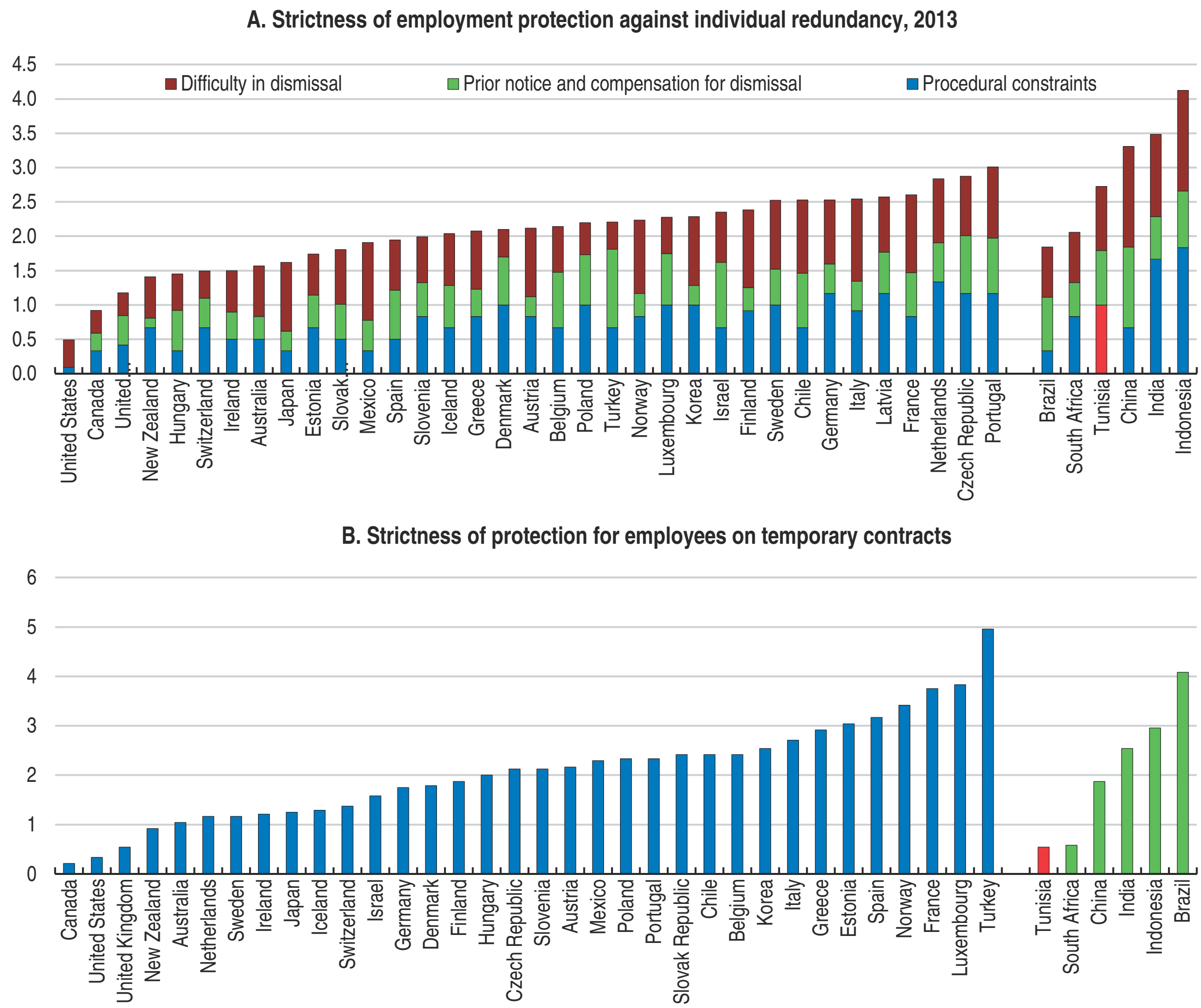
StatLink http://dx.doi.org/10.1787/888933693301

International experience suggests that cutting taxes on labour can help to create jobs in the formal sector. For example, in 2012 Colombia introduced a tax reform that eliminated or reduced certain wage-based contributions, reduced others, and it translated led into an increase in formal employment. The increase in employer and employee contributions to social security funds included in the 2018 finance law risks burdening formal employment. It would be better if certain social provisions, such as the vocational training grant or some family allowances, were to be financed from general tax revenues in order to lighten the cost of labour and thereby encourage formal employment.

Legislation on employment protection, collective bargaining and wages. Some labour market regulations and practices that also hold back the creation of stable jobs in the formal sector seem currently more difficult to reform without sparking protests that could block the reform process. While the regulations governing dismissal for the holders of permanent contracts are stricter than in many emerging and partner countries, persons under temporary contracts have little protection (Figure 2.11). This creates a dual labour market with, on one hand, groups that are protected and, on the other hand, groups that are marginalised or excluded, with scant possibilities for workers to move from one group to the other.

Wage negotiations are based on a tripartite system, comprising the State, the UGTT (the national labour union) and the UTICA (the Tunisian Union of Industry, Commerce and Crafts, the country's principal employers' association). Negotiations are conducted by branch of industry, and give rise to collective agreements in the majority of sectors in the formal economy (OECD, 2015b). Application of these agreements to non-unionised workers is automatic once the agreement is approved by the government. Since 2011, following an accord between the UGTT and the UTICA, national collective agreements have been focused solely on wages and salaries. Although the Tunisian labour code provides for collective agreements at the company level, these in fact play only a minor role (Ennaceur, 2000;

Figure 2.11. **Employment protection legislation is strict for people on open-ended contracts**



Note: OECD indicators on employment protection are synthetic indicators of the strictness of regulations on dismissals and the use of temporary contracts. For each year, the indicators relate to regulations in force as of 1 January.
Source: *OECD Employment Protection Database*, 2013 version.

StatLink http://dx.doi.org/10.1787/888933693947

Kriaa, 2012), mainly because pay and working conditions agreed in this context cannot be less favourable than those stipulated in the sector-wide collective agreements (it is prohibited to establish opposite provisions). Companies rarely take part directly in collective bargaining, therefore, and must resign themselves to applying the wages and working conditions agreed at the sector level. Some have proposed greater decentralisation in the wage bargaining process, giving priority to company-specific agreements over sector-wide agreements (Kriaa, 2012).

Since the end of the 1980s, several reforms have encouraged the decentralisation of collective bargaining in several OECD countries, meaning that more room has been given to bargaining at the level of the company, establishment and workplace. At present, collective bargaining takes place mainly at the level of the company in two-thirds of OECD Member and accession countries (OECD, 2017db). That said, there are substantial differences between countries in terms of the possibility for the agreements negotiated at the level of the company to change the conditions of employment established in agreements negotiated at a higher level. While complete centralisation may guarantee a high level of coverage and inclusion, it does not provide much flexibility and may compromise the viability of struggling businesses. At the other end of the spectrum, total decentralisation may provide considerable flexibility to employers and unions at the level of the company, but results in low coverage and even differential treatment, and so is clearly limited in terms of inclusion and social fairness. Co-ordination between sector-level and company-level bargaining, the content of sector-level agreements, and the use of extensions and exemption clauses (general and temporary), are some of the key tools on which to focus in order to ensure a proper balance between flexibility and inclusion (OECD, 2017db).

Moreover, the bargaining process in Tunisia is lengthy and many employers complain that these centralised bargaining sessions impose on them wage increases that sometimes exceed their financial capacity, especially in periods of economic downturn. This could encourage them to mechanise or automate their production processes in order to reduce their reliance on labour. Wages increases are linked to inflation and purchasing power, not productivity. Employers would like to see a clearer link between wage increases and productivity. It should be noted that since 2010 real wages have outstripped productivity growth, especially in government, the hydrocarbons sector, construction and productive services (Ben Chaâben, 2017). There is, therefore, a plan to implement a strategy which proposes to improve purchasing power and increase productivity, by defining criteria that would tie salary increases to productivity improvements.

The level of wage and salary increases in the public sector has generated disruptions on the labour market. In fact, the gap between the pay and advantages offered in the public sector and those in the private sector leads to higher minimum pay demands and a plethora of candidates for positions in the public sector. It is becoming more difficult, then, to hire persons in the private sector at the going wage (OECD, 2015b). Tunisia needs to review its incomes policy to avoid distortions between the public and private sectors, to eliminate current biases in favour of employment in the public sector, which is already overstaffed, to encourage job creation and to boost productivity through more direct linkages between wage increases, productivity, and company size.

In comparison to OECD countries, the minimum wage does not seem particularly high in Tunisia, in relation to the average wage. Moreover, Tunisia has introduced a minimum wage for youth under the age of 18, equivalent to 85% of the minimum wage for adults. Introduction of a lower minimum wage for young people is a practice that is fairly widespread in OECD countries. Around half of those countries have a reduced minimum wage for youth that represents, on average, 72% of the minimum wage for adults. This reflects the difference in productivity vis-à-vis more experienced workers. These trimmed minimum wages seek to offset the negative impact that a minimum wage can have on youth employment. Tunisia could consider extending this reduced minimum wage to young people up to the age of 20 or 22, and cutting it slightly to encourage the employment of young people, who are the most severely impacted by unemployment and marginalisation.

Active labour market policies. Active labour market policies (ALMP) have not managed to place many workers, even in those sectors that have created jobs (World Bank, 2015a). On average between 2013 and 2015, Tunisia spent 0.8% of its GDP on ALMP and the public employment service, an amount slightly higher than the OECD average of 0.5%. These labour market policies are often ill-conceived, and few prior studies are performed to examine their pertinence and the modalities for implementing them. Moreover, few programmes are targeted at the unskilled. The unemployed First-time jobseekers benefit only from low social coverage (medical care for a limited time only), and this worsens inequalities even further. From 2018, the unemployed will enjoy free healthcare in public health establishments. Existing ALMPs should be subject to in-depth assessments to analyse the quality of their design and implementation, as well as their effectiveness in achieving the objectives selected in terms of the number and quality of jobs. Non-performing programmes should be discontinued and only replaced by those that are better designed and learn the lessons of earlier programmes. Some of the resources allotted to ALMPs would be better spent on high-quality training programmes targeted at the specialisations and qualifications employers are looking for. A report on the evaluation of ALMPs is currently being finalised as part of the preparatory work for the national employment strategy in collaboration with the ILO.

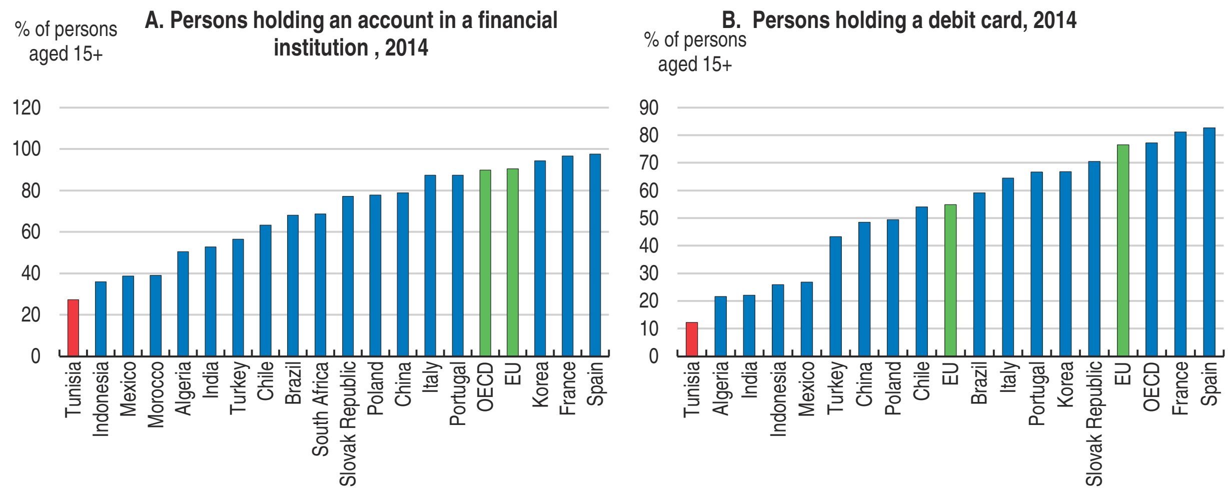
Simplifying the business climate. As in most countries of the MENA region, business dynamics (entry and exit) have remained weak in Tunisia, suggesting that there has been little reallocation of resources (Rijkers et al., 2014, Shiffbauer et al., 2015). There are several reasons behind the low rate of business creation, and hence of job creation, and the failure of business to flourish. Although Tunisia ranks ahead of many emerging countries regarding its business climate, several dimensions could be improved (World Bank, 2017). In particular, financing problems and red tape are often cited as the major constraints on the business environment (World Economic Forum and World Bank, *Doing Business*). Preliminary work at the OECD on product markets shows that barriers to entrepreneurship are high in Tunisia, particularly with respect to the permits and licenses needed to create a business (see Chapter 1).

The authorities are planning to establish a statute for entrepreneurs and to simplify the creation of start-ups. To this end, a platform with a one-stop window has been created. For the time being this platform handles only the creation of a business, and does not provide the authorisation to exercise it. Simplifying the procedures for creating a business, and introducing permanent, high-quality technical assistance for project initiators (market studies, business plan preparation, assistance in mobilising financing, commercial support, access to public procurement, etc.), would do much to encourage entrepreneurship and to enhance the probability of success for start-ups, thereby contributing to the creation of wealth and jobs.

A strategy for financial inclusion is needed. Universal access to efficient financing services can stimulate growth and employment and help to reduce inequalities. According to the World Bank, the offer of inclusive financial services in Tunisia is fragmented, incomplete and inaccessible (World Bank, 2015ba). Only 27% of Tunisians have an account in a financial institution (22% in rural areas) and fewer than 7% have a credit card, a rate that is low in comparison with emerging countries and OECD members (Figure 2.12). Overall, it is estimated that 64% of individuals in Tunisia are excluded or poorly served by the formal financial sector, meaning that the financial inclusion rate is only 36% (World Bank and CAWTAR, 2015).

Many businesses identify access to credit as one of the major obstacles to their development (World Bank, Enterprises Survey). In its *Ease of Doing Business* report, the World Bank ranks Tunisia near the average of MENA countries, but far behind OECD countries, in terms of access to credit. For businesses, access to financing allows them to sustain investment, production and hence employment (World Bank, 2015ba). Between

Figure 2.12. **Financial inclusion is still weak**



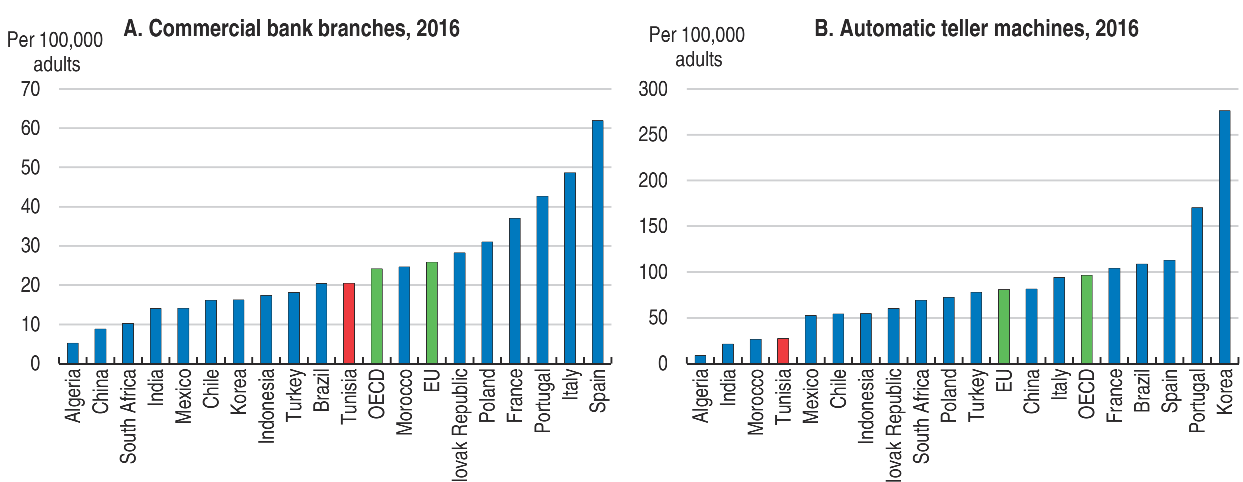
Source: World Bank, Global Financial Inclusion database.

StatLink http://dx.doi.org/10.1787/888933693966

245 000 and 425 000 formal micro and small businesses are estimated to be in need of financial services in Tunisia (World Bank, 2015ba).

Financial services are at a rudimentary stage of development (Figure 2.13) and they are concentrated geographically in the coastal areas, although the presence of the post office across the country allows rural people and those in isolated areas to have some access to basic financial services. The post office plays an important role in fostering financial inclusion, but it does not yet offer micro-savings or readily usable means of payment. Moreover, with a quarter of its agencies not yet connected to the central server, with relatively restrictive opening hours for its agencies, and with minimum deposit requirements, the post office is probably not in a position to respond fully to the needs of businesses (World Bank, 2015b). The services offered by the banks are not suited to micro and small enterprises or to low-income people, as the fees for keeping an account and the

Figure 2.13. **Banking services could be further developed**



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

StatLink http://dx.doi.org/10.1787/888933693985

collateral demanded for loans are high. Individuals who have no access to formal financing must turn to informal sources that are often risky and costly.

One important way of removing obstacles to demand for financial services would be to develop financial education (Atkinson and Messy, 2013). Financial knowledge can be improved through awareness campaigns or individual or collective training sessions (Deb and Kubzansky, 2012).

The authorities have launched a strategy for financial inclusion to be implemented over the period from 2018 to 2022, which that aims, among other things, at to developing digital finance, micro-insurance, the social and solidarity economy and financial education. In 2011, a new law regulated the activity of micro-finance institutions, and allowed a new legal form to be introduced for microfinance institutions in addition to the creation of a new regulatory watchdog for the sector. The range of financial services available remains limited, however, and neither microsavings nor microinsurance are on offer. In 2016, the Observatory of Financial Inclusion was set up within the Central Bank, with the chief aim of evaluating and tracking the development of access to financial services. Many emerging countries have implemented measures to enhance financial inclusion, and Tunisia could benefit from their example: Brazil, Colombia and India, for instance, have promoted financial inclusion by opening bank accounts for all, and paying social benefits into those accounts.

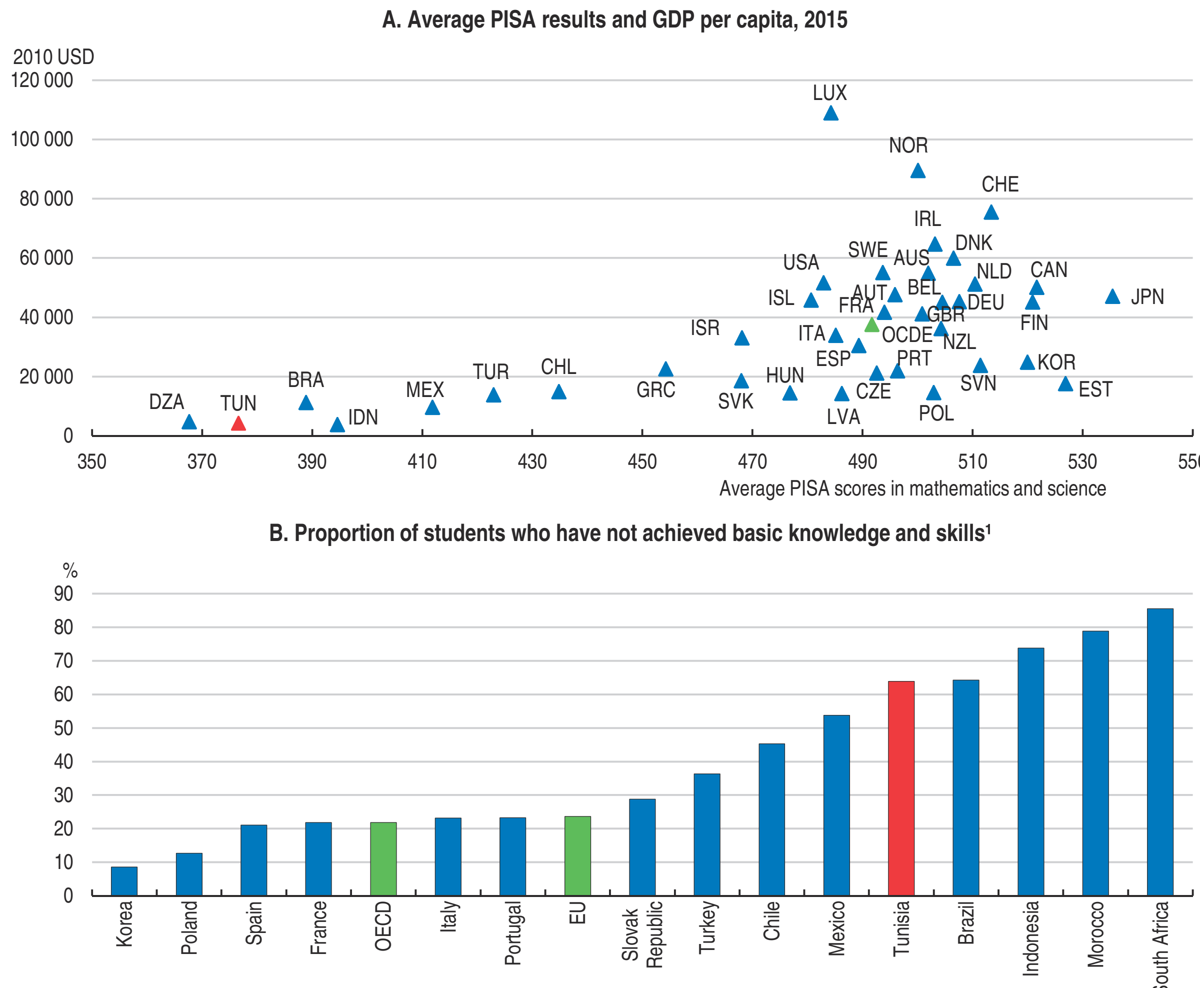
A survey of financial inclusion was launched in late 2017 and was designed to determine the level of financial inclusion on the basis of indicators. The exercise will be repeated in the future by the Observatory of Financial Inclusion in collaboration with the INS. The bill concerning the promotion of start-ups was approved by the Council of Ministers at the end of 2017. It provides for the simplification of administrative procedures, facilitates access to financing, encourages entrepreneurship and creates the right conditions for start-ups to enter the global market.

Promoting the quality of education to improve workers' employability. Human capital development is the very basis of inclusive growth. In Tunisia, policies implemented over many years have resulted in nearly universal enrolment for boys and girls, and improved performances at the different levels of education, including higher education. Compulsory and free schooling between 6 and 16 years has led to nearly universal enrolment (Daghari, 2017): 100% for primary school, and 81.3% for secondary. The number of students pursuing higher education has tripled over the last 20 years (World Bank, World Development Indicators database). The number of graduates from higher education doubled over the same period.

There seems to be a problem with the quality of education and the fact that the skills acquired are not geared to the needs of the labour market. The OECD PISA tests for Tunisia show little or no improvement since 2006 in the performance of students in mathematics, sciences and reading comprehension: indeed, that performance ranks near the bottom of the countries covered by the survey, and does not correspond to Tunisia's level of development (Figure 2.14.A). Moreover, a very high proportion of persons have not achieved the basic education level (in reading and writing) (Figure 2.14.B). Beyond the fact that it can improve personal well-being, investment in quality education is essential for growth and hence for job creation.

The quality of education depends on the quality of teacher training, programme relevance, pedagogical methods and evaluation, and the associated infrastructure. Public

Figure 2.14. **The level of education level is still fairly weak**



1. Proportion of students achieving less than 420 points in mathematics and science in international tests. PISA participants: based on PISA 2012 microdata; TIMSS participants (non-PISA): based on microdata of eighth-grade, TIMSS 2011, transferred to PISA scale.

Source: OECD, PISA database; World Bank, World Development Indicators (WDI); OECD (2015), *Universal Basic Skills: What Countries Stand to Gain*, OECD Publishing.

StatLink http://dx.doi.org/10.1787/888933694004

spending on education is relatively high, representing 6.3% of GDP (World Bank, World Development Indicator database), and is above the average for the MENA region (4.5%) as well as for OECD countries (5.3%). Support for teachers, in terms of modernising teaching methods, programmes or curricula, and the methods used for evaluating the performance of students and teachers alike, have been identified by the Tunisian authorities as the weak points of the country's education system. Teachers need continuous training to adapt their teaching methods and update their curricula. They also need support in order to modernise student assessment methods and to identify those at risk of dropping out as quickly as possible so that they can receive adequate help. To this end, the school must have sufficient autonomy and appropriate resources such as evaluation tools, teaching materials and support staff, so that it can make the changes needed by pupils and provide the necessary improvements for high-quality learning.

Experience in many OECD countries has shown that initial training together with knowledge and methodological refresher courses for teachers throughout their professional career are essential for maintaining a sound level of quality in the education system. It is essential, then, to implement programmes and adapt them steadily to the needs of the national economy in order to prepare students to respond more effectively to the needs of employers, whose requirements are rapidly evolving apace with technological progress and swiftly changing market demands. For this reason, improving the quality of education, especially in the scientific area (in 2015, 30% of the unemployed who had a higher diploma had a Masters in exact science), has become an important factor for international will increase the country's competitiveness and provide a source of economic and social growth for countries. By way of illustration, the OECD has estimated that if all Tunisian students could achieve the basic knowledge level, GDP would rise by 0.9 percentage points a year over the long term (OECD, 2015d).

Various studies have shown that employers have difficulty in finding qualified the right workers for their needs (e.g. World Bank Enterprises Survey, 2013 and IACE, 2016). The dearth of unskilled or semiskilled workers is especially severe. The fact that many graduates of higher education cannot find a job is also indicative of this misalignment. The rates of underemployment and mismatch (defined as persons holding a job that does not correspond to their skills) among university graduates is as high as 30% for technicians and 36% for persons with a humanities degree. Moreover, the most popular fields of training do not convey the skills demanded by the labour market, such as those of machinery operators, artisans, accountants and sales personnel (Angel-Urdinola et al., 2015). The Tunisian authorities should encourage businesses, vocational training centres and universities to collaborate more actively to ensure that students receive the training needed for the labour market.

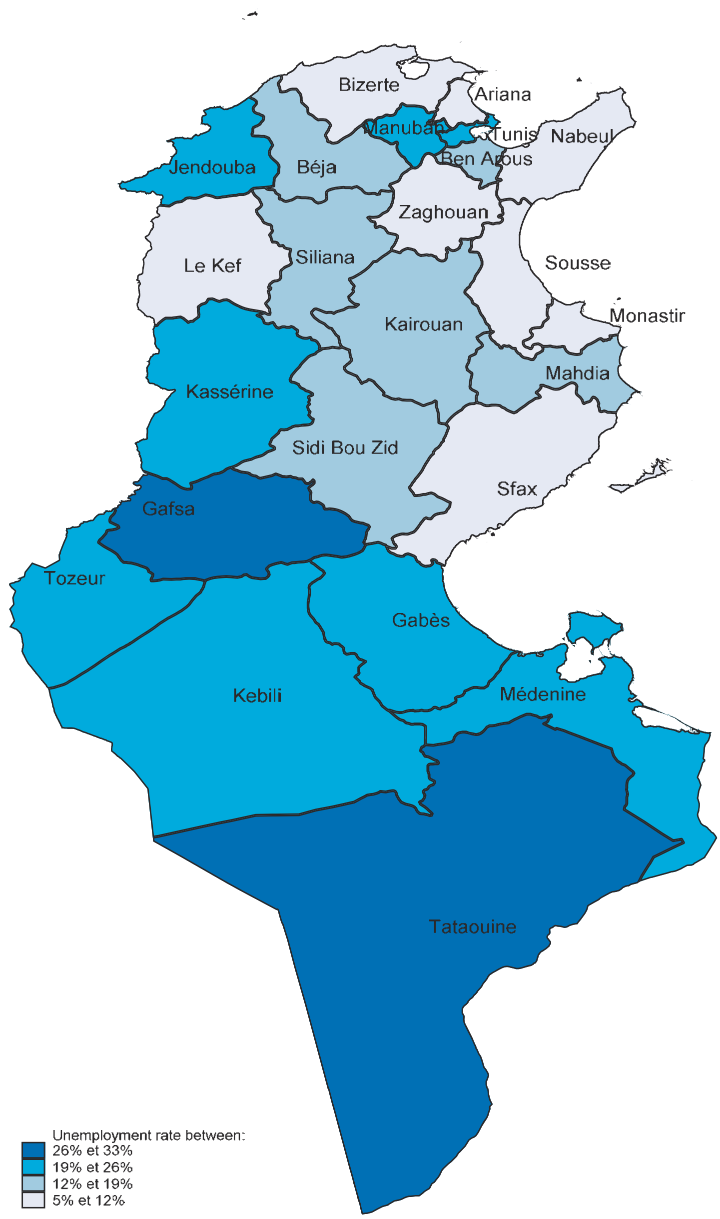
Vocational training can equip many young people with the skills needed to join the labour market and pursue a successful career (OECD, 2010a). The Tunisian authorities are planning a reform of vocational education and training (VET), which currently presents several gaps. The training opportunities provided depend essentially on system capacities, and do not reflect the needs of the economy. Moreover, students reveal a lack of interest in vocational training, reflecting the low esteem in which technical schools are held and the shortage of quality options in the second cycle of secondary school. Students enrolled in VET are often there against their choice, and may well come from disadvantaged families, thus perpetuating marginalisation on the labour market, and inequalities. The planned reform would improve the quality and the governance of the system while boosting its capacity to accept students. The possibility of shifting between general education and the vocational streams needs to be enhanced. Moreover, the quality of these programmes seems relatively weak. Co-ordination among the ministries in charge of VET must be strengthened (OECD, 2015b).

The Tunisian authorities have initiated a series of reforms as part of a strategic plan for education 2016-20. The intent is to improve the quality of the system by providing better training to teachers and upgrading programmes and infrastructure. In 2015, the government launched the "Strategic plan to reform higher education and scientific research, 2015-2025." Its aims are to improve the quality of university education and the employability of graduates, to promote research and innovation, to foster good governance of the system and optimise resource management, to revise the universities map to achieve a better regional balance, and to encourage teacher training (Republic of Tunisia, 2015).

Toward a new regional development policy

Living standards in all Tunisian regions have improved. The poverty rate has declined and access to basic infrastructure and public services has improved greatly over the last 20 years. Nevertheless, the choice of an economic development model based on manufactured exports and continued reliance on centralised decision-making, along with the lack of fast connections between the inland regions and coastal areas, has tended to concentrate activities in the coastal areas, leaving the inland regions behind. This concentration has led to low levels of private investment in the interior regions, with little development of productive activities or job creation, and to consequently large disparities in the unemployment rate across regions (Figure 2.15).

Figure 2.15. **The unemployment rate differs greatly between regions**



Source: INS.

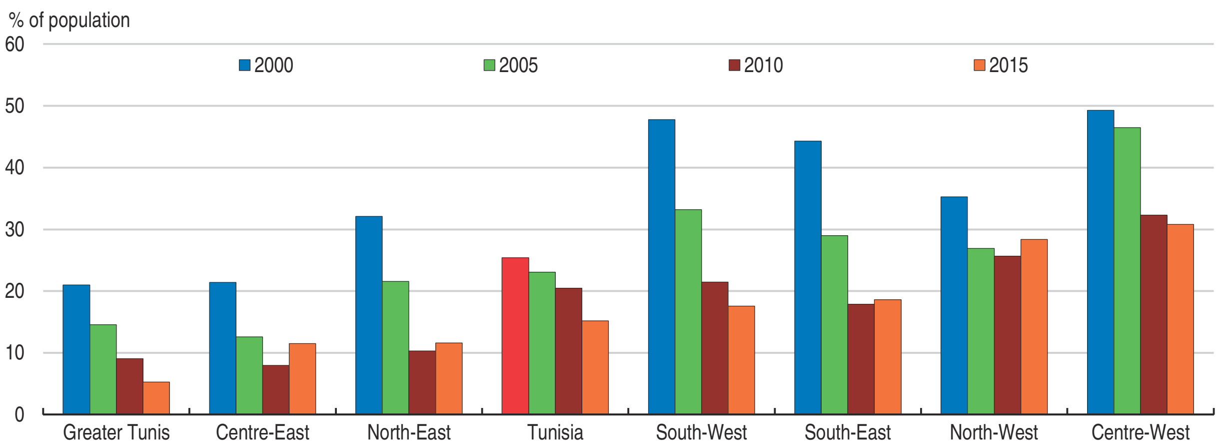
StatLink http://dx.doi.org/10.1787/888933693320

Living standards have improved across all regions

The priority given to raising living standards in Tunisia since independence has resulted in a significant drop in the poverty rate across all regions. Yet disparities persist between regions, and the poverty rate remains high in some of them (Figure 2.16). According to the INS, while Greater Tunis had a poverty rate of 5.3% in 2015, the Centre-West and the North-West recorded rates of 31% and 28% respectively.

Figure 2.16. **The poverty rate has dropped in all regions**

Poverty rate by district in 2000, 2005, 2010 and 2015



Source: Tunisian Institute of Competitiveness and Quantitative Studies, 2017, "Inclusion sociale en Tunisie : Les enjeux de l'emploi, de l'éducation et de la répartition des revenus".

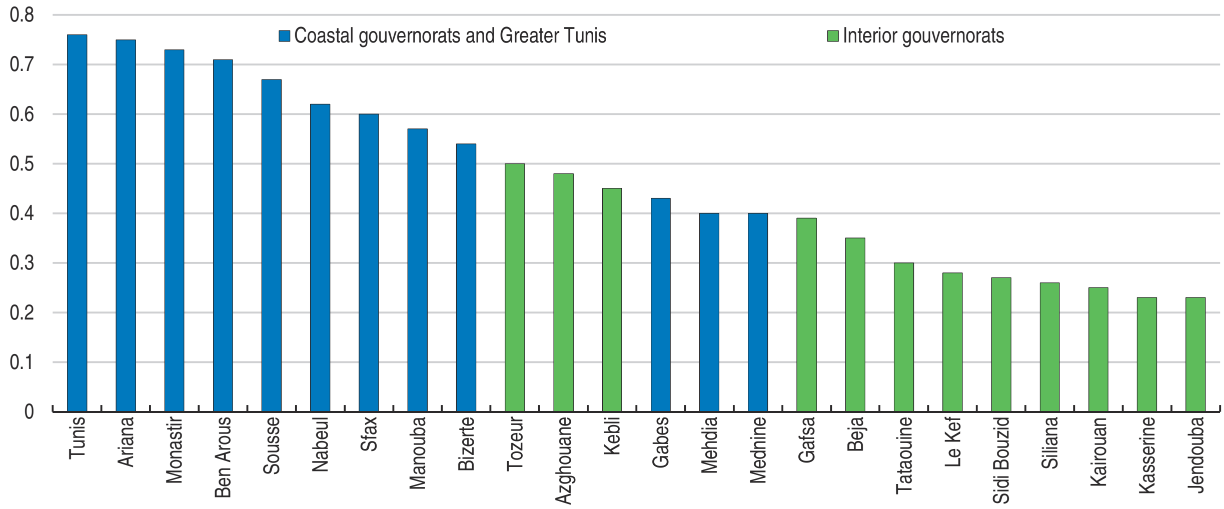
StatLink http://dx.doi.org/10.1787/888933694023

The Ministry of Development, Investment and International Cooperation has produced an index of regional development on the basis of four components: living conditions, social and geographic indicators, human capital, and labour market indicators. These indicators reveal clearly the disparity among regions, with Tunis and the coastal regions boasting living standards substantially higher than the other regions (Figure 2.17).

As well, access to infrastructure has improved greatly. The rate of household connections to the drinking water network in the Centre-West region, which is one of the poorest, rose from 38% in 1994 to 65% in 2014. Progress has also been made in access to health services. Thus, basic public health centres have been installed throughout the territory, but they are under-used, particularly in the interior regions, given the lack of hospital staff and the shortage of equipment. The interior regions also lack medical specialists, who for the most part are concentrated in Tunis and a few coastal cities.

Regional statistics are fairly scarce in Tunisia. It is therefore difficult to assess and evaluate in detail regional performances in comparison with other countries of the zone or of the OECD. The introduction of financing for the regions, as part of the decentralisation plan, should be based on regional indicators such as GDP. The Tunisian government is urged to encourage the INS to identify economic and social information at the regional level, and to collect and publish it systematically so as to permit the economic analysis needed for the design and implementation of truly effective regional policies. The OECD is working with the INS on this project.

Figure 2.17. **The regional development index reveals disparities between *gouvernorats***



Note: The regional development index is a synthetic indicator based on four components: living conditions, social and geographic indicators, human capital, and labour market indicators.
Source: Ministry of Development, Investment and International Cooperation.

StatLink http://dx.doi.org/10.1787/888933694042

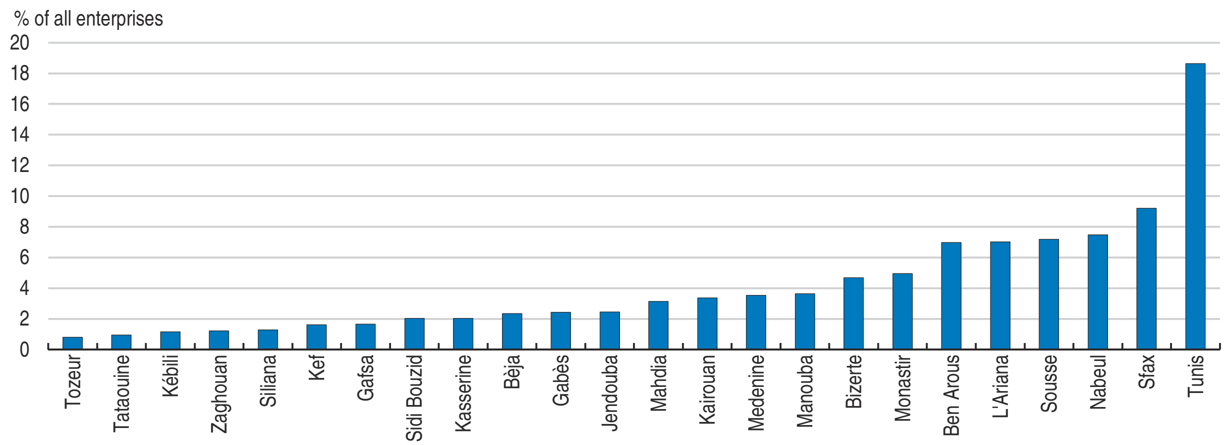
Productive economic activity is concentrated in the coastal regions

Since independence, Tunisia has given priority to the development of thriving cities, commercial openness, and industrial competitiveness. This policy was intended to meet the needs for public services and jobs generated by rapid growth in the major cities. As a result, Tunis and the central and northeast coastal regions occupy a dominant position (Ministry of Regional Development, 2011). Despite the importance of public investment and strong incentives to private investment in the interior regions, this export-based development model has created a "two speed" economy where the offshore sector, located primarily in the coastal regions, has developed rapidly while the onshore sector struggles to grow and create jobs. Moreover, the onshore sector has proven unable to profit from the opportunities and positive fallout that the offshore sector could offer (see Chapter 1). Consequently, inhabitants of interior regions remote from the ports have been obliged either to move to the coastal cities, where there are more remunerative employment opportunities, or to devote themselves to low-productivity and poorly-paid rural activities (Ministry of Regional Development, 2011).

Public investment per capita between 1990 and 2005 was higher in the interior than in the coastal regions. On the other hand, and despite the incentives targeted at the interior regions, private investment has, for the most part, benefited the coastal regions and has led to a concentration of businesses there. Thus, nearly 56% of the population and 92% of all industrial firms are concentrated within an hour's drive of the country's three largest cities: Tunis, Sfax and Sousse. Nearly 20% of all private firms are located in Tunis, and 50% of firms are located in only five districts or *gouvernorats* (Figure 2.18). Moreover, the private firms located in the coastal regions are generally of larger size, allowing them to be more productive and therefore to accord higher pay to their employees, and to make more frequent investments. The majority of new enterprises have been created in the North-East and Centre-West.

Figure 2.18. **Private enterprises are concentrated in a few regions**

Presence of private enterprises



Source: INS.

StatLink http://dx.doi.org/10.1787/888933694061

Economic activity in the interior regions is less diversified than in the coastal areas, making the former more vulnerable to shocks and more volatile in their output (AfDB, 2014; OECD, 2015c, 2015a). The interior regions generally depend on a narrow range of traditional basic products, and they are little integrated into global value chains. It should be noted that the diversification of the industrial structure in the *gouvernorats* along the coast has in fact been relatively stable for some 15 years (AfDB, 2014).

Unemployment rates vary widely

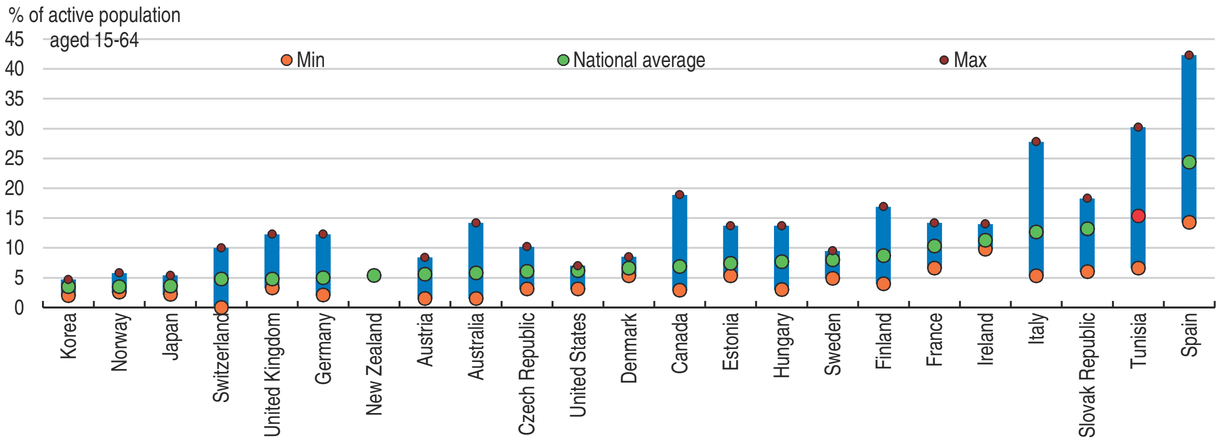
This concentration of activities in Tunis and the coastal regions naturally leads to divergent unemployment rates across regions. While unemployment in 2016 affected less than 10% of the population aged 15 to 64 years in Monastir and Sfax, it exceeded 25% in Gafsa and Tatouine. More alarmingly, unemployment has been rising more sharply in regions where it was already high. This discrepancy is among the most severe in OECD countries (Figure 2.19).

Disparities in terms of unemployment resulting from the concentration of economic activity are exacerbated by disparities in education, which are more significant than in the majority of OECD countries (Figure 2.20). Despite efforts to ensure universal access to education, illiteracy (which still affected 18% of the population in 2014) stood at 12% in the communes, and 32% outside the communes, essentially in rural areas. School enrolment rates also vary from one region to the next. Thus, 14 regions have net enrolment rates for children ages 6-11 years that are below the national average (98%). The enrolment rate for 12 to 18 year-olds, which was 79% nationally in 2012-13, was only 70% in the central regions such as Kairouan and Kasserine (Dhaoui, 2017, 2015). The level of human capital is known to be an important determinant of regional economic growth (OECD, 2012b, 2012c). It is more precisely the level of education of unskilled individuals that is important, as they are less mobile. The existence of a large proportion of unskilled workers can have a major impact on growth.

Although enrolment rates have risen throughout Tunisia, access to education is not the same everywhere. The lack of connectivity (physical or technological) in rural areas is a constraint on the expansion of education. In 2013, Internet access varied from more than

Figure 2.19. **Differences in unemployment rates are significant**

Unemployment rate[1], 2016 or latest year available



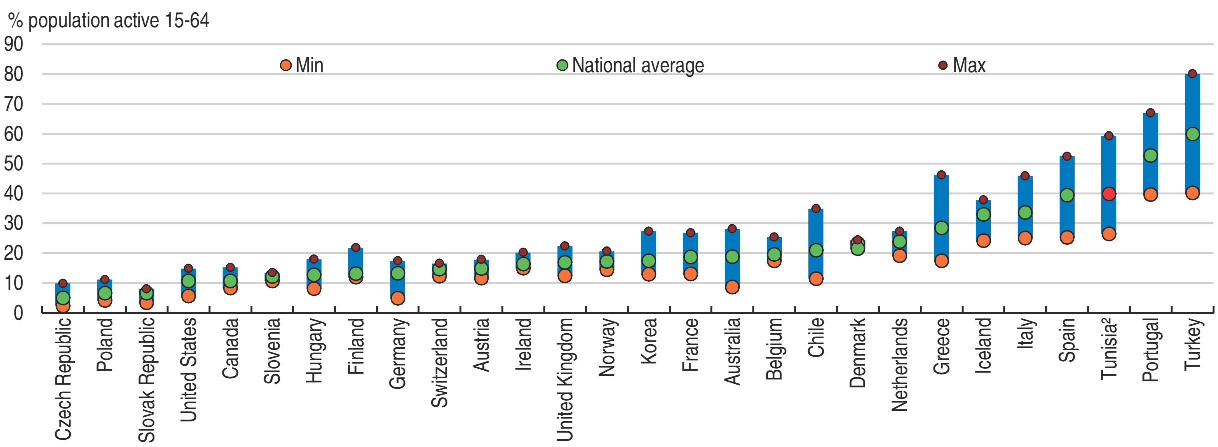
1. TL3 regions for OECD countries, and governorates for Tunisia.

Source: *OECD Regional Database*; and INS.

StatLink http://dx.doi.org/10.1787/888933694080

Figure 2.20. **The education level differs more widely than in OECD countries**

Active population with basic or no education[1]



1. TL2 regions for OECD countries, and *gouvernorats* for Tunisia.
2. For Tunisia, the data refer to the active population aged 15 and over.

Source: *OECD Regions Database*; and INS.

StatLink http://dx.doi.org/10.1787/888933694099

75% of schools in Tozeur, Tunis and Monastir enjoyed access to the Internet, while coverage was to less than just 10% in Sidi Bouzid, Kasserine and Kairouan (Dhaoui, 2015). Access to safe drinking water is still inadequate for schools in the interior: in 2015-16, while the majority of coastal regions were covered to the extent of more than 95%, Sidi Bouzid and Kasserine had coverage of less than 40%. Moreover, students in the interior must walk greater distances to school, as many schools cannot be reached by road (ITCEQ and ILO, 2017). The quality of education is often lower in isolated regions. The difference between the *baccalaureat* success rates in the interior and those in coastal regions can be attributed to the socio-economic differences between these regions, as well as to the quality of the teaching.

The Ministry of Education has since 2000 established priority education zones, to which the government allocates additional personnel and material resources so that these regions can catch up with the rest in terms of education. It is particularly important that regional policies should target zones (regional and local) where the quality of education is still below that of other regions. Specific remedial programmes should be prepared and implemented in these zones.

A new regional development policy is needed

In the past, regional development policies in OECD countries relied essentially on sector-specific subsidies and on financial aid to disadvantaged regions. These policies had the effect of making these regions economically dependent on more dynamic regions, and did very little to expand their capacity. At the present time, OECD countries are adopting multi-sector policies that capitalise on the specific assets of each region, while ensuring co-ordination, both vertical (among the different levels of government) and horizontal (across different policies and different sectors) (OECD, 2012b2012c). The intent is to make use of regions' underutilised potential in order to improve their competitiveness. Thus, the regions must identify the sectors that will give them entry into global value chains and attract foreign direct investment.

The main factors for growth at the regional level are human capital, the availability and quality of infrastructure and the effects of urbanisation which encourage innovation and increase productivity. To take greater advantage of these factors, their complementarity must be taken into account in an integrated approach in which they can be mutually reinforcing (OECD, 2012b2012c). Regional development also depends on the business climate at the local level, and on the quality of local governance. It is important to ensure efficient co-ordination among the different levels of government, so that policy decisions will be coherent and their effects will not cancel each other out. Horizontal cooperation is also needed between adjacent regions, so as to avoid the waste of resources and promote economies of scale.

Since 2011, the government has put regional development back in the spotlight. has become a priority for the Tunisian authorities. This priority is a feature of the 2016-2020 development plan, and it is part of the six broad thrusts of the Carthage Pact. The 2014 Constitution includes the principle of equality of living standards between the regions, and stresses the importance of equitable regional development, social justice, and sustainable development. It notes that positive discrimination on behalf of regions in the interior can be applied to achieve these objectives. This strategy is based on five pillars (Box 2.1). The new Constitution also provides for a reorganisation of local government, with the creation of the district. The new administrative and financial set-up of these entities is among the subjects defined by the law on local authorities, which is still being discussed by the Assembly of the Representatives of the People.

The new investment code, which came into effect in April 2017, makes specific provisions for promoting investment in the regions of the centre and south of the country. Thus, there are plans to offer an investment premium ranging from 15% to 30%, with a ceiling of 3 million dinars, for the priority zones for regional development (*zones d'encouragement au développement régional*), the list of which is set by decree in the sectors of industry, crafts and certain services (Republic of Tunisia, 2017). It is also planned to allow a 100% deduction from the tax base for 5 or 10 years, and to have the State cover the employer contribution for 5 or 10 years. It will be important to monitor and evaluate the impact of

Box 2.1. **A regional strategy based on positive discrimination**

To achieve the objective of reduce inequality among between regions, as stipulated in the 2014 Constitution, the authorities plan to implement a strategy based on positive discrimination. That strategy relies on five pillars:

- Tax and financial incentives targeting market failures and facilitating vertical integration of economic activities, as well as equality of opportunities in the areas of procurement, education services, health, recreation and culture.
- Development programmes that modernise infrastructure so as to support a better quality of life and connectivity, as well as making economic activities attractive.
- More autonomous local governance that brings decision makers closer to the people by decentralising responsibility and decision-making and enshrining the principles of transparency, monitoring and evaluation, accountability, and the participatory approach.
- Solidarity within and across regions, by strengthening the cooperative sector and institutional cooperation, and adopting objective and transparent criteria for budgetary transfers.
- Strengthening international cooperation and facilitating the economic integration of the border regions with neighbouring countries, by improving living conditions and public services, promoting joint projects, and reinforcing infrastructure.
- Ensure that all regions have access to Internet.
- Update and simplify the financing system for regional development.
- Promote regional development and increase attractiveness.
- Raise living conditions at local and regional level.
- Step up decentralisation and set up a base for local and regional governance.

Source: ITCEQ and ILO (2017). Tunisian government's five-year plan.

these measures in order to eliminate those that do not work and improve those that seem to be having a concrete impact on investment and on development in the target regions.

As well, the 2015 law on public-private partnerships (PPP), with its application decrees of 2016, includes regional development as an essential objective. That law gives local governments the power to enter directly into PPPs as a means of boosting the local economy and developing social infrastructure projects.

The government plans to implement a national strategy for regional development based on supporting lines of activity rather than sectors, which is the current practice through the installation of development agencies in all the *gouvernorats*. Within the framework of the new Law on investment, the Tunisian investment body would be present in the 24 *gouvernorats*, thereby replacing the existing structures (such as the API, etc.). This strategy based on the development of value chains is a step in the right direction but, in order to be genuinely efficient, will need to be backed up by several measures.

One potential regional development strategy, based on other successful experiments, might see the authorities promoting the development of two or three regional centres or "poles" in the country's interior. They would draw support from two or three urban centres (existing cities to develop), in order to harness the economies of agglomeration that only cities of a certain size can generate, because of the size of their market and their ability to attract productive investment. The ripple effects of these poles would allow them to serve as engines for development in their respective regions, by creating trading markets and economic integration both at regional and national level.

There currently exist three regional development offices, which each manage four *gouvernorats,* and one commission, which is in charge of the other *gouvernorats,* including Tunis. All *gouvernorats* also have a regional development directorate. Rationalising and modernising the institutions responsible for A regional development, agency by recruiting staffed by highly skilled officers and enjoying financial and decision-making autonomy could be created for would pave the way for the deployment of thise strategy. The staff would consist of local recruits with knowledge of their region, supported by central government officials who could contribute any additional skills needed as the local staff learnt through hands-on experience. These independent institutions It would be fully dedicated to planning and managing development projects in response to the region's needs and economic potential, identifying private investment opportunities and searching for potential developers and entrepreneurs, establishing a suitable climate for private investment (lifting regulatory and administrative barriers) and helping the region's investors and young entrepreneurs to set up their projects quickly. The strategy would have to be assessed and adjusted on a continuous basis according to the results obtained and the actual conditions in the field. The upgrading of infrastructure and public services in the regions of the interior, and a rapid improvement in their physical and digital connectivity would reduce inequalities and boost living standards, while making those regions more attractive and better integrated into national and international markets.

The urbanisation process can strengthen productivity and people's well-being

Economic development has always been accompanied by a process of urbanisation. Its success relies on suitable policies in terms of transport, housing and land use planning. Successful urbanisation also requires good governance at the level of the metropolitan area, and it must support partnerships among the communes or municipalities.

Urbanisation is a source of economic growth, because cities are on the whole more productive and innovative than rural areas (OECD, 2015b, 2015e). People who move to the cities generally enjoy higher incomes and better public services. In most OECD countries, labour productivity and wages rise with the size of the cities, even when certain characteristics of workers such as level of education are taken into account. Metropolitan areas can reap economic advantages, deriving from the concentration of enterprises and workers in the same place. This allows enterprises to benefit from technological advances, better opportunities for sharing intermediate inputs, access to a large pool of workers with multiple skills, and access to a major market that allows them to exploit economies of scale (OECD, 2014). A city's performance can also have positive fallout for its surrounding region, within an estimated radius of an hour by road (OECD, 2015e, b).

For Tunisia, it will be important to support the development of two or three urban hubs (in the North-West, the Centre and the South-West) that can serve as engines of development for the regions in which they are located, by generating economies of agglomeration. Infrastructure for these hubs will have to be developed in order to connect them to the various markets, and it should be given priority in public investment plans financed by the State. Improving public services (education, health etc.) and institutions would make the hubs more attractive and allow them to draw in qualified personnel. According to a business survey by IACE, 50% of districts do not have a sufficiently high level of infrastructure and quality of life to attract investors (IACE, 2016b).

Enhancing the connectivity of isolated regions

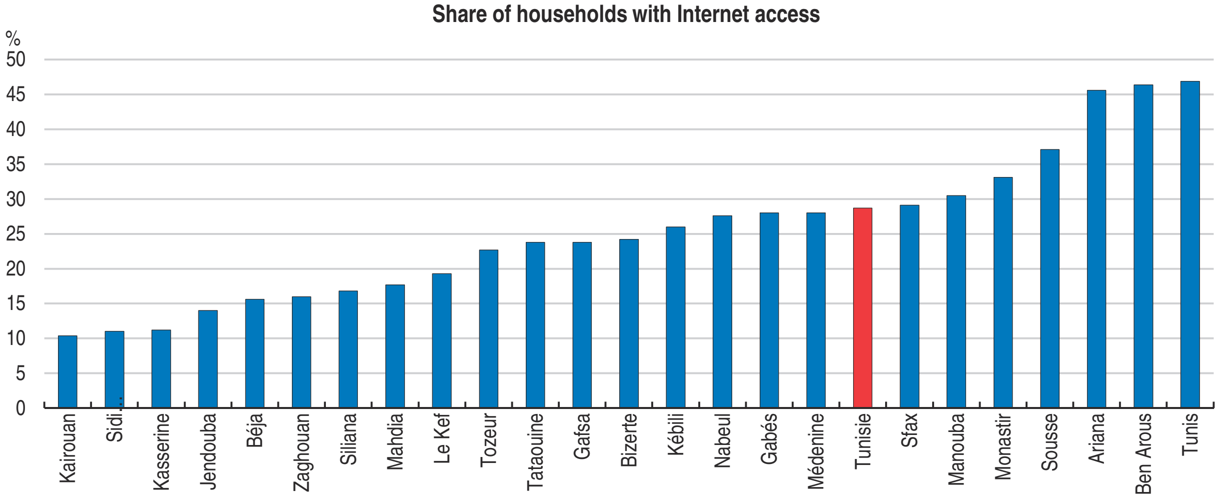
It is important to develop the connectivity of remote regions to allow them to expand their markets and to enable workers to move from declining regions to more dynamic ones. The National Development Plan 2016-2020 includes a fairly sizable public investment plan that would strengthen connections between the regions by developing a hybrid network. The quality of road infrastructure varies greatly across regions: the road networks in the regions of the South and Centre-West are obsolete and poorly maintained. Although the development of road infrastructure is not in itself sufficient to promote growth in isolated regions, efficient infrastructure is an important asset for businesses. The development of better highway links and secondary roads can play an important role in regional development policy. The development of roads in isolated regions makes them more accessible by reducing transport times and costs. Businesses can in this way achieve productivity gains and improve their production and distribution. Lastly, isolated populations will have better access to jobs and to public services (OECD, 2002). Building road networks is therefore essential to improving mobility for workers.

Mobility can also be reinforced by a suitable housing policy aimed, for example, at promoting the rental market or lowering the transaction costs for a property. While around 60% of households in Tunis are homeowners, this figure is nearly 80% in the communes of the Gafsa district, and 75% in Kasserine. This tends to show that the rental sector is less developed in these two cities than it is in Tunis.

Improving workers' technological (Internet) connectivity with employment zones is also important for purposes of training and dissemination. For example, the number of households with Internet access varies greatly from one region to the next. Although the rate is more than 45% in Tunis, Ben Arous and Ariana, it is only 10% in Kairouan, Sidi Bouzid and Kasserine (Figure 2.21). The introduction of high-speed broadband throughout the national territory is essential for regional development.

Figure 2.21. **Internet access varies across regions**

Share of households with Internet access



Source: INS.

StatLink http://dx.doi.org/10.1787/888933694118

Decentralisation to promote regional development

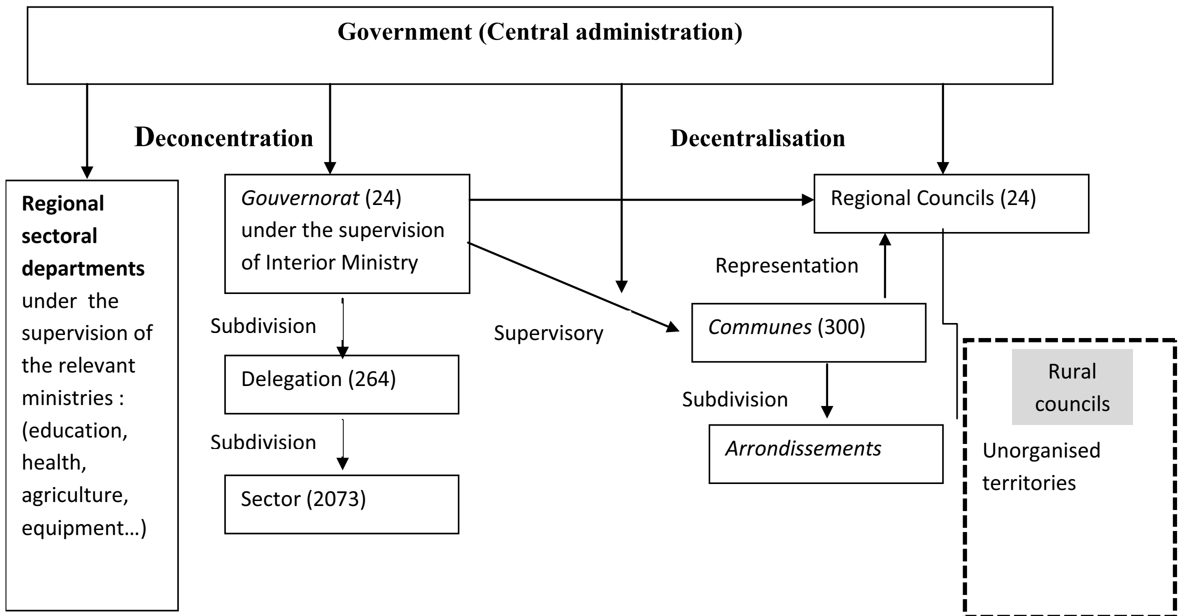
As part of their regional development strategy, the authorities plan a greater devolution of responsibilities to elected governments at the regional and local (commune) levels. At the present time, the responsibilities of the regions and the communes are very limited. The regional council is notably responsible for preparing and implementing the regional development plan to be integrated into the national plan for economic and social development, and for preparing land-use plans outside of the remit of the communes and the review of the *gouvernorat*'s urban master plan. The municipal council is responsible in particular for the communal budget and establishes, subject to the commune's resources and the means at its disposal, the community equipment programme. The draft law on decentralisation provides for three levels of local government in addition to central government: the commune, or municipality, of which there are currently 350 across the entire territory; the region, of which there are 24; and the district, which encompasses a certain number of regions. The number of districts has yet to be determined. The decentralisation process, consisting of the devolution of responsibilities and transfer of resources, is expected to be gradual in order to allow the decentralised local authorities to acquire the requisite management skills for their new responsibilities (Figure 2.22).

Local budgets represent only 3.6% of the national government budget, compared to 10% in Morocco and 20% in Turkey (World Bank, 2015bc). Local taxation (levied at the level of the municipality) includes, notably, the tax on buildings and on undeveloped land, the tax on industrial, commercial and professional establishments, the hotel tax, the tax on entertainment and the licence fees for licensed premises. The communal authorities face financial difficulties as municipal staffing rise along with the associated payroll (which doubled between 2011 and 2015). At least 70 to 90% of the municipal budget goes to wages, and accordingly transfers from the central government are now being used to cover the communes' operating expenses, instead of financing their investments, as in the past. Moreover, the financing of local governments has suffered from a significant drop in the recovery rate of local taxes, as well as poor governance of local affairs, and a lack of control over expenditure quality.

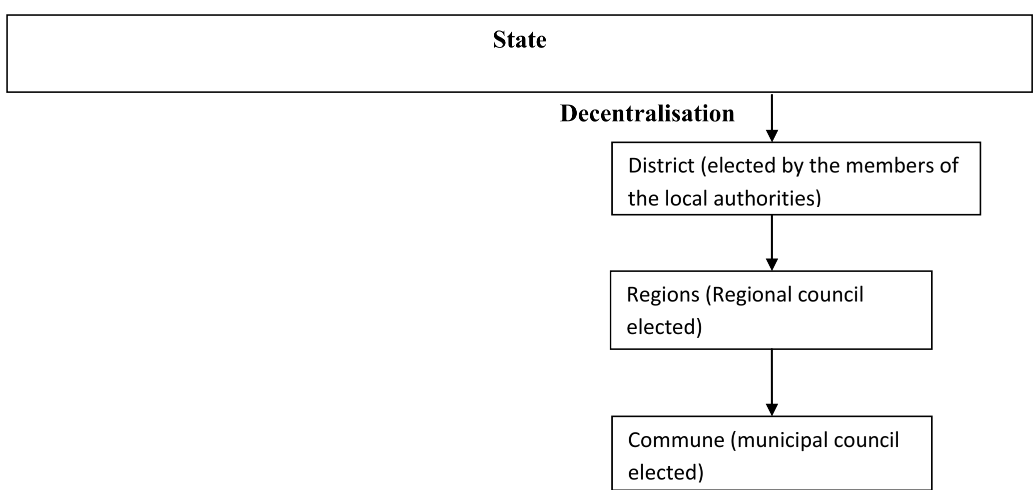
In OECD countries, local governments have two sources of revenue: the taxes they collect, and the transfers they receive from the central government aiming at financial equalisation. As a general rule, revenues should, to the extent possible, cover the expenses of local entities. The generated revenues enhance the commune's autonomy in determining the levels of municipal public services, the responsibility of the local authorities vis-à-vis their citizens, the mobilisation of resources, and the sustainability of expenditures (OECD/KIPF, 2016). It is not an easy matter to select the taxes that should fall to the regions. The voluminous literature on the subject suggests that local governments should levy taxes for which there is a clear link between what households and businesses pay and the public services they receive (Oates and Schwab, 1988). Thus, taxes levied at the regional level should be non-mobile, non-redistributive and non-cyclical (to prevent local governments from pursuing pro-cyclical budgetary policies). Experience in OECD countries suggests that, with a mix of property taxes, a portion of personal income taxes and in some cases consumption taxes, a revenue-neutral increase in the share of local taxes could go hand in hand with a more efficient overall tax system and a reduction in intergovernmental grants (OECD/KIPF, 2016). This would require a transparent local tax administration, which is not always the case in emerging countries.

Figure 2.22. **Territorial organisation**

A. Current organisation



B. Draft law on local authorities



Note: Deconcentration is defined as the transfer of some administrative powers from the central authority at the local level to a State official. Decentralisation is defined as the delegation of some administrative powers from the central authority at the local level to officials elected by citizens.
Source: Authors and Turki and Verdeil, 2013.

Decentralisation generally makes for a better fit between the supply of public goods and services and the preferences of citizens. But all regions should be able to benefit from this devolution: this is particularly true of the poorest regions, which could see their competitiveness suffer due to differing institutional capacities (financial capacity and competence of the local government) and differing economic characteristics (productivity, infrastructure etc.) (Rodriguez-Posé and Gill, 2004). A study of OECD countries confirms that devolving taxes and revenues tends, under certain conditions, to reduce regional disparities. This reduction derives from the regions' responsibility for collecting taxes, and hence their capacity to undertake expenditures that will best meet the needs of their citizens (Bartolini et al., 2016).

The Tunisian authorities are aware of the risks associated with decentralisation, such as the short-term impact on public finances, the lack of human and technical capacity at the local level, and the risk of increased bribery at local level, which has been observed in several countries which recently increased decentralisation. On one side, decentralisation can reduce the scope of corruption, as local authorities are held accountable to their citizens, but on the other hand the opportunities may be greater and the obstacles fewer, given for example weaker governments or closer contacts between the authorities and the business world at the local level (OECD, 2016). Because of this, it makes sense to reduce the risk to the integrity of local officials by improving the financial and administrative checks on local authorities provided for under the new law, by clearly determining their form and scope, identifying the person responsible for supervisory control, and setting out the consequences of administrative and jurisdictional control measures (OECD, 2017c, 2017e).

The decentralisation project is still in its initial stages and is expected to take 20 to 30 years to implement. The new decentralisation policy will have to be implemented gradually, by giving the regions and the communes a degree of autonomy and clear and complementary prerogatives (without overlap) and adequate financial and human resources. This would allow the regional and local authorities to pursue economic and social development in their territory, to improve people's living conditions, and to create economic opportunities for all.

Box 2.2. **Summary of recommendations to foster job creation and regional development**

Main recommendations

- Ensure that systems for education, learning and training respond to the requirements of businesses.
- Diversify the funding sources for social security.
- Encourage the recruitment of women through campaigns to raise awareness of the repercussions of educational choices on opportunities in terms of employment, entrepreneurship, career development and salaries.
- Speed up the implementation of the financial inclusion strategy.
- Modernise regional structures and institutions to take better advantage of investment opportunities and help investors in the regions.

Recommendations for promoting employment and reducing labour market inequalities

- Give more weight to wage negotiations at the enterprise level, so that firms can respond more flexibly to economic trends.
- Ensure that wages and salaries rise with productivity.
- Improve the business climate and simplify regulatory and administrative procedures in order to favour enterprise creation and employment.
- Facilitate families' access to lower-cost childcare services by boosting the supply of public daycare centres.

Box 2.2. **Summary of recommendations to foster job creation and regional development** *(cont.)*

- Institute initial training and refresher training for teachers throughout their career and promote the modernisation and adaptation of curricula and teaching methods.
- Strengthen the arrangements for involving employers and establish a balance between students' preferences and employers' needs in order to improve the match between employer business demands and training.

Recommendations for promoting financial inclusion

- Improve access to financing for small and medium-sized enterprises.
- Reinforce the capacities of the post office agencies in the regions.

Recommendations for promoting regional development

- Consider a new approach to the development of regions in the interior based on the harnessing of economies of agglomeration in major cities. Develop two or three urban centres from existing towns.
- Roll out a regional programme for upgrading economic and social infrastructure and improving digital connectivity in the regions of the interior in order to connect them directly to national and international markets and enhance their attractiveness.
- Continue to give priority to isolated regions by ensuring that they have adequate resources and qualified staff for providing a quality education.
- Pursue construction of the secondary roads network in order to enhance worker mobility.
- Modernise the governance of the regions and local authorities. Give the regions the autonomy and resources they need to determine their own development strategies.
- Develop and operate economic and social information systems in order to base economic policy decisions on credible information.

Bibliography

AfDB (2014), "Industrial Policy at the Service of Balanced Territorial Development in Tunisia".

Aly, H., Y. Daoud, A. Ragab and A. Saad (2017), Economic Research Forum, *Working Paper* No. 1121.

Amara and Jemmali (2017), "On the decomposition of economic inequality: A methodology and an application to Tunisia", Economic Research Forum, *Working Paper* No. 1096, *http://erf.org.eg/wp-content/uploads/2017/05/1096.pdf*.

Angel-Urdinola, Diego F., A. Nucifora and D. Robalino (2015), "Labor Policy to Promote Good Jobs in Tunisia: Revisiting Labor Regulation", *Social Security, and Active Labor Market Programs*, Directions in Development. Washington, DC: World Bank.

Atkinson, A. and F. Messy (2013), "Promoting Financial Inclusion through Financial Education: OECD/INFE Evidence, Policies and Practice", *OECD Working Papers on Finance, Insurance and Private Pensions,* No. 34, OECD Publishing, Paris.

Bargain, O. and P. Kwenda (2010), "The informal sector wage gap: New evidence using quantile estimations on panel data", *IZA discussion Paper* No. 4286.

Bartolini, D., S. Stossberg and H. Blöchliger (2016), "Fiscal Decentralisation and Regional Disparities", *OECD Economics Department Working Papers*, No. 1330, OECD Publishing, Paris.

Bauernschuster, S. and M. Schlotter (2015), "Public childcare and mothers' labour supply – evidence from two quasi-experiments", *Journal of Public Economics*, 123:1-16.

Belkacem, L. and F. Mansouri (2013), *2012 GEM Tunisia: National Report*, Global Entrepreneurship Monitor, Sousse.

Ben Chaâben (2017), “La rémunération des salariés 2010-2017”, *Notes et analyses de l'ITCEQ*, Working Document No. 60.

CRES (2016), “Protection sociale et économie informelle en Tunisie, Défis de la transition vers l'économie informelle”.

Daghari, S. (2017), “Evolution du système éducatif tunisien”, *Notes et analyses de l'Institut Tunisien de la Compétitivité et des Etudes Quantitatives (ITCEQ)*, No. 51.

Daza, N. and L.F. Gamboa (2013), “Informal-formal wage gaps in Colombia”, *ECINEQ Working Paper* No. 301.

D'Costa, S., E. Garcilazo and J. Oliveira Martins (2013), “The Impact of Structural and Macroeconomic Factors on Regional Growth”, *OECD Regional Development Working Papers*, 2013/11, OECD Publishing, Paris.

Deb, A. and M. Kubzansky (2012), “Bridging the Gap: The Business Case for Financial Capability”, a report commissioned and funded by the Citi Foundation, Cambridge, Mass: Monitor, March.

Dhaoui, I. (2015), “Efficacité du Système Éducatif Tunisien: Analyses et Perspectives”*, Notes et Analyses de l'ITCEQ,* No. 29.

Dickens, W. and K. Lang (1985), “A Test of the Dual labor Market Theory”, *American Economic Review*, Vol. 75, No. 4, pp.792-805.

Ennaceur, M. (2000), “Les syndicats et la mondialisation: Le cas de la Tunisie”, *Working Documents*, No. DP/120/2000, ILO, Geneva.

Henrekson, M. and D. Johansson (2010), “Gazelles as job creators: A survey and interpretation of the evidence”, *Small Business Economics 35*, No. 2 (2010): 227-244.

Hijzen, A. and B. Menyhert (2016), “Measuring labour market security and its implications for individual well-being”, *OECD Social, Employment and Migration Working Papers*, No. 175, OECD Publishing, Paris, *http://dx.doi.org/10.1787/5jm58qvzd6s4-en* .

Hoeller, P., I. Joumard, M. Pisu and D. Bloch (2012), “Less Income Inequality and More Growth – Are They Compatible? Part 1. Mapping Income Inequality Across the OECD”, *OECD Economics Department Working Paper*, No. 924, OECD publishing, Paris.

IACE (Institut Arabe des Chefs d'Entreprises) (2014), “L'Entreprise et le capital humain : Productivité et partage”, 29th edition of the Enterprise Days.

IACE (2016a), “Rapport National sur l'Emploi – 1e partie du rapport”.

IACE (2016b), “Rapport sur l'Attractivité Régionale 2016”.

INS (Institut National de Statistiques) (2012), “Measuring poverty, inequalities and polarization in Tunisia 2000-2010”.

INS (2016), “Statistiques Issues du Répertoire National des Entreprises, Edition 2016”.

ITCEQ (Institut Tunisien de la Compétitivité et des Études Quantitatives) (2017), “Inclusion sociale en Tunisie : Les enjeux de l'emploi, de l'éducation et de la répartition des revenus”.

ITCEQ and ILO (2017), “La discrimination positive : Un principe constitutionnel à concrétiser pour la promotion de l'emploi décent dans les régions”.

Kriaa, M. (2012), “Le marché de l'emploi – État des lieux et perspectives” [The labour market: State of affairs and prospects], *Notes de synthèse*, Initiative pour le développement économique et social (IDEES), Tunis.

Ministry of Regional Development (2011), “Une nouvelle vision du développement régional : Livre blanc”.

Oates, W. and R. Schwab (1988), “Economic Competition among Jurisdictions: Efficiency-Enhancing or Distortion-Inducing?”, *Journal of Public Economics,* Vol. 35.

OECD (2002), “Impact of Transport Infrastructure Investment on Regional Development”.

OECD (2010a), “Learning for Jobs”, *OECD Reviews of Vocational Education and Training*, OECD Publishing, Paris.

OECD (2011), *Divided We Stand, Why Inequality Keeps Rising*, OECD Publishing.

OECD (2012a), *Closing the Gender Gap: Act Now*, OECD Publishing, Paris.

OECD (2012a, 2012b), *Starting Strong III: A Quality Toolbox for Early Childhood Education and Care*, OECD Publishing, Paris.

OECD (2012b, 2012c), *Promoting Growth in All Regions*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264174634-en*.

OECD (2014), *OECD Regional Outlook 2014: Regions and Cities: Where Policies and People Meet*, OECD Publishing, Paris.

OECD (2015a), "Tunisia: A Reform Agenda to Support Competitiveness and Inclusive Growth", *Better Policies Series*.

OECD (2015b), "Investing in Youth: Tunisia: Strengthening the Employability of Youth during the Transition to a Green Economy", OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264228290-fr*.

OECD (2015e, c), *In It Together: Why Less Inequality Benefits All*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264235120-en*.

OECD (2015d), *Universal Basic Skills: What Countries Stand to Gain*, OECD Publishing, *http://dx.doi.org/10.1787/9789264234833-en*.

OECD (2015e, b), *The Metropolitan Century: Understanding Urbanisation and its Consequences*, OECD Publishing, Paris.

OECD (2015c), "Tunisia: A Reform Agenda to Support Competitiveness and Inclusive Growth", *Better Policies Series*.

OECD (2016), "Preventing corruption in public procurement".

OECD (2017a), "Youth in the MENA Region: How to Bring Them In".

OECD (2017b), *Discussion paper on the engagement of young people in public life in Tunisia*.

OECD (2017c), *Women's Economic Empowerment in Selected MENA Countries: The Impact of Legal Frameworks in Algeria, Egypt, Jordan, Libya, Morocco and Tunisia, Competitiveness and Private Sector Development*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264279322-en*.

OECD (2017bd), *OECD Employment Outlook 2017*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/empl_outlook-2017-fr*.

OECD (2017d, 2017e), *Un meilleur contrôle pour une meilleure gouvernance locale en Tunisie: le contrôle des finances publiques au niveau local*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/22265961*, *www.oecd.org/mena/governance/finances-publiques-Tunisie.pdf*.

OECD/KIPF (2016), *Fiscal Federalism 2016: Making Decentralisation Work*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264254053-en*.

Republic of Tunisia (2015), "Plan stratégique de la réforme de l'enseignement supérieur et de la recherche scientifique, 2015-2025".

Republic of Tunisia (2017), "Loi de l'investissement".

Rijkers, B. et al. (2014), "Which Firms Create the Most Jobs in Developing Countries? Evidence from Tunisia", *Labour Economics*, 31(2014), 84-102.

Rodriguez-Posé, A. and N. Gill (2004), "Is there a Global Link Between Regional Disparities and Devolution?", *Environment and Planning A*, Vol. 36, pp. 2097-2117.

Schiffbauer, M. et al. (2015), "Jobs or Privileges: Unleashing the Employment Potential of the Middle East and North Africa", Washington, DC: World Bank, *http://dx.doi.org/10.1596/978-1-4648-0405-2*.

Sparreboom and Stavena (2014), "Is education the solution to decent work for youth in developing economies?", *ILO Work 4 Youth Publication Series* No. 23.

Stampini, M. and A. Verdier-Chouchane (2011), "Labor market dynamics in Tunisia: The issue of youth unemployment", *Review of Middle East Economics and Finance*, Vol.7, No. 2, pp. 1-35.

Thévenon, O. (2015), "Do 'institutional complementarities' foster female labour force participation?" *Journal of Institutional Economics* 12:2, 471-497.

Turki, S.Y. et E. Verdeil (2013), "La décentralisation en Tunisie" dans Harb M. et Atallah S. (éd.), 2014, Local Governments and Public Goods: Assessing Decentralization Experiences in the Arab World. Beirut, LCPS.

UNDP (2017), "Etude stratégique sur l'économie social et solidaire en Tunisie".

World Bank (2014), Tunisia Urbanization Review: Reclaiming the Glory of Carthage. Washington, DC: World Bank.

World Bank (2014a), "The Unfinished Revolution: Bringing Opportunity, Good jobs and Greater Wealth to all Tunisians".

World Bank (2015a), "Consolidating social protection and labor policy in Tunisia: Building systems, connecting to jobs", *Policy Note*, December.

World Bank (2015b), " Snapshot: Financial inclusion in Tunisia – low-income households and micro-enterprises".

World Bank (2015b, 2015c), "Tunisia: Municipal Finance Note", July.

World Bank (2015a), "Snapshot: Financial inclusion in Tunisia – low-income households and micro-enterprises".

World Bank (2016), "Tunisia Poverty Assessment, 2015".

World Bank (2017), "Doing Business 2017: Equal Opportunity for All". Washington, DC: World Bank, *http://dx.doi.org/10.1596/978-1-4648-0948-4*.

World Bank and CAWTAR (2015), "Services financiers mobiles et inclusion financière en Tunisie".

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The OECD is a unique forum where governments work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies.

The OECD member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The European Union takes part in the work of the OECD.

OECD Publishing disseminates widely the results of the Organisation's statistics gathering and research on economic, social and environmental issues, as well as the conventions, guidelines and standards agreed by its members.

OECD PUBLISHING, 2, rue André-Pascal, 75775 PARIS CEDEX 16
(10 2018 06 1 P) ISBN 978-92-64-29174-4 – 2018

OECD Economic Surveys

TUNISIA

ECONOMIC ASSESSMENT

OECD Economic Surveys are periodic reviews of member and non-member economies. Reviews of member and some non-member economies are on a two-year cycle; other selected non-member economies are also reviewed from time to time. Each Economic Survey provides a comprehensive analysis of economic developments, with chapters covering key economic challenges and policy recommendations addressing these challenges.

Tunisia has experienced strong economic and social progress in recent decades and, more recently, a successful democratic transition. The convergence process has slowed down, however, due to the low level of investment since the early 2000s, while regional and labour market inequalities have persisted. Since 2011, the external and public debt-to-GDP ratios have risen sharply. To put them back on a sustainable path, structural reforms that can sustain growth and competitiveness are needed. In order to boost business investment, regulatory and administrative constraints – including the many licences, permissions to operate and administrative authorisations, pricing constraints and restrictions on competition in certain sectors – need to be reduced. Strengthening Tunisia's competitiveness in global value chains through trade facilitation measures and greater efficiency of logistics services is also key. Encouraging women's participation in the labour market, adapting training to the needs of employers and reducing social security contributions on payroll will help create quality jobs. A new regional development policy, emphasising the specific assets of each region around the development of urban centres, is needed.

SPECIAL FEATURES: INVESTMENT; EMPLOYMENT AND REGIONAL DEVELOPMENT

Consult this publication on line at ***http://dx.doi.org/10.1787/eco_surveys-tun-2018-en***.

This work is published on the OECD iLibrary, which gathers all OECD books, periodicals and statistical databases. Visit ***www.oecd-ilibrary.org*** for more information.

Volume 2018/6
March 2018

OECD*publishing*
www.oecd.org/publishing

THE LONDON BOOK FAIR WINNER
INTERNATIONAL EXCELLENCE Awards 2017
IN PARTNERSHIP WITH THE PUBLISHERS ASSOCIATION

ISSN 0376-6438
2018 SUBSCRIPTION
(18 ISSUES)

ISBN 978-92-64-29174-4
10 2018 06 1 P

9 789264 291744