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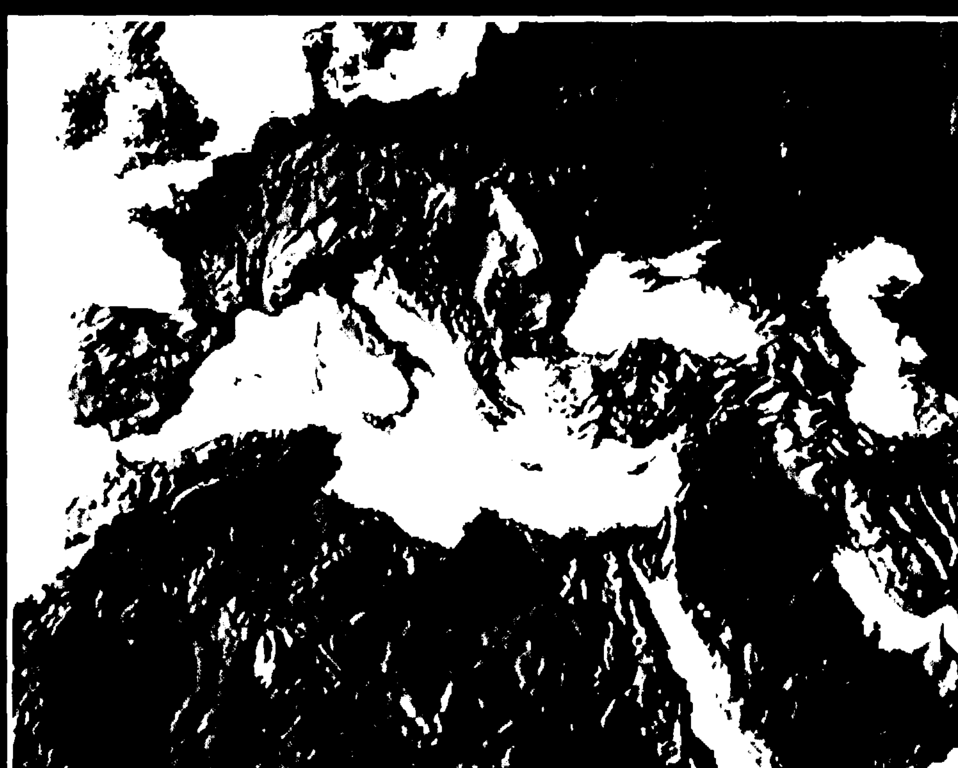
Tunisia's Global Integration and Sustainable Development

Strategic Choices for the 21st Century



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Tunisia's Global Integration and Sustainable Development

Strategic Choices for the 21st Century

The World Bank
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Foreword

This report is the second in a series of World Bank Middle East Economic Studies. It describes the economic progress and prospects of the Republic of Tunisia, and proposes ways in which the Government can build on past successes to raise the standard of living of the Tunisian people.

Tunisia's recent progress has made it one of the best performing economies in the Middle East and North Africa (MENA) region. Thanks to a decade-long program of macroeconomic stabilization, structural adjustment, and gradually opening up the economy to the outside world, Tunisians have seen a doubling of the annual rate of growth of average income per head compared to the early 1980s-over a period when region-wide trends have been stagnant or falling. Macroeconomic outcomes have included relatively low inflation, a halving of the current account deficit since the early 1980s, and a small primary account budget surplus since 1992. Meanwhile, poverty is low and declining, the rate of population growth has been reduced to around 2 percent a year, and most social indicators are above regional averages, reflecting Tunisia's long-standing commitment to high quality social services (especially health).

Nevertheless, much still remains to be done if Tunisia is to achieve further acceleration of economic growth and welfare for its citizens. The report identifies three key areas for priority attention. *First,* if Tunisia is to become competitive in today's fast-moving global economy, its ongoing economic reform program needs to be deepened and speeded up, especially in the area of *trade and investment liberalization.* In particular, the recent Association Agreement signed with the European Union (EU) commits Tunisia to a gradual process of trade liberalization over a 12-year period. It would be beneficial for Tunisia to accelerate this process-not for the sake of liberalization in and of itself, but in order to achieve the enhanced competitiveness that liberalization promotes, and without which more rapid growth would not be feasible. *Second,* the public sector still plays a substantial role in the economy, constraining private sector development and creating difficulties for a clear separation between the political and economic spheres in society. *Privatization and deregulation of publicly provided services* will be at the core of any strategy for improving economic efficiency and promoting domestic and foreign private investment. *Third,* Tunisia is running into environmental constraints that will only worsen as it enters the 21st century. It needs to continue its *strong environmental policies* to deal with natural resource degradation and scarcity (especially land and water), problems of solid and industrial waste disposal, and air pollution in some urban and industrial centers. Taken together, determined policies in each of these areas today will pay huge dividends tomorrow in terms of rapid and balanced growth that benefits all Tunisians.

More generally, Tunisia, like the other countries of the region, faces the challenge of globalization. Here "the race is to the swift," as developing countries compete for the international investment and know-how that will determine their long-run prosperity. For Tunisia, an educated workforce and a strong, competitive and outward looking private sector, able to integrate effectively into the wider international economy, will be central to successful participation in the benefits of world economic growth.

The World Bank has worked closely with successive Tunisian governments in helping to bring their past reform programs to fruition. We would hope to deepen our collaboration with the government and its EU partners in the next phase of this effort, whose ultimate reward will be further improvements in the economic and social well-being of the Tunisian people.

Kemal Dervis
Vice President, Middle East and North Africa Region
The World Bank

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The cooperation of the Government of Tunisia, particularly the Ministry of Economic Development and the Institut d'Economie Quantitative, is gratefully acknowledged.

Abbreviations, acronyms, and definitions

ANPE	Agence Nationale de Protection de l'Environnement (Environment National Agency)
BCT/CBT	Banque Centrale de Tunisie (Central Bank of Tunisia)
BNA	Banque Nationale Agricole (Agricultural National Bank)
CDs	Certificates of Deposits (Certificats de Dépôt)
CNSS	Caisse Nationale de Sécurité Sociale (National Social Security Fund)
CPI	Consumer Price Index (Index des Prix à la Consommation)
CTN	Compagnie Tunisienne de Navigation (Tunisian shipping company)
EPA	Etablissement Public Administratif (administrative entity)
EPIC	Etablissement Public Industriel et Commercial (quasi-commercial entity)
EU	European Union (Union Européenne)
FDI	Foreign Direct Investment (Investissement Direct Etranger)
FODEP	Fonds de Dépollution (Anti-Pollution Fund)
FTA	Free Trade Agreement (Accord de Libre-Echange)
FTZ	Free Trade Zone (Zone de Libre-Echange)
GATT	General Agreement on Tariffs and Trade (Accord Général sur les Tarifs Douaniers et le Commerce)
GDI	Gross Domestic Investment (Investissement Intérieur Brut)
GOT	Government of Tunisia (Gouvernement de Tunisie)
IDF	Institutional Development Fund (Fonds de Développement Institutionnel)
INNORPI	Institut National pour la Normalisation des Produits Industriels (National Institute for Industrial Products Normalization)
INS	Institut National de Statistiques (National Institute of Statistics)
MEAT	Ministère de l'Environnement et de l'Aménagement du Territoire (Ministry of Environment and Regional Planning)
MMR	Money Market Rate (Taux du Marché Monétaire)
MOA	Ministry of Agriculture (Ministère de l'Agriculture)
MOH	Ministry of Health (Ministère de la Santé)
NIE	Newly Industrializing Economies (Economies Nouvellement Industrialisées)
OC	Office des Céréales (National Agency for Cereal Marketing)
OECD	Organization for Economic and Cooperation and Development (Organisation de Coopération et de Développement Economique—OCDE)
ONAS	Société Nationale d'Assainissement (National Sewerage Company)
ONH	Office National de l'Huile (National Agency for Edible Oil)
O&M	Operation and Maintenance (Exploitation et Entretien)
QRs	Quantitative Restrictions (restrictions quantitatives)
SICAF	Société d'Investissement à Capital Fixe (closed-end mutual fund)
SICAV	Société d'Investissement à Capital Variable (open-end mutual fund)
SME	Small-Medium Sized Enterprises (Petites et Moyennes Entreprises)
SONEDE	Société Nationale d'Exploitation et de Distribution des Eaux (National Water Supply Utility Company)
STAM	Société Tunisienne d'Affrêtement Maritime (Tunisian cargo-handling company)

STIL Société Tunisienne d'Industrialisation Laitière (National Company for Milk Marketing)
VAT Value-Added Tax (taxe à la valeur ajoutée)
WTO World Trade Organization (Organisation Mondiale du Commerce)

List of definitions

Accord de place: Informal agreement between commercial banks not to compete for deposits based on interest rates.
Appel d'offres: A weekly auction by the Central Bank of a fixed amount of seven-day funds provided to commercial banks. The *appel d'offres* operations are based on precisely defined collateral (loans to priority sectors, e.g. agriculture, micro-enterprises.
Bon d'équipement: Treasury bonds mandatorily placed by the Government.
Bon du Trésor: Treasury Bills at market-related interest rates.
Bon du Trésor négociable: Treasury Bills negotiable (NTB) on the *bourse* and set at maturities of five years or more.
Contrat de liquidité or *accord de liquidité:* Obligation for commercial banks to repurchase the securities sold to customers virtually on demand regardless of maturity.
Emprunts nationaux: "National loans", borrowing of the Government through bond issues.
Prise en pension: A seven-day repurchase facility at a higher interest rate than the appel d'offres, designed to provide banks with additional liquidity.

Currency and exchange rates

Currency unit: Tunisian Dinar (TD)
TD per US$

Period averages
1980=0.4050
1981=0.4938
1982=0.5907
1983=0.6788
1984=0.7768
1985=0.8345
1986=0.7940
1987=0.8287
1988=0.8578
1989=0.9493
1990=0.8783
1991=0.9246
1992=0.8844
1993=1.0037
1994=1.0116

Fiscal year
January 1–December 31

Weights and measures
Metric system

Executive summary

Elements of Tunisia's success

In the mid-1980s, Tunisia made the strategic choice to become a modern, market-oriented, and internationally integrated economy. Tunisia's macroeconomic performance since introducing stabilization and structural adjustment reforms in 1986 has been impressive. The per capita GDP growth rate increased significantly from an average of 1.15 percent a year for the period 1981–86 to 2.44 percent a year for the period 1987–94. The inflation rate (4.5 percent in 1994) is approaching the average rate of the EU countries (4.1 percent). The central-government primary balance has been in a slight surplus since 1992, and the ratio of tax revenues to GDP is higher than the respective averages for selected countries in the Latin American, Southeast Asian, and Middle Eastern regions. The current account deficit averaged 4 percent of GDP during 1986–93, thus improving with respect to the early 1980s when it averaged 8.5 percent of GDP.

The economy is also becoming more diversified and more open, as manufactured output replaced the previous dominance of oil and phosphate production and as the ratio of nonpetroleum and nonphosphate exports to GDP increased from 25 percent in the early 1980s to 35 percent in the early 1990s. With the implementation of monetary and financial sector reforms, Tunisia's financial market is deepening and the capital market is becoming very active (after more than twenty years of dormancy). At the same time, the country has made impressive social advances over the past decade: the incidence of poverty is low and declining, and income distribution is improving. The progress achieved in the development of human capital, the reduction of the population's growth rate, and an increase in life expectancy are also highly commendable and are important ingredients for stronger growth.

Strategic choices in the 1990s

This report focuses on the policies that will influence the future growth and development of Tunisia. The report analyzes the areas expressed by the government as being strategic for Tunisia's future: achieving higher rates of growth in the context of sustainable environmental management and the enhanced competitiveness of the economy in the global market. In addition, the report includes key issues raised by other groups in Tunisia (the private sector and members of the academic community) on the role of the state in the economy, the development of the financial sector, and the adequacy of the education system in meeting the human capital requirements of the twenty-first century. Three key messages emerge from the analysis which can contribute to the country's strategy formulation:

- The pace of structural reform needs to move forward more decisively, particularly in the areas of trade and investment liberalization. Although the Tunisian economy has become stronger and more sophisticated since the late 1980s, the external environment has not stood still. The rest of the world is also changing rapidly, so that countries like Tunisia need to liberalize their economy with determination and in a timely manner to maintain their growth prospects and enhance their international competitive position.
- The state needs to decrease further its size and role in the economy, strengthen its actions in the provision of public goods, and encourage a higher level of private investment—domestic and foreign. Further disengagement of the state and the deregulation of public sector monopolies (for example in telecommunications, maritime transport, and in the banking sector) and an acceleration of the privatization program would promote productive and allocative efficiency in the economy and enable the Government to focus on the enforcement of regulations that encourage profitable activities, protect the public, and preserve the country's natural resources.
- Environmental constraints mean that further adjustments in growth plans must take place, particularly in agriculture and tourism. By undertaking the necessary adjustments now, the Government will be in a better position to implement these reforms gradually.

Report outline

The report is organized as follows: chapter 1 (Macroeconomic policies) covers monetary, balance of payments, exchange rate and fiscal policies; chapter 2 (Role of the state) covers the role and size of public enterprises in the economy, the provision of infrastructure services, health and education policies, and environmental management; chapter 3 (Strengthening market forces) covers a range of policies designed to create a more competitive economy (trade, pricing, labor, industrial, financial and agriculture); chapter 4 (Policies for higher growth) applies the findings of the more recent growth literature and comparative country analysis to the case of Tunisia; and chapter 5 (Challenges of globalization) proposes a strategy to maximize the benefits to Tunisia of a closer integration with Europe and the rest of the world. The following sections summarize the main points of each chapter.

Macroeconomic policies and management (chapter 1)

The stabilization measures introduced after 1986 brought a significant degree of macroeconomic stability and a much improved level of efficiency in the use of resources in Tunisia. The accomplishments described earlier are remarkable. Nevertheless, some areas in macroeconomic policy still merit further improvements.

Monetary policy

Further liberalization of interest rates is essential to obtain a market-driven yield curve in Tunisia. This can be accomplished by eliminating all remaining preferential rates, encouraging competition among commercial banks on the basis of both interests rates and portfolio quality, and promoting a secondary market in Treasury securities through the removal of restrictions in their clearance and settlement procedures. These changes will also allow the Central Bank of Tunisia (BCT) to control monetary expansion through system-wide open-market operations in Treasury bills rather than by allocating funds on a bank-by-bank basis, provided an integrated secondary market for Treasury bills and bonds exists and provided the banks achieve stronger deposit bases in proportion to their credits. System-wide monetary expansion, market-driven interest rates, and a thriving secondary market in government securities are all necessary elements for the efficient conduct of monetary policy, whose goals consist of achieving price stability and minimizing GDP fluctuations around its full-employment level.

Balance of payments

Tunisia's rather sizable trade deficit and the large role of tourism receipts and workers' remittances in financing the trade deficit make Tunisia's external position vulnerable to adverse developments in the region's economic and political stability. Faced with an adverse economic or political shock, it would be rather difficult under current international conditions to finance a larger current account deficit. This is so because of both higher interest rates in developed countries and less optimism toward emerging markets (partly as a result of the Mexican crisis). However, Tunisian authorities have demonstrated, as in their handling of the Gulf crisis repercussions on Tunisia in 1990 and 1991, their determination to avoid serious balance of payments disequilibria. Imposing trade restrictions (as in 1991) is effective in the short run to deal with balance-of-payments imbalances, but at a high cost. In the long run, only policies that encourage competition and a diversified production structure, stimulate flexibility of wages and relative prices, induce higher public and private savings (which are all goals of the Tunisian structural reforms), and allow for a market-determined exchange rate (which is the motivation behind the introduction of the interbank foreign-exchange market) result in a socially efficient, sustainable external position.

An examination of the behavior of national savings and investment shows that the worsening of the current account deficit from 1989 to 1993 was accompanied by a rise in both savings and investment, with the latter increasing at a faster rate. To the extent that external savings are being used to finance higher and better quality domestic investment, the sustainability of the current account deficit is preserved. This confirms the conclusion that Tunisia's external position is secure to the extent that the structural reforms are implemented.

Fiscal policy

Generalizing the value-added tax (VAT) and broadening the income-tax base will both reduce the reliance on foreign-trade taxes and increase total tax revenues. These improvements and controlling the expansion of the government wage bill are necessary not only to compensate for a likely future decline in petroleum-sector revenues but most importantly, to finance increased expenditures in infrastructure, education, and public health.

Although the deficit of the central government seems to be well under control, the question of the sustainability of the consolidated-government deficit, for which accurate information is unavailable, remains. The Government should prepare information on (1) the consolidated nonfinancial public sector (consolidating the central government with local government, social security, and nonfinancial public enterprises) and on (2) the consolidated total public sector (which adds to the first consolidation the central bank and the public banks). Some data on public banks and enterprises reveal that their profitability is considerably lower than that of their private counterparts. This, together with the distortionary effect of government direct participation in competitive economic activities, calls for an acceleration of the privatization process initiated in 1987.

Role of the state (chapter 2)

Estimates of the public sector's (government and public enterprises) share in total output and in total investment have slowly come down between the early 1980s and early 1990s from 48 percent to 42 percent for output and from 57 percent to 54 percent for investment. But this share is still quite high compared with other countries. For developing economies as a whole, the public enterprise (PE) share of GDP is around 11 percent (14 percent for the poorest countries), and it has come down to about 7 percent for industrial countries, compared to an estimated 20–25 percent in Tunisia. Privatization, namely the divestiture of state assets and public enterprise closures, have so far played a modest role in the government's restructuring and "competitiveness upgrading" efforts. Total cumulative sales since 1987 amounted to about US$180 million in 1994 (about 1 percent of GDP), with roughly half of the privatizations in the tourism sector.

Privatization and divestiture

The Government's strategy so far has focused more on constraining new PE investments and on trying to make PE operations more efficient and more autonomous. While these efforts have had a positive impact on reducing transfers to the PEs, transfers are still significant (3 percent of GDP), and it is unclear whether some of the transfers have been shifted to the banking system (through debts) or to the public (through higher prices charged by PEs in a protected or quasi-monopoly position). Several cross-country studies show that even in spite of improved PE performance, ownership does matter. It determines the incentive structure of the enterprise, which, in turn, is the force that promotes productivity in a competitive environment. For a variety of reasons—political and social—PEs have more difficulty than private enterprises in adapting quickly to an open, competitive, and rapidly changing international environment. Since 1991/92, the Government has been preparing sectoral studies (in order to evaluate divestiture options) and amendments in legislation in order to create a legal environment which will facilitate stronger privatization efforts in 1995/96.

Deregulation and increased efficiency in infrastructure services

In 1985, a law was passed that opened merchandise transport to the private sector, but the law was not applied until 1989. The Government has also been slow to deregulate cargo handling and maritime transport in the main Tunis ports, despite the slow and costly service. Several studies have been prepared, and in 1995 the Government is in the process of exploring privatization/deregulation options to improve the situation. Deregulation of public bus transport has been slow, and noncharter air transport and telecommunications are both state-owned monopolies.

Progress has been made in reducing public sector force account for operation and maintenance (O&M) works under the National Water Supply Utility Company (SONEDE) and the National Sewerage Comapny (ONAS), both of which use private subcontracting for most of their O&M works. In the transport sector, recurrent road maintenance is still largely done by public sector force account. In 1995 the Government is planning to open some infrastructure projects in electricity, solid waste treatment, highways and water purification to private concessions, hoping to attract foreign investment. The Government is also raising prices for many infrastructure services with the objective of encouraging demand management and covering the full cost of operations and part of investment costs by the year 2000.

The quality, access, and affordability of social services

The Government has secured good quality and nearly universal access to health care through the public provision of health services. The Government needs, however, to secure a sustainable system for financing growing costs—a problem not dissimilar from what many OECD countries face. Tunisia also needs to meet the demands of a population still growing at 2 percent a year as well as the demands of a growing older population with more chronic diseases that are expensive to treat. As the main provider and financier of health care, the Government needs to promote the active private sector provision of health services by enhancing its own supervisory role and by reducing its widespread provision of subsidized services (nearly half the population receives free or highly subsidized care). To maintain the quality of existing services, the Government needs to better target health care subsidies, increase some user fees, encourage an expanded use of private resources and services, and focus public funds on preventive care.

The Government's Secondary Education Reform Program must succeed in increasing the completion rates of primary education (grades 1–9). A solid primary education base provides the cognitive, language and analytical skills to improve employment and earning opportunities and ensure Tunisia's ability to integrate confidently with the highly educated European labor force. The Government is trying to make tertiary education and vocational training more relevant to the country's future development needs. A comparison of 1992 higher level student curriculum shows that the largest share of students (one quarter) are studying humanities, compared to 5 percent in teacher training, about 6 percent in business administration, and less than 10 percent in engineering. These percentages contrast quite sharply with those in such countries as Portugal, Malaysia, and Chile. In order to meet the demands of growing numbers of young people seeking higher education and to provide the quality needed, more resources will be required. At present, virtually all (97 percent) of higher education is provided and financed by the state, contrasting with trends in other parts of the world where private funds and private provision play a larger role in vocational training and higher education.

In Tunisia, regulatory reforms, including accreditation and supervisory policies, can speed up the entrance of private investors in many different service activities which have been traditionally dominated by the public sector (higher education, vocational training, medical services, agricultural extension, and veterinary services). Shifts in public/private financing policies need to be introduced so that limited public funds are used to finance priority areas with high social and economic returns, for example, increasing completion rates of nine years of basic education and further improving preventive health care. Private financing needs to increase in areas where private benefits are high: medical expenses (with public/private insurance policies) and tertiary education (with loans and scholarships for the needy).

The environment—paying the price for resource use and degradation

The natural beauty of Tunisia, its vulnerability to climatic variations, and the important role of such an environmentally sensitive activity as tourism in the economy have heightened the need to take full account of the costs and pricing of resource use and degradation. The authorities have learned from past experience: inappropriate pricing policies that did not take into account the economic value of resources; haphazard coastal zone planning; and fiscal and financial advantages for activities that exacerbated erosion and water scarcity problems. The Government is making good progress in correcting these policies and in organizing itself institutionally to assess the costs and benefits of development and investment initiatives with a longer term perspective. The donor community is providing budgetary assistance and technical advice to support the Government's program.

Tunisia's environmental program can, nevertheless, be strengthened by: (1) ensuring that the costs of environmental degradation are borne by resource users and polluters; (2) promoting community-based actions and developing the central and local capacity to monitor progress; and (3) ensuring that the government's development strategy in agriculture, industry, and tourism is based on the economic value of natural resources, particularly land and water. The types of problems which Tunisia will face in the twenty-first century include natural resource scarcity, solid and industrial wastes, and water and air pollution in selected areas. To tackle these problems will require additional resources (generated through pollution charges), and some reallocation of expenditures—away from municipal waste water treatment, for example.

Progress in strengthening market forces (chapter 3)

The number of import restrictions, or quantitative restrictions (QRs), has come down since 1990. Those that remain were estimated to cover 25 percent of domestic production by end 1994 (mainly some agricultural products, processed food, and textiles). Many of the restrictions, however, could be replaced with tariffs, since the estimated tariff equivalents of the QRs fall within Tunisia's legal tariff range agreed to under the GATT. The average tariff rate for domestic producers is still quite high (33 percent) compared to 36 percent prior to liberalization reforms. The reason the average rate has not fallen more sharply is because the removal of many QRs after 1990 was offset by temporary surcharges of up to 30 percent.

Trade liberalization

On July 17, 1995, Tunisia became the first country in the Middle East and North Africa region to sign a Free Trade Agreement (FTA) with the EU—its largest trade partner, accounting for 75 percent of its imports and exports. The agreement marks another important step in opening Tunisia's economy to international competition, a process which began in 1986, and has included its accession to the GATT in 1990 and its signature to the Uruguay Round agreement in 1994. The elimination of the remaining trade barriers in Tunisia will largely be influenced by the pace of Tunisia's trade and commercial integration with the EU. The draft FTA provides for extensive technical support from the EU to harmonize product standards and upgrade the quality of Tunisian goods and services which brings important benefits to Tunisia. The agreement also allows for some tariffs to be removed immediately (those that do not affect domestic production), while other tariffs on more sensitive products would be removed more gradually—over the next five to twelve years. Discussions on market access for agricultural products and services both in the EU and Tunisian markets have been postponed for five years (although the access for some agricultural products has been increased). The benefits of free trade with the EU are estimated to be very large for Tunisia (between 4–5 percent of GDP a year), provided Tunisia removes the high tariffs on the most protected sectors in the short term (less than five years). It would, thus, be beneficial for Tunisia to: (1) compress the schedule of QR eliminations and tariff reductions currently agreed on with the EU; (2) begin lower tariffs on all manufactured goods in the first year (1996); (3) apply reductions to all of its trade partners; and (4) seek greater access to the EU market, particularly for services.

Investment liberalization—domestic and foreign

A 1987 manufacturing investment law abolished capacity licensing and removed prior government authorization for all projects not requesting investment incentives. The problem with the law, however, was that it introduced generous incentives on a sectoral basis (exceeding 1 percent of GDP) and created distortions in the allocation of investment resources. Most investors wanted the incentives, hence Government approvals continued to play a critical role. In December 1993 Parliament passed the Unified Investment Code which was ratified in 1994. The law reduces sectoral incentive distortions and reduces the number of investments requiring government approval. The new code is more open to foreign investment and strengthens the investment liberalization commitment begun in 1987. But investment restrictions in many support services (such as transportation, telecommunications, tourism, education and cultural establishments, real estate, computer and information technology, consulting, and auditing) remain in place and investments in sectors not specified under the new code remain regulated (restaurants, financial services, mining, energy).

Foreign investment in Tunisia has not been well-integrated into the rest of the economy. Already in the 1970s, a dichotomy developed between the "offshore" companies (that produce for export) and the "onshore" companies (that produce for the domestic market). Offshore companies face a completely liberalized trade regime and pay little or no taxes, while onshore companies were heavily protected, but faced more controls with respect to import duties, taxes, and other regulations. The new code attempts to place domestic companies on a more equal footing with export companies. Continued efforts, perhaps with the support of the EU, to improve infrastructure services, rationalize tax laws and incentives, and ensure that the tariff protection system is applied in a streamlined and uniform manner for all enterprises—direct and indirect exporters alike—would promote a closer integration of domestic companies in offshore activities and promote higher levels of private investment.

Price liberalization

Considerable progress has been made in reducing producer price controls and regulated distribution margins in the agricultural and manufacturing sectors. By end 1994, only 13 percent of producer prices in agriculture and manufacturing were still regulated and 30 percent were regulated at the distribution stage. The two main sectors where controls account for a significant share of production are agroindustries and construction materials, and, at the distribution stage, for machinery and equipment. Regulated distribution margins for fresh fruits and vegetables should be removed, given the extent of domestic competition in this subsector and the need to transmit clear price signals back to producers. Cereal prices are not included in the price liberalization calculation, but are set by the Government, and the prices of many services and nonmanufactured goods continue to be regulated.

Labor markets

The population growth rate of 2 percent (and the young age structure of the population), the entrance of more women into the work force, and rural to urban migration flows are increasing the urban labor force at the rate of an estimated 5 percent a year. Unemployment is estimated by the Bank to be between 11–12 percent, with the main unemployment problem being for first-time job seekers. The growing size of the urban work force puts pressure on the authorities to increase economic growth and create more jobs. Between 1989–93, job creation has been faster than the average for the economy in the services sector (4.3 percent) which accounts for the largest share of total employment (24 percent). Employment in government administration is high (18 percent of total employment and 25 percent of total wage earners), and it has also been growing faster than the economy's average (3.2 percent compared to 2.1 percent). The authorities may wish to introduce quarterly or annual labor surveys, which are used in many countries to give policymakers more up-to-date information on labor market changes. The Government is currently preparing a strategic study of labor issues for the Ninth Plan covering labor legislation, costs, productivity and wages. In particular, the Government is reassessing labor legislation with the objective of increasing employer flexibility to adjust the size of the work force.

Reforming agriculture

Input subsidies have been reduced significantly, but the Government should reassess its agricultural policies that hinder private sector participation in marketing some agroindustrial products. Policies that entail price supports and credit subsidies to maintain or increase cereal production need to be reassessed in light of trade integration with Europe and the expected impact of the Uruguay Round agreement. The land tenure system (characterized by poorly defined property rights) hinders the use of market mechanisms as a means of ensuring that land and agricultural inputs are used as efficiently as possible. The state, as a major owner of prime crop land (11 percent of total cultivable land) should consider expanding its program of leasing land to the private sector and reassess the costs and benefits of selling state lands to the private sector.

Banking reform

Tunisia has come quite far in creating a healthier and more efficient banking sector. Prudential regulations were reinforced in 1994, including stringent capital adequacy requirements, and the supervisory role of the central bank has been strengthened. The most notable feature of the banking sector is the predominance of public sector banks, which account for 70 percent of the banking sector's total assets and whose performance is significantly weaker than that of the private banks.

The Government's efforts have focused on recapitalizing the public sector banks and improving the quality of their portfolios. In order for these efforts to succeed, the policy environment has to encourage competition—based on the provision of services and on interest rates. A gradual divestiture of these banks (through selling some shares on the stock exchange) would be an ineffective substitute for selling a controlling interest to a core group of shareholders that can appoint key board members and managers that can run the banks after divestiture. With respect to the government-owned development banks, the Government should explore options with its partners (the governments of other Arab states) to reorient the development banks' activities toward investment banking, restructure some, or link some of them up with commercial banks.

Financial market development

After being dormant for more than 20 years, since 1989, the Government has strengthened the necessary laws and regulations which have encouraged the stock and primary bond markets to begin functioning. Between 1990 and 1994 primary bond market activity grew steadily, while stock market activity increased dramatically. Over this period, the stock index increased 350 percent, the capitalization of the 20 listed companies on the Tunis stock exchange jumped from TD 543 million to TD 2.4 billion, and the demand for stocks exceeded the supply by 200–500 percent. The average price/earnings ratio on the Tunisian stock market is high (25), compared to average ratios in other emerging markets that range between 10 and 15. The Government should consider: (1) speeding up the privatization program to increase the supply of stock offerings and help to satisfy the excess demand for stocks and (2) removing fiscal distortions in the form of large tax benefits that encourage investors to oversubscribe to initial stock offerings. It will nevertheless take time for many of Tunisia's traditional, family-owned companies to go public. The Government has overseen the development of an increasingly sophisticated financial sector. With the implementation of reforms to strengthen institutional investors, and by ensuring market-driven interest rates and an active secondary market for government securities, the financial sector will be significantly strengthened.

Policies for higher growth (chapter 4)

In the mid-1980s, several prominent economists began focusing their attention on how long-run growth is enhanced by socioeconomic developments and government policies. This theoretical and empirical research uses cross-country data to measure to what extent different structural reforms promote economic growth. Their main conclusion is that economic growth is maximized when the incentives to invest in physical and human capital as well as in technological innovation are determined by free-market forces. Governments assist this process by providing an environment of macroeconomic and political stability and the appropriate public infrastructure.

This work has been applied to the case of Tunisia, by comparing per capita GDP growth improvements from 1981–86 (the period prior to undertaking adjustment reforms) with those during 1987–94 (the period during which structural reforms have been under implementation). The analysis compares the predicted improvement with the actual improvement, and it estimates the growth impact of several policy measures, as determined by the cross-country empirical analysis. The main elements that contributed to improved growth in Tunisia were estimated to be (1) an increased openness of the economy, (2) a reduction in price distortions, (3) improvement in population health indicators, (4) advancement in the level of education, and (5) financial deepening. All these elements significantly increased the economy's total factor productivity. Given that physical capital investment as a ratio to GDP was lower in 1987–94 than in 1981–86, the rise in total factor productivity was the main source of the improved growth performance in the reform period.

Conditional on a timely completion of the reform program, real GDP is projected to grow at an average of 6.2 percent over the next nine years. It is estimated that about one third of the growth improvement with respect to the period 1987–94 would be explained by a larger investment rate. Thus, most of the growth improvement would come through a further rise in total factor productivity, generated by both stronger market incentives for private activity and more efficient public services. Given the environmental constraints facing Tunisia, agriculture's share in total production is projected to decrease in the coming years at the same time as manufacturing and nongovernment services (with a slightly decreased role for tourism) become the leading growth sectors. Tunisia's external position would remain sustainable, particularly under the high-growth scenario, as private savings respond favorably to financial sector reforms and as the exports to GDP ratio rises due to Tunisia's enhanced international competitiveness.

The challenges of globalization (chapter 5)

Successful economic performance will be increasingly determined by a country's adaptability to accelerating change in the rest of the world. A strong human capital base, transparent rules and regulations, and private sector dominated enterprise management structures offer Tunisia its best chance to compete successfully in the global economy. The government plays an enormous role in creating an environment that promotes entrepreneurial agility, strong human resources, and labor force flexibility.

Tunisia has been liberalizing its economy for nine years, and in many respects it has gone quite far. But past sources of growth are diminishing and many face growing environmental resource constraints (hydrocarbons, mining, agriculture, tourism). New investments and new sources of growth need to be developed with the private sector taking the lead in a competitive environment. At this advanced stage in the adjustment process, the remaining reforms that need to be undertaken are all important and complement each other, and therefore should, ideally, be pursued concurrently. Although undertaking numerous reforms simultaneously may be economically desirable, it may be politically difficult. For this reason, the report places a particularly strong emphasis on trade liberalization measures, since the pressure of international competition will require Tunisia to follow a comprehensive adjustment strategy to respond to that pressure. By adhering to well-known and straightforward reform timetables, the Government shows strong political commitment toward competition, and economic agents—entrepreneurs, local and foreign investors, and civil servants—become convinced that the system has changed irreversibly.

Tunisia has much to gain from accelerating reforms in trade liberalization, the deregulation of state monopolies, and a reduction in the predominance of the state in the provision of goods and services. The goal of high sustainable growth is achievable in Tunisia, but requires strong determination to maintain macroeconomic stability and push forward the implementation of structural reforms.

Chapter 1
Macroeconomic policy

The mid-1980s marked a turning point for the Tunisian economy. Since 1986, the economy has been undergoing a transformation which has combined the elimination of macroeconomic disequilibria with gradual but important structural reforms aimed at refocusing the role of the state (see chapter 2), and transforming a highly regulated and protected economy to an open, market-oriented one (see chapter 3). Stabilization measures launched the reform program in 1986. Structural reforms have been applied throughout the period, but gained increasing importance after 1990. This chapter looks at the macroeconomic developments and policies pursued from the mid-1980s to today, tracing the shifts in monetary policy, balance of payments and exchange rate policy, and fiscal policy. The analysis of Tunisia's growth performance and its sources, particularly in relation to the reform program, is undertaken in chapter 4.

Monetary policy

Prior to 1986, the main objective of the Tunisian Central Bank (BCT) was to provide credit to support the Government's economic development plan. The Government's control of the commercial banking system allowed the BCT easy management of financial markets. The BCT controlled the growth and distribution of credit as well as various interest rates (table 1.1). The spread between the rate paid on deposits and that charged to the private sector bore little relationship to the excess demand for credit. Furthermore, to enforce the distribution of credit according to the rationing scheme imposed by the BCT, commercial banks needed the Central Bank's approval for most of their operations. Priority sectors (mainly agriculture, tourism, manufacturing of heavy equipment, exports, and small enterprises) had preferential access to credit and paid lower interest rates. In fact, the real interest rate on loans to priority sectors was negative for most of the period from 1972 to 1985. Heavily subsidized credit created an incentive to invest in low-return projects and crowded out investment in other areas of the economy.

Loan repayment was low, because of the highly cumbersome judicial process, which slowed down payment collection through legal means. The BCT had to give prior approval for most loans. Knowing that the BCT would bail them out, banks were mainly concerned with expanding loans, with little consideration to their portfolio quality. The real interest rate on term deposits was also mostly negative during 1972–85, hence generating financial disintermediation. Thus, the reduced amount of savings channeled through the banking sector could not satisfy the large demand for loans that the artificially low interest rates had generated. The excess demand for loans created the need for an expansion in money supply, which in turn led to a significant rise in inflation (8–9 percent).

Monetary and exchange rate policy after 1986

Given a nominal exchange rate fixed with respect to Tunisia's main trading partners, a relatively high domestic

TABLE 1.1
Nominal and real interest rates

Year	Inflation (CPI)	BCT preferential rate		Money market rate (end of period)	
		Nominal	Real	Nominal	Real
1981	8.9	—	—	8.50	–0.40
1982	13.7	—	—	8.25	–5.45
1983	9.0	—	—	8.38	–0.62
1984	8.5	—	—	8.89	–0.39
1985	8.0	—	—	10.28	2.28
1986	5.8	5.13	–0.68	10.25	4.45
1987	7.2	5.31	–1.89	9.50	2.30
1988	6.3	5.31	–0.99	9.63	2.33
1989	7.7	5.31	–2.39	11.31	3.61
1990	6.5	6.50	0.00	11.81	5.31
1991	8.2	6.50	–1.70	11.81	3.61
1992	5.8	8.50	–2.70	11.31	5.51
1993	4.0	8.50	4.50	8.81	4.81
1994	4.5	8.50	4.00	8.81	4.31

— Not available.
Source: Central Bank of Tunisia, except MMR from 1981 to 1985, IMF Financial Statistics.

inflation hindered the competitiveness of Tunisia's products in world markets and led to an unsustainable current account deficit by 1986. To deal with the short-run balance-of-payments crisis, the BCT sharply devalued the Dinar and, more importantly, changed its monetary and exchange rate policies in accordance with a comprehensive package of economic reforms.

With the goal of improving the efficiency of credit allocation, decreasing inflation, and maintaining equilibrium in the external accounts, in 1987 the Government initiated two major improvements in monetary policy: (1) a shift of emphasis from direct control of credit and monetary expansion to indirect management through refinance facilities and (2) a gradual elimination of preferential interest rates and quotas (box 1.1).

Since 1987, monetary policy in Tunisia has been directed at reducing inflation and strengthening the external reserve position of the Central Bank. On both accounts, the BCT has been quite successful. There are a few aspects of interest rate policy that warrant further discussion and improvement.

Interest rate policy

Preferential interest rates and mandatory financing for priority sectors are still in effect, although their share in outstanding bank loans declined from 25 percent in 1990 to 10 percent in 1993. Authorities intend to eliminate all the remaining preferential rates and mandatory financing by the end of 1995.

Nonpreferential interest rates have been considerably liberalized, and all interest rate controls have been removed. Nevertheless, interest rates have been surprisingly stable over the past years (table 1.2). There are two aspects to the stability of nominal interest rates. The first refers to the nearly constant spread between the two BCT refinancing rates (*appel d'offres* and *pension*) and the money-market (MMR) and deposit rates. The second refers to the over-time stability of these rates.

The rigidity of the spread between BCT-controlled rates and the money-market and deposit rates is largely due to the *accord de place,* an arrangement by which commercial banks agree for the most part not to compete on the basis of interest rates. The *accord de place* is a form collusion, which hampers market-driven competition, unduly protects the less efficient banks, and erodes the informational content of interest rates as relative prices.

The stability of the BCT-controlled rates over time results mainly from a policy of monetary expansion based on interest rate targeting. The BCT only partially fulfills the banks' demand for auctioned funds and through dissuasion, curtails the use of the pension. Although refinancing facilities are open to all banks, some credit access regulation must be in effect in view of the fact that the interest rates are so stable and the BCT has a target for monetary growth.

The use of the interest rate as an intermediate target of monetary policy—that is, pegging the interest rate by accommodating money demand changes—may not accomplish an important objective of the Central Bank, namely, the minimization of real GDP fluctuations around its full employment level. In an economy with limited international capital mobility and a managed exchange rate, targeting the interest rate will lead to smaller fluctuations in GDP only if the main source of uncertainty arises from shocks to the demand for money. However, if the main source of uncertainty resides in the demand for goods and services or in aggregate supply, then interest rate pegging will lead to higher GDP fluctuations.[1] In Tunisia, shocks to aggregate supply and the demand for goods and services are a significant source of uncertainty, as demonstrated by several events in the early 1990s: the Gulf crisis, which led to a substantial decrease in export growth and tourism receipts in 1991; the droughts of 1993 and 1994, which led to a considerable drop of cereal harvest; and the sharp terms-of-trade deterioration and the slowdown in market growth of Tunisia's trading partners in 1992. Given the importance of these nonmonetary shocks, a mixed (interest rate/money supply) targeting rule seems more appropriate to minimize fluctuations of real GDP around its full-employment level in Tunisia.

An additional problem of having nominal interest rates that are adjusted infrequently is that rate movements follow, rather than anticipate, changes in the inflation rate. Consequently, in the context of decreasing inflation which characterizes the Tunisian experience of the last seven years, real interest rates have tended to be high. During 1993 the BCT induced the sharpest decline in nominal interest rates of the previous four years, with the biggest single drop (from 11.81 percent to 8.81 percent) occurring only late in the year. However, inflation had already decreased significantly in 1992 (figure 1.1 and table 1.1). The resulting high real interest rates in 1992 and 1993 explain in part the sharp drop in investment and GDP growth in 1993.

BOX 1.1

Monetary policy instruments, government securities, and foreign-exchange markets

Monetary instruments

The control of monetary expansion is conducted on a bank-by-bank, rather than a system-wide, basis through two instruments: the *appel d'offres* and the *prise en pension*. The *appel d'offres* is a weekly auction of a fixed amount of seven-day funds. The *prise en pension* is a seven-day repurchase facility at a punitive, higher interest rate, designed to provide banks with additional liquidity to that obtained through the *appel d'offres*. Whereas for *prise en pension* operations the BCT accepts as collateral all refinanceable papers (except Treasury bills), *appel d'offres* operations are conducted on the basis of precisely defined collateral (certain loans to priority sectors, for example, agriculture, microenterprises).

The *appel d'offres* and pension rates maintain a fixed spread between them: 1.5 percentage points through 1991 and 1992, and 1 percentage point since December 1992 (see table 1.2). Since 1990, the interbank (money-market) interest rate has stayed fairly constant for long periods of time, changing discretely when the *appel d'offres* and the *pension* rates are changed by the Central Bank; since December 1990, the interbank rate has remained at 1/16th below the *pension* rate.

Interbank trading, which on average amounts to only one-third of the liquidity obtained through the Central Bank facilities, has remained low because of the lack of easily tradeable financial instruments and the banks convenient access to the *pension*. As explained below, banks have been virtually unable to trade government securities with each other in the secondary market.

Government securities

Prior to 1991, non-bank domestic financing of the fiscal deficit consisted of the forced placement of ten-year Treasury investment bonds (*bons d'équipement*) at below-market rates. As part of the financial liberalization program, the government has, since 1991, relied mainly on Treasury bills (*bons du Trésor*) at market-related interest rates to finance the deficit. Treasury bills were first introduced in 1989 and modified on several instances. These securities are placed through weekly auctions to the banks, which then sell them to the public at a slightly lower interest rate. The rates for Treasury bills bid by the banks have remained virtually constant with respect to the *appel d'offres* rate, and the interest rates for the shortest maturities are only slightly lower than for the longest-maturity Treasury bills.

Treasury bills have been quite successful as a means to finance the budget deficit. In principle, Treasury bills may also serve as the basic instrument of open market operations and interbank trading. However, a secondary market on Treasury bills has not developed in Tunisia due to (1) the lack of competition among banks on the placement of government securities and (2) restrictions in clearance and settlement procedures. In fact, transactions have been limited to those between each bank and its customers because property rights cannot be transferred from one bank to another in the accounts of the BCT. The market-making responsibility assigned to the banks by the BCT has been thus interpreted as an implicit *contrat de liquidité*, by which banks are obligated to repurchase government securities virtually on demand, regardless of maturity. Consequently, the term structure of interest rates (yield curve) has been basically flat.

In order to obtain a suitable, longer-term debt maturity structure, the Tunisian authorities introduced in late 1993 the option of having banks convert a Treasury bill (*bon du Trésor*) into a negotiable Treasury bond (*bon du Trésor négociable*), which would be traded solely at the Bourse. At first, due to problems in the settlement procedure, trading in the new securities did not take place. In June 1994, the authorities changed the bon du Trésor négociable into a bond with maturities of five years or more, to be issued through and traded at the Bourse. Correspondingly, the maturities of the simple bon du Trésor were limited to four years or less. It is expected that this change, together with improvements in the settlement procedure, will increase the attractiveness and marketability of the negotiable Treasury bonds, thus increasing their share in domestic public debt.

Foreign exchange markets

Until recently, the BCT has tightly controlled the determination of the nominal exchange rate. In March 1994, the BCT introduced an interbank foreign-exchange market with the purpose of obtaining a more flexible and market-determined rate. During the launching period, the BCT sets a central exchange rate on a daily basis around which banks trade among themselves within a ± 1 percent band. Furthermore, in order to protect small customers, the BCT dictated a maximum buy-sell spread of 0.25 percent. Although these controls help avoid erratic daily fluctuations of the exchange rate, they should be relaxed, and eventually eliminated, in order to obtain market-determined rates as banks adapt to the new system. The BCT has instituted prudential regulations to prevent the excessive exposure of banks to foreign exchange risks. Currently, 70 to 80 percent of all foreign exchange transactions are conducted in the interbank market. Such a large bank participation is an early indication of the success of the new system. The level of sophistication in foreign-exchange transactions is bound to improve: presently, derivative products (swaps, reverse repurchase agreements, futures, and options) are absent from the market.

Note: Also Brun and Burakreis 1995.

TABLE 1.2

Selected interest rates

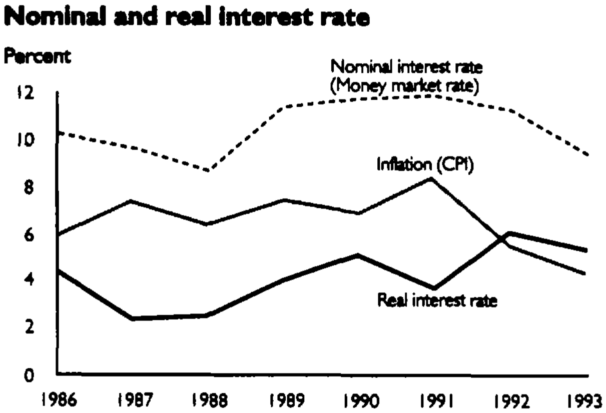
	1986	1987	1988	1989	1990	1991	1992	1993	1994
Money market rate	10.25	9.50	8.63	11.31	11.81	11.81	11.31	8.81	8.81
Central bank									
Appel d'offres[a]	—	—	—	10.31	10.38	10.38	10.38	7.88	7.88
Prise en pension[b]	—	—	—	11.31	11.88	11.88	11.38	8.88	8.88
Rediscount of preferential credit (end of period)							8.25 7.75		
Export-related credit	4.00	4.00	4.00	4.00	6.25	6.25	8.50	8.25	8.25
Crop credit	4.50	4.75	4.75	4.75	5.75	5.75	9.50	7.75	7.75
Agricultural equipment	5.50	6.00	6.00	6.00	6.50	6.50	—	8.50	8.50
Small- and medium-sized enterprises	6.50	6.50	6.50	6.50	7.50	7.50	—	9.50	9.50
Commercial banks									
Maximum lending rate[c]	12.63	13.00	11.63	13.75	14.81	14.81	16.50	14.44	—
Special saving deposit rate[d]	8.15	7.50	6.63	9.25	9.63	9.63	9.63	7.38	7.38

a. Auction of refinance credit. It is a fixed amount of seven-day liquidity that is auctioned against assets held by the bank.
b. Repurchase facility. It is an automatic repurchase window at the initiative of the bank.
c. The maximum lending rate was set at the money market rate plus 2.5 points in 1989 and plus 3 points in 1990–91. In 1992, the average lending rate for each bank was limited to the MMR plus 3 points. All restrictions were lifted in June 1994.
d. The interest rate for special saving deposits was set at the MMR of the previous month minus 2 points since 1987.
— Not available.
Source: Central Bank of Tunisia, *Statistiques Financières* and *Rapport Annuel*.

The BCT's reliance on interest rate targeting (and some credit regulation) to control monetary expansion may be due to three factors. First, the BCT has not based its interventions on a monetary programming framework, that is, on formal estimation of the demand for money. With appropriate monetary programming, the BCT would not have to rely on interest rate targeting (or credit regulation) in order to satisfy movements in money demand to accomplish its objectives of inflation control and real GDP stability. Second, the BCT has controlled money growth on a bank-by-bank basis rather than on a system-wide basis, partially due to the lack of an active secondary market on Treasury notes. Open-market operations on Treasury notes will help accomplish monetary control on a system-wide basis, provided an integrated secondary market for Treasury bills and bonds exists, and provided the banking system achieves stronger deposit bases in proportion to their credits. Banks would meet their specific liquidity needs in the system through the secondary market for Treasury notes, having at their disposal both short-term instruments, traded over the counter in the interbank money market, and long-term instruments, traded on the Bourse. Third, banks are emerging from a past in which they accumulated weak portfolios and are now being obliged to meet stringent prudential norms. The banks' needs differ and the BCT may feel that it must nurse them through this transition by using its refinancing facilities discriminately across banks.

FIGURE 1.1

Nominal and real interest rate



Source: Central Bank of Tunisia, *Statistiques Financières*.

Inflation and other monetary developments

The annual inflation rate—as measured by changes in the consumer price index (CPI)—decreased from an average of 9.5 percent during the first half of the 1980s to 6.2 percent during 1986–94 (see table 1.3). An annual inflation rate of 4.5 percent is estimated for 1994, close to the average rate of 4.1 percent in Tunisia's main trading partners for 1994.

After the stabilization program of 1986, the average growth rate of the money supply (M1 and M2) decreased significantly, in accordance with a policy of inflation control. Starting in 1988, domestic credit was redirected away from

TABLE 1.3
Main monetary indicators

	1986	1987	1988	1989	1990	1991	1992	1993	1994
Annual percent change									
Domestic credit	8.3	7.9	1.9	18.7	10.4	9.7	14.7	7.4	7.1
Government	13.2	15.0	–6.2	6.7	11.9	5.6	10.1	–0.3	–6.5
Private sector	7.5	6.7	3.3	20.8	10.2	10.4	15.3	8.4	8.9
Money plus quasi-money (M2)	5.7	13.7	19.3	16.5	7.3	5.3	7.5	6.7	7.9
M1	3.5	–1.6	21.3	2.9	4.9	–0.4	5.4	4.8	10.2
Quasi-money	9.5	39.7	17.0	33.6	9.7	10.5	9.2	8.2	6.2
Net foreign assets	–73.3	228.6	199.3	25.6	–10.9	–12.2	–24.1	–34.9	–60.8
Inflation									
CPI	5.8	7.2	6.3	7.7	6.5	8.2	5.8	4.0	4.5
GDP deflator	3.1	6.7	8.5	7.9	5.1	7.0	6.2	4.6	5.2
Growth									
Nominal GDP	1.6	13.9	8.6	9.7	13.3	11.1	14.6	6.8	8.7
Real GDP	–1.4	6.7	0.1	1.7	7.8	3.9	8.0	2.1	3.3
Nominal effective exchange rate	–16.2	–17.2	–5.2	–4.2	–4.6	–2.3	0.7	–1.8	–1.1
Ratios									
Monetary base/GDP (percent)	11.0	10.0	13.0	14.0	11.0	11.0	10.0	10.0	11.0
M4/GDP (percent)	47.0	46.0	51.0	55.0	55.0	55.0	52.0	54.0	54.0
M3/M1	1.6	1.8	1.8	2.0	2.1	2.2	2.3	2.3	2.3
Velocity of M1 (GDP/M1)	3.4	3.9	3.5	3.8	4.1	4.5	5.0	5.0	5.0
Velocity of M2 (GDP/M2	2.1	2.2	2.0	1.8	1.9	2.1	2.2	2.2	2.2

Source: Central Bank of Tunisia and Ministry of Economic Development.

the central government. As of 1994, 92 percent of domestic credit was allocated to the private sector and public enterprises. The reduction of money financing of the budget deficit was accomplished by the introduction of competitively priced Treasury bills in late 1989.

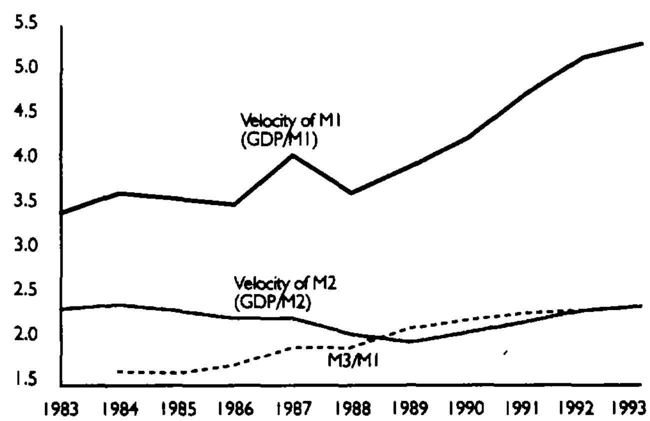
Since 1986 the growth rate of quasi money (the interest-earning component of M2) has been consistently higher than that of M1 due in part to the consistently positive real saving interest rates in the period. However, since 1989 the velocity of M2 has trended upwards as more attractive long-term financial instruments became available. In 1988, commercial paper (issued by nonfinancial institutions) and certificates of deposit (issued by commercial banks) were introduced, open- and closed-end mutual funds (SICAVs and SICAFs) were started, and in 1989 Treasury bills were successfully introduced. The rising ratio of M3 to M1 provides evidence of the degree of financial deepening occurring in Tunisia during this period (figure 1.2).

Balance of payments and exchange rate policy

In the first part of the 1980s, Tunisia suffered large current-account deficits, which averaged 8.5 percent of GDP for the years 1981–85. These large deficits were mainly produced by a marked deterioration in the Tunisian terms of trade and a decline of petroleum exports due to adverse price and volume developments. Such continuous current-account deficits led to both rising external debt and an erosion of international reserves. The deterioration of Tunisia's external position was evidenced by the doubling of the ratio of debt service to current receipts between 1981 and 1986.

During 1986 and 1987, the BCT devalued the Tunisian dinar, inducing a real depreciation of about 27 percent. Starting in 1987, the Tunisian government initiated a pro-

FIGURE 1.2
Velocity of money and financial deepening



Source: Table 1.3.

gram of trade liberalization, aimed at shifting resources from inefficient import-substituting activities to the export sector, and a policy of fiscal-deficit control, to diminish the need for external savings. These policies were successful in reducing the current account deficit to an average of 4.0 percent of GDP during 1986–93.

The reduction of the current account deficit was particularly important in 1987 and 1988 due to the strong effects of the real exchange rate depreciation combined with an excellent agricultural crop, an increase in oil prices, and the near doubling of tourism receipts caused by the opening of the border with Libya in 1988. From 1989 to 1993, the current account deficit gradually rose (table 1.4 and table SA.1) due to a deterioration of the terms of trade in the period 1990–92; a decrease in the volume of energy and phosphate exports; the Gulf crisis in 1990/91, which led to a decline in receipts from tourism and workers' remittances; a slowdown in market growth in Tunisia's trading partners (mainly EU countries) in 1992 and 1993; and a recovery of private sector investment, following some trade liberalization measures and the devaluation of the dinar (see figure 2.1). The current account deficit fell sharply in 1994 with an unusually large sale of olive oil stocks, lower imports with the economic slowdown, and stronger manufactured exports.

In 1992 and 1993 the current account deficit was abnormally large (6.9 percent and 8.1 percent of GDP, respectively) due to substantial foreign-financed imports related to the construction of a trans-Tunisia pipeline and natural gas development (the Gazoduc and Miskar projects). Even excluding these projects, the current account deficit as a percentage of GDP worsened gradually from 3.1 percent in 1989 to 5.9 percent in 1993 (with the exception of 1991, as described below). In the same period, the trade deficit (excluding items related to the Gazoduc and Miskar projects) averaged 12 percent of GDP. This trade deficit was to a considerable extent financed through receipts from tourism and workers' remittances, which respectively covered an average of 61 percent and 37 percent of the trade deficit during 1989–93. In the same period, foreign direct investment and grants respectively financed about 33 percent and 28 percent of the current account deficit (again excluding the Gazoduc and Miskar projects), whereas external loans and short-term capital financed the remaining 39 percent.

Tunisia's rather sizable trade deficit and the large role of tourism receipts and workers' remittances in financing the trade deficit make Tunisia's external position vulnerable to adverse developments in the region's economic and political stability. In the presence of an economic or political shock that would worsen the trade deficit or decrease tourism receipts and workers' remittances, it would be rather difficult under current international conditions to finance a larger current account deficit. This is because of both higher interest rates in developed countries and less optimism toward emerging markets (due to the Mexico effect). However, Tunisian authorities have demonstrated their determination to avoid serious balance of payments disequilibria. This was evidenced by the authorities' management of the repercussions of the Gulf crisis on Tunisia. In 1991 the current account balance actually improved as a result of the Government's mandated reductions of public enterprises' investments having high import content. Tunisian authorities have at their disposal several mutually complementary ways to increase the competitiveness of domestic products in inter-

TABLE 1.4

External sector indicators

	1986	1987	1988	1989	1990	1991	1992	1993	1994
Ratio (percent)									
Trade balance/GDP[a]	−12.8	−9.2	−12.8	−12.0	−13.6	−9.1	−12.1	−12.9	−9.1
Current account balance/GDP[a]	−8.0	−1.0	1.0	−3.1	−5.5	−4.4	−5.8	−6.7	−1.8
Debt service/export of goods and services	28.2	28.4	21.9	21.8	24.3	23.8	20.0	20.7	20.3
External debt/GDP	67.2	70.6	67.2	69.5	61.5	61.9	55.1	59.5	57.4
Gross official international reserves (in months of imports)	1.4	2.1	2.8	2.6	1.7	1.8	1.6	1.7	2.6
Overall balance of payments (in millions of dollars)	−704.9	−98.5	96.5	−310.8	−679.0	−577.4	−897.3	−973.7	−315.4
Gross official international reserves (in millions of dollars)	305.3	525.5	89.3	961.9	794.8	865.9	923.6	937.8	1,544.4

a. Excluding the Gazoduc and Miskar projects.
Source: Ministry of Economic Development.

national markets and ensure the sustainability of the country's external position. Imposing trade restrictions is effective in the short run to deal with balance-of-payments imbalances, but in the long run, only policies that encourage competition, stimulate flexibility of wages and relative prices, induce higher public and private savings, promote technological innovation and high quality investment, and allow for a market-determined exchange rate result in a socially efficient, sustainable external position. To the extent that the structural reforms in Tunisia are implemented, the country's external position is strengthened.

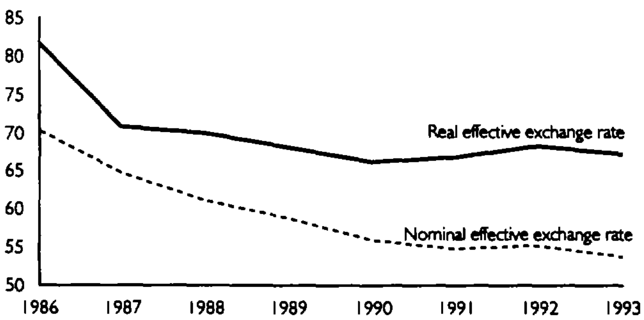
After the strong nominal depreciation in 1986 (16.2 percent) and 1987 (17.2 percent), the Tunisian dinar has depreciated at moderate and declining rates. In fact, since 1988 the rate of depreciation of the Tunisian dinar has been similar to the inflation differential between Tunisia and its trading partners. Therefore, the BCT has been able to keep the real effective exchange rate stable at the targeted level (figure 1.3). In early 1994 the BCT introduced an interbank foreign-exchange market, which is expected to lead, by stages, to a market determined exchange rate. This development implies the gradual abandonment of the policy of real-exchange-targeting, a policy which in principle is unsatisfactory, because the real exchange rate, as a relative price, must be allowed to react to changing market conditions.

The Tunisian government has announced that it is aiming for full convertibility of the dinar. The structural reforms in progress (particularly those in the financial system), a further reduction of macroeconomic imbalances, and the introduction of an interbank foreign-exchange market are all consistent with the goal of full integration in international financial markets.

FIGURE 1.3

Nominal and real effective exchange rate

(1980=100)



Source: International Monetary Fund.

Savings and investment

The savings-investment relationship is, of course, the domestic counterpart to the current account balance, and its analysis sheds light on, among other things, the sustainability of the country's external position. National (and domestic) savings decreased steadily during the first years of the 1980s from 24.6 percent in 1980 to 15.5 percent in 1986. Subsequently, the declining trend was reversed and in 1992–93, national savings averaged 22.2 percent of GDP. This recovery was strongly led by noncentral government national savings, which rose gradually from 9.6 percent in 1986 to an average of 21.0 percent in 1992–93.

Gross domestic investment was fairly stable during 1980–84 at around 31 percent of GDP. Then, in the midst of the balance-of-payments crisis and the ensuing adjustment program, it decreased to 19.4 percent of GDP in 1988. Most of this decline was due to a contraction in gross fixed investment by the noncentral government, especially by public enterprises. From 1989, gross domestic investment recovered strongly to an average of 29.7 percent of GDP in 1992–93.[2] This recovery was led by private investment (figure 2.1), which responded favorably to the stronger macroeconomic stability and the new incentive structure generated by the structural reforms, and by some public enterprises. As shown in chapter 4, the efficiency of investment increased significantly in the period 1987–94 with respect to the previous six years (see the section on structural reforms and growth).

The examination presented above shows that the worsening of the current account deficit from 1989 to 1993 was accompanied by a rise in both savings and investment, with the latter increasing at a faster rate. To the extent that external savings are being used to finance higher and better-quality domestic investment, the sustainability of the current account deficit is preserved.

Fiscal policy

A declining and, to a large extent, market-financed central-government deficit, combined with a fairly successful tax reform and a rationalization of government expenditures, has significantly strengthened Tunisian fiscal accounts. Nevertheless, there are several areas in fiscal policy that can be improved with potentially large benefits. This section tries to identify those areas in the context of an analysis of the tax reform, expenditure and revenue policy, and fiscal-deficit management.

Tax reforms

Until the mid-1980s, Tunisia's tax system was complicated, difficult to administer, and inequitable. Moreover, it contributed to numerous distortions in the allocation of economic resources. Maintaining a relatively high ratio of tax revenues to GDP (23.1 percent in 1986) became increasingly difficult as the high fiscal pressure led to rising tax evasion and the establishment of a complex system of fiscal exemptions granted under sectoral investment codes. Beginning in 1987, a comprehensive tax reform was gradually implemented in Tunisia. The reform measures were designed to be revenue-neutral and to cover all areas of taxation, including indirect taxes, personal and corporate income taxes, customs duties, and tax administration.

Effective July 1988, the three existing turnover taxes (on production, consumption, and services) were replaced by a value-added tax (VAT) with three rates: (1) 17 percent on most goods and services, (2) 6 percent on basic consumer goods and services, and (3) 29 percent on luxury goods. In 1993 the respective shares in total VAT revenues from the three rate categories were 86.5 percent (for the 17 percent rate category), 6.5 percent (6 percent rate), and 7.0 percent (29 percent rate). The introduction of the VAT improved collection efficiency and eliminated the distortions inherent in a system of cascading taxes imposed at various stages of production. The current VAT system can, however, be improved.

The efficient functioning of the VAT is being hampered by the current "suspensive" schemes, whereby buyers of some intermediate products, particularly investment goods, are allowed to forgo payment of the VAT when buying inputs. By breaking the chain of the VAT system, the "suspensive" schemes induce fraud and evasion. These schemes were enacted to compensate for the sluggishness of credit reimbursements in the VAT system. The recommended solution is, of course, to expedite credit reimbursements rather than allow agents to circumvent the system. Furthermore, the VAT should be generalized to include the retail stage of the distribution process and consolidated around a single rate. In the short term, the overvalued 29 percent rate should be eliminated, the list of products subject to the 6 percent rate revised, and the list of exemptions reduced. In the medium term, the VAT system should be completely consolidated around a single rate (which could be the current 17 percent standard rate). This is important because multiple VAT rates and exemptions to the system invite tax avoidance and induce deviations from efficient patterns of production. The potential welfare benefit of these measures are substantial (box 3.1).

Effective January 1990, a new tax code covering personal and corporate income was introduced. Prior to the reform, the personal income tax consisted of a general tax (with marginal tax rates ranging from 10 percent to 80 percent), a solidarity tax, and a schedular tax (which contained a large number of taxes whose rates and coverage differed according to the sector of activity.) These taxes were abolished and replaced by a single personal income tax with six income brackets and marginal tax rates ranging from 15 percent to 35 percent. The new corporate income tax replaced the old system of six rates (differentiated by area of economic activity, with a top rate of 44 percent) by a system of two rates, a standard rate of 35 percent and a special rate of 10 percent. The latter rate applies to enterprises in the agriculture, fishing, and handicrafts sectors.

The 1990 tax code reduced exemptions and deductions to expand the tax base, shifted tax payments to a current basis to better match the agents' actual ability to pay, and prevented double taxation of capital income. However, the tax code is weakened by the fiscal advantages granted under the 1994 Unified Investment Incentives Code. Some of the fiscal advantages and tax relief provided in the investment incentives code are investment tax deductions within a limit of 35 percent of reinvested earnings, the possibility of accelerated depreciation for a widespread list of capital goods, and specific tax breaks such as exemption from the corporate income tax for exporting enterprises for up to ten years.

Regarding foreign-trade tax reform, quantitative restrictions have been gradually reduced and replaced by tariffs, and the customs-tariff reform reduced the maximum tariff rate and significantly narrowed the dispersion rate (see chapter 3, section on creating an open, competitive economy). However, the rate structure of the customs tariffs remains complex. It imposes an administrative burden on both the customs service and the importer, preventing a clear formulation of tariff policy concerning protection for domestic production, and inducing avoidance of customs duties with strong repercussions on fiscal revenues. A further restructuring and simplification of the tariff system will be achieved with the establishment of a free trade area with the European Union (EU).

Government revenues

Total revenues decreased from 31.8 percent of GDP in 1986 to 27.4 percent in 1993. To a large extent, this was due to a steady decline in nontax revenues, especially from the petroleum sector. Tax revenues fell by 2.6 percentage points of GDP in 1987, the first year of the stabilization program; thereafter, they stabilized at about 20–21 percent of GDP (figure 1.4, table 1.5, and table SA.2). The shares of all tax-revenue categories, with the exception of taxes on goods and services, have remained quite stable since 1987. Since the imposition of the VAT in 1988, taxes on goods and services have become an increasingly important revenue source.

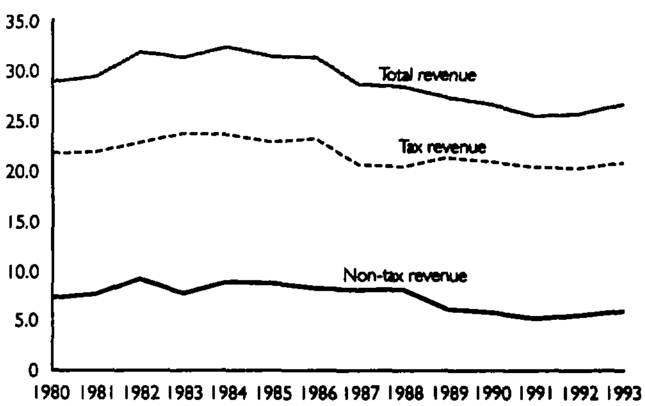
Regarding tax revenues as a share of GDP, Tunisia's fiscal performance compares quite favorably to that of other developing countries, and Middle-Eastern countries in particular (table 1.6). The fact that such good performance has been achieved with moderate marginal tax rates is an indication of the high compliance ratio achieved by the Tunisian tax administration. This is true except for income taxes, which represent a notoriously low fraction of government revenues compared to other countries with a similar tax rate structure. The shares of taxes on goods and services and taxes on international trade in total revenue are similar to those of other developing countries. Nevertheless, a comparison with the respective average shares for the European Union reveals that taxes on international trade play too big a role in the Tunisian fiscal accounts, reflecting both a relatively high protection for domestic production and a diminished ability to raise revenues from other tax sources, particularly on income and on goods and services. Improvements in the VAT system should help increase the importance of taxes on goods and services. Broadening the base and strengthening collection enforcement is indispensable to bring taxes on income (especially on individual income) up to international averages.

Fiscal expenditures

Since 1986, the Tunisian government has followed a policy of fiscal expenditure reduction to compensate for the decline in oil revenues and the increased debt-service payments. At the same time, the weights of different expenditure categories have been changed to reflect the new government priorities and its effort to improve the efficiency of fiscal resource use. Total fiscal expenditures fell from 37.3 percent of GDP in 1986 to 29.9 percent of GDP in 1993 (table 1.5 and figure 1.5). Most of this decline was accounted for by reductions in capital expenditures (5.2 percentage points.) Current expenditures could only be reduced by 2.3 percentage points.

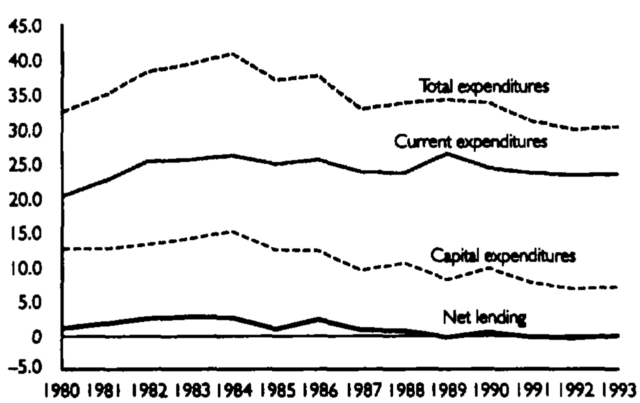
For current expenditures, the wage bill remains the largest category: the average wage bill from 1987 to 1993

FIGURE 1.4
Central government revenue
Percent of GDP



Source: Ministry of Economic Development.

FIGURE 1.5
Central government expenditures
Percent of GDP



Source: Ministry of Economic Development.

TABLE 1.5

Fiscal indicators

(percentage of GDP)

	1986	1987	1988	1989	1990	1991	1992	1993
Total revenues	31.8	29.6	29.9	30.1	28.0	26.5	26.7	27.4
Tax revenues	23.1	20.5	20.3	21.1	20.8	20.2	20.1	20.7
Taxes on income and profit	5.4	4.1	3.7	3.8	3.7	4.2	4.1	4.8
Taxes on goods and services	16.6	15.3	15.5	16.2	16.0	16.0	16.0	16.9
Taxes on international trade	4.6	4.1	4.5	4.8	4.6	4.4	4.4	4.4
Other	1.1	1.1	1.1	1.1	1.1	0.0	0.0	0.0
Nontax revenues[a]	8.1	7.9	8.0	6.1	5.7	5.1	5.4	5.8
Of which petroleum sector	4.5	4.4	4.5	4.1	3.6	2.1	2.2	2.0
Capital revenues	0.7	1.2	1.7	2.9	1.5	1.2	1.2	0.9
Total expenditures	37.3	32.6	33.6	34.0	33.4	30.5	29.2	29.9
Current expenditures	25.3	23.5	23.3	26.2	24.1	23.4	22.9	23.0
Wage bill	11.1	10.5	10.5	11.1	10.6	10.9	10.7	10.7
Goods and services	4.0	3.7	3.5	3.8	3.6	3.5	3.4	3.3
Interest payments	2.7	2.9	2.9	3.1	3.0	2.9	3.1	3.3
Subsidies and transfers	7.5	6.4	6.4	8.2	6.9	6.1	5.8	5.7
of which to enterprises	5.2	4.2	4.1	5.6	4.5	3.7	3.4	3.4
Capital expenditures	12.1	9.1	10.3	7.9	9.2	7.1	6.2	6.9
Direct investment	4.1	3.5	3.6	4.0	4.7	4.2	4.4	4.4
Capital transfers	3.9	2.9	2.0	2.1	3.0	2.0	1.8	1.9
Net loans	2.0	0.6	0.4	–0.5	0.3	–0.4	–0.6	–0.1
Other capital uses	1.4	1.1	3.3	1.0	0.7	0.5	–0.2	0.0
Primary balance	–2.8	–0.1	–0.7	–0.9	–2.6	–1.1	0.7	0.8
Overall deficit including grants	–5.5	–3.1	–3.6	–4.0	–5.7	–4.1	–2.4	–2.6
Total financing	5.5	3.1	3.6	4.0	5.7	4.1	2.4	2.6
Net foreign financing	3.0	1.0	2.0	1.0	2.9	1.1	–0.1	0.6
Net domestic financing	2.5	2.1	1.7	2.9	2.7	2.9	2.6	2.0

a. Nontax revenue is defined as sum of the oil revenue, interest and dividends, and transfers from social security to government.

Source: World Bank calculations; data from Ministry of Economic Development, *Compte consolidé de l'Etat*, table V-1 to V-8.

TABLE 1.6

Regional comparisons

	Government revenue as a share of GDP 1990–92 (percent of GDP)					Composition of government Revenue, 1990–92 (percent)				
	Tunisia	LAC	EU	Middle East	Southeast Asia	Tunisia	LAC	EU	Middle East	Southeast Asia
Total revenue	29.5	18.8	33.8	25.6	22.9	100.0	100.0	100.0	100.0	100.0
Tax revenue	23.9	17.2	30.0	20.4	18.6	81.0	92.0	89.1	80.3	82.6
On income	3.9	6.6	8.4	6.2	6.9	13.2	37.1	25.2	26.1	29.4
Individual	1.7	n.a.	5.3	3.6	1.9	5.8	n.a.	15.6	12.7	8.6
Corporation	1.6	n.a.	2.4	2.2	4.5	5.6	n.a.	7.2	5.5	19.0
Social security	3.8	0.8	6.5	0.3	0.2	12.8	4.0	17.4	1.3	0.7
On property	0.5	0.1	1.0	0.6	0.3	1.9	0.5	3.3	2.1	1.5
On goods and services	10.0	6.7	14.4	7.5	6.8	33.8	34.1	45.2	30.0	31.7
On international trade	4.8	2.4	0.2	5.0	4.0	16.4	12.7	0.6	17.8	17.5
Other	0.9	0.3	1.0	0.7	0.4	2.9	1.5	3.0	2.8	1.7
Nontax revenue	5.7	1.6	3.4	5.0	4.3	18.9	7.6	9.7	19.1	17.0
Entrepreneurial	4.8	0.0	1.4	2.7	3.1	15.8	0.0	3.9	9.4	12.3
Fees and fines	0.4	0.8	0.4	0.8	0.6	1.2	3.9	1.2	2.9	2.4
Other	0.5	0.7	1.6	1.3	0.6	1.9	3.7	4.5	5.8	2.3
Capital revenue	0.0	0.1	0.4	0.1	0.1	0.2	0.4	1.3	0.7	0.4

Note: LAC = Ecuador and Chile; EU = Greece and Portugal; Middle East = Jordan, Morocco, and Turkey; Southeast Asia = Malaysia and Thailand.

Source: Data are from IMF Government Financial Statistics. The data for Tunisia include social security and are not comparable with World Bank standard classification.

was actually higher than that for the early part of the 1980s. Expenditures on goods and services were maintained at about 3.5 percent of GDP during 1988–93. Within this category, more emphasis was given to operation and maintenance outlays, especially for infrastructure. Subsidies and transfers have declined from 7.5 percent of GDP in 1986 to 5.7 percent of GDP in 1993, with temporary increases in 1989–90 to compensate for two years of drought and high international cereal prices. Transfers to public enterprises to cover their operating losses have declined but seem to be still large (although more detailed data on the breakdown of current transfers to public enterprises is needed for an unequivocal conclusion).

It is encouraging that government direct investment saw its share in GDP, after a significant decline in 1987–88, recover to an average of 4.4 percent in the early 1990s. This is important because the provision of public infrastructure is vital to ensure high productivity of capital, which in turn produces high rates of economic growth. Capital transfers and net lending declined sharply from 1986 to the present, from 5.9 percent to 1.8 percent of GDP. If this means that public enterprises are becoming less dependent on government support and are seeking to finance their investments on competitive domestic and foreign financial markets, then the fall of capital transfers and net lending is a very healthy development. However, if some of these transfers and lending are now provided by commercial banks or if public enterprises are deteriorating as result of low replenishing investment, the current fall of capital transfers and net lending may only represent a fiscal burden for the Government in the future.

Fiscal deficit

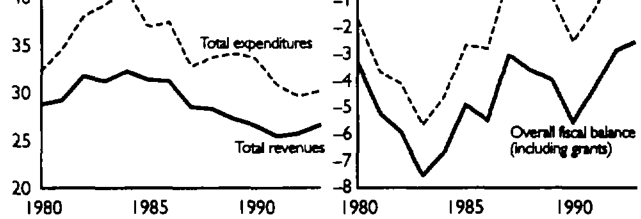
In the period from 1986 to 1993, the central government deficit has ranged from 2.4 percent to 5.5 percent of GDP (figure 1.6 and table SA.2). The budget deficit was highest in the years 1989, 1990, and 1991. In 1989, this was due to the 1988–89 drought (the deterioration of the budget balance was attenuated by drought-related grants); and in 1990 and 1991, to the Government's attempt to mitigate the adverse economic impact of the Gulf crisis. Because of the appropriate management of the fiscal balance by the Tunisian authorities, these increases in the budget deficit remained transitory. As a matter of fact, since 1991 the budget deficit has been declining, and in 1992 and 1993 primary surpluses of 0.7 percent and 0.8 percent of GDP, respectively, were achieved.

For a complete analysis of the sustainability of the fiscal deficit, not only information on the central-government deficit is required but also information on the consolidated nonfinancial public sector (which consolidates the central government with local government, social security, and nonfinancial public enterprises) and on the consolidated total public sector (which adds to the first consolidation the Central Bank and public banks). Unfortunately, relevant data on public enterprises and banks are not readily available. However, there are some indications that the public enterprise, public bank sector is potentially a source of fiscal disequilibrium.

Data for 121 of the estimated 200–250 public enterprises, in 1992, show a deficit of 6.8 percent of GDP out of total revenue of 34.6 percent of GDP (see chapter 2, section on public sector activity and table 2.1). Regarding the public sector banks, the 1993 audits show that they have a significantly higher proportion of non performing loans as a share of their portfolio than the private banks. To a large extent, the difference in nonperforming loans can be explained by the public banks' exposure to loss-making public enterprises and because of the public sector banks' efforts (and obligation) to follow/implement government development programs over the past three decades. The situation is improving, as the share of nonperforming loans as a percentage of assets decreased in 1993 over 1992 and is anticipated to improve again in 1994 (the latter will be confirmed when all the 1994 audits are completed and analyzed.

Deficit financing has changed considerably since 1986. The share of the budget deficit financed from foreign sources fell from an average of about 55 percent in the first half of the 1980s to about 30 percent in 1987–93 (table SA.2). Correspondingly, the share of domestic financing of

FIGURE 1.6
Fiscal balance
Percent of GDP



Source: World Bank calculation; data from Ministry of Economic Development.

the budget deficit rose. The domestic banking sector sharply declined in importance as a source of deficit financing—its share fell from about 28 percent in 1986 to 9 percent in 1991 before turning negative in 1992 and 1993. Therefore, non-bank domestic financing became the main source of funds to cover the budget deficit. (Box 1.1 discusses the evolution of public debt instruments since 1989.)

Conclusions

The reform program initiated in 1986 has brought a significant degree of macroeconomic stability and a much improved level of efficiency in the use of resources in Tunisia. The inflation rate is approaching that of the EU countries, the central-government primary balance has been in surplus since 1992, the ratio of tax revenues to GDP is higher than the respective average for the Latin American, Southeast Asian, and Middle Eastern regions. Notwithstanding such important accomplishments, there remain some areas in both the guiding principles and fine-tuning of monetary, balance-of-payments, and fiscal policy that merit further improvement.

Monetary policy

Further liberalization of interest rates is essential to obtain a market-driven yield curve. This can be accomplished by eliminating all remaining preferential rates, encouraging competition among commercial banks on the basis of both interest rates and portfolio quality, and promoting a secondary market in Treasury securities through the removal of restrictions in their clearance and settlement procedures. These changes will also allow the BCT to control monetary expansion through system-wide open-market operations in Treasury bills rather than by allocating funds on a bank-by-bank basis. System-wide monetary expansion, market-driven interest rates, and a thriving secondary market in government securities are all necessary elements for the efficient conduct of monetary policy, whose goals consist of achieving price stability and minimizing GDP fluctuations around its full-employment level.

Balance of payments and exchange rate policy

Tunisia's rather sizable trade deficit and the large role of tourism receipts and workers' remittances in financing the trade deficit make Tunisia's external position vulnerable to adverse developments in the region's economic and political stability. Faced with an adverse economic or political shock, it would be rather difficult under current international conditions to finance a larger current account deficit—because of both higher interest rates in developed countries and less optimism towards emerging markets (partly as result of the Mexican crisis). However, Tunisian authorities have demonstrated, as in their handling of the Gulf crisis repercussions on Tunisia in 1990 and 1991, their determination to avoid serious balance of payments disequilibria. Imposing trade restrictions (as in 1991) is effective in the short run to deal with balance-of-payments imbalances; but in the long run, only policies that encourage competition, stimulate flexibility of wages and relative prices, induce higher public and private savings (which are all goals of the Tunisian structural reforms), and allow for a market-determined exchange rate (which is the motivation behind the introduction of the interbank foreign-exchange market) result in a socially efficient, sustainable external position.

An examination of the behavior of national savings and investment shows that the worsening of the current account deficit from 1989 to 1993 was accompanied by a rise in both savings and investment, with the latter increasing at a faster rate. To the extent that external savings are being used to finance higher and better-quality domestic investment, the sustainability of the current account deficit is preserved. This confirms the conclusion in the above paragraph that Tunisia's external position is secure to the extent that the structural reforms are implemented.

Fiscal policy

Generalizing the VAT and broadening the income-tax base will both reduce the reliance on foreign-trade taxes and increase total tax revenues. These improvements and controlling the expansion of the government wage bill are necessary not only to compensate for a likely future decline in petroleum sector revenues but most importantly to finance increased expenditures in infrastructure, education, and public health.

Although the deficit of the central government seems to be well under control, there remains the question of the sustainability of the consolidated-government deficit, for which accurate information is unavailable. Some data on public banks and enterprises reveal that their profitability is considerably lower than that of their private counterparts. This, together with the distortionary effect of direct government participation in competitive economic activities, calls for an acceleration of the privatization process initiated in 1987.

Notes

1. See Poole 1970, and Blanchard and Fischer 1989, for a formal treatment on the optimality of monetary policy based on interest-rate targeting.
2. These figures include the Gazoduc and Miskar projects. The savings-investment gap data excluding these projects are given in table 1.4.

Chapter 2

Role of the state in the economy

The emergence of a significant public sector role in the economy dates back to independence. Prior to 1956, Tunisia's public sector included only the post and telephone systems, hospitals, schools and other similar services. Of the 290 industrial enterprises existing at the time, 257 were owned by foreigners. In the early 1960s, the Government nationalized different enterprises (import/ export companies, banks, agricultural land, railways, energy, mining) and set up new public enterprises (PEs) (tourism, textiles, mechanical/electrical industries). The state forged a dominant presence in the economy, the effects of which still exist today. This chapter analyzes the size and role of the public sector and reviews progress toward limiting its role to: establishing the appropriate legislative/administrative framework for the private sector and; seeking better outcomes where markets fail (pollution control, education, poverty alleviation and infrastructure).

Public sector activity

The public sector can be divided into three broad categories: (1) government administration (the central ministries, governorates, and municipalities); (2) administrative and quasi-commercial entities and agencies that are under the direct control of the government and have a mix of commercial and nonprofit public policy functions (*les établissements à caractère administratif,* EPA, *établissements à caractère industriel et commercial,* EPIC, and *les offices nationaux*); and (3) public enterprises, namely commercial, industrial, and financial institutions (banks, pension funds, and insurance companies).

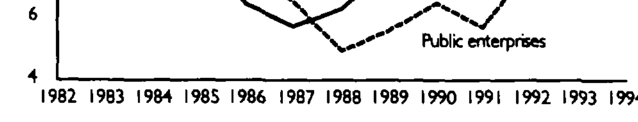
Definition and size of the public sector

The number of public enterprises in the country varies depending on the official definition. Based on the 1969 definition (any enterprise in which the state held 10 percent or more of the share capital), the total number of PEs grew from 179 in 1969 to 465 in 1993. A 1985 public enterprise law reduced the number to roughly 300, by redefining PEs as those where the state held 34 percent or more of the shares, and in 1989, the number of PEs was further reduced by defining nonfinancial PEs as having 50 percent or more state held shares. These changes gave enterprises more autonomy and reduced the oversight burden of the state, but they underestimate the supervisory role of the government, since often it continues to appoint the company's Board and President. The Institut National de Statistiques (INS) has consistently defined PEs as companies where the state owns more than 35 percent of the share capital.

In terms of total gross fixed investment, INS data shows that the public sector's share (central government and public enterprises) has come down from 57 percent in the early 1980s to 54 percent in 1994. Figure 2.1 compares investment trends of public and private firms. In terms of revenues and expenditures relative to GDP in 1992, the share of 121 public enterprises (for which information was available) showed an estimated deficit of 6.8 percent. Public enterprise expenditures as a share of GDP are significantly higher than revenues, due primarily to estimated interest payments. Government administration accounts for 66 percent of total public sector employment and public enterprises account for the remaining 34 percent. Government employees accounted for about 25 percent of total employed wage earners in Tunisia in 1991, compared to Portugal (18 percent), Thailand

FIGURE 2.1

Tunisia: Fixed investments by agents



Source: Data from Ministry of Economic Development; staff calculation.

(10 percent), and Malaysia (12 percent). When employment of the PEs are included, Tunisia's share of public sector employees reaches about 35 percent of total employed wage earners. These figures show why the size of the public sector plays an important role in wage and labor policies for the economy as a whole (see chapter 3, section on labor markets).

The latest INS data shows the public sector's share in total value added (48 percent) remained the same between 1983 and 1988. A recent estimate shows that the share has gone down slightly from 48 percent in 1985 to 42 percent in 1993 (20 percent for government administration and 22 percent for public enterprises). For the PE sector, the share fell most sharply for mechanical and electrical industries, while for a few other subsectors the share actually increased, for example nonmanufacturing and some services (table 2.1). This share is high by international standards. A recent study, "Bureaucrats in Business: the Economics and Politics of Government Ownership," estimates that for developing economies the PEs' share of GDP has remained at 11 percent in the 1980s and 1990s (14 percent in the poorest countries), while the PE share in industrial countries fell from 9 percent to 7 percent compared to an estimated 22 percent PE share in Tunisia.

Divestiture of public enterprises

One of the government's objectives as part of its structural adjustment strategy of the mid-1980s was to divest all public enterprises operating in competitive areas of the economy. Its immediate objectives were to remove the financial and managerial burden of the loss-making companies and to relinquish government from financing the investment needs of the solvent but undercapitalized companies. The government recognized that it could neither finance these investments nor provide the strategic guidance to enhance these enterprises' efficiency and growth prospects. Already by the end of 1985, Parliament authorized the Ministry of Finance to begin restructuring operations with the authority to proceed to privatization, but in practice the process focused more on restructuring, giving public enterprises more autonomy, and constraining the expansion of the public sector. The Government's efforts are having a positive impact but the size of transfers is still significant. Capital transfers and subsidies from government to public enterprises have come down from a high of 5.6 percent of GDP in 1983 to about 2 percent in 1993. Privatization and deregulation have not played as strong a role as they might have in the difficult process of restructuring and rendering the Tunisian economy more efficient and more dynamic.

A recent study of the period between 1988–92 shows that Tunisia's privatization program was modest, well below many other countries in Eastern Europe, Asia, and Latin America (table 2.2). Since 1992, a few additional sales have taken place raising total proceeds from sales from about US$100 million in 1992 to US$160 to US$180 million in 1994. The bulk of the privatizations have been in the tourism sector (nearly 50 percent of the total), followed by the mechanical and chemical sector (21 percent), and

TABLE 2.1

Public sector's share of value added

(Percent share)

Selected subsectors	1985	1993
Agriculture and fishing	24	25
Manufacturing		
Agroindustries	22	17
Construction materials	43	41
Mechanical and electrical	58	28
Chemical	55	63
Textiles	19	12
Other	19	18
Non-manufacturing		
Mining	78	78
Energy	66	70
Services		
Commerce	46	48
Transport	66	68
Tourism	11	6
Total	48	42

Source: Lakhoua 1995.

TABLE 2.2

Privatization proceeds, 1988–92

Countries	Accumulated proceeds as a percentage of GDP a year
Nigeria	0.34
Mozambique	0.45
Ghana	0.61
Tunisia	0.81
Brazil	1.06
Turkey	1.17
Sri Lanka	1.50
Philippines	2.42
Chile	3.33
Portugal	6.21
Czechoslovakia	6.25
Hungary	7.92
Malaysia	8.84

Source: Sader 1993.

agroindustries (10 percent). The program came up against several obstacles: (1) the limited size of the financial market; (2) concerns that a few groups, families, or foreigners would dominate too much of the economy; and (3) most important of all, resistance from well-organized unions and from management and government bureaucrats that benefit from sitting on the boards of public enterprises.

Slowing down the pace of privatization may help to maintain stability, but at a cost, because it also slows down the pace of new job creation through the establishment of new and more efficient private investments, and it prolongs the inefficiencies and misuse of scarce resources in the economy. Most studies, including the Sader privatization study (table 2.2), find that weak privatization programs slow down the adjustment process and discourage foreign and local private investors. Without clear signals that the system has changed, the reform process becomes much more tenuous and subject to costly political, social, and economic setbacks. After all, if the government is not ready to relinquish productive activities to the private sector, either because of social concerns or because it is not convinced the private sector can do a better job, then private and foreign investors will not be convinced that the time and conditions are right for investment. Two recent Bank studies of cross-country experience, Galal and others 1994 and Galal and Shirley 1995, assess the political and social complexities of divestiture and measure the impact of PE ownership on an economy's per capita income, savings, and growth prospects. The findings support the view that there are substantial advantages in terms of efficiency, enhanced international competitiveness, and long-term growth of selling public enterprises and supporting divestiture measures with appropriate competition policies.

Since 1991/92, the Government has been preparing sectoral studies, evaluating divestiture options, and identifying constraints and opportunities. It has also focused on creating the necessary legal environment to regulate the stock exchange which will permit them to move forward in a prudent way for a stronger privatization effort in 1995/96.

TABLE 2.3

Basic infrastructure

(1990 = 100)

	1985	1990	1991	1992	1993
Capacity					
Roads (kilometers)					
Paved	76	100	100	100	100
Transport vehicles in service					
Passenger vehicles (units)		100	106	114	125
Cargo vehicles (units)		100	115	130	150
Electricity generating capacity (megawatts)					
Total	100	100	100	100	100
Electricity distribution network (length)					
High Tension	81	100	110	110	111
Medium Tension	73	100	107	115	123
Low Tension	67	100	108	118	127
Total	70	100	108	117	125
Potable water network (kilometers)	73	100	104	n/a	133
Telephone lines (lines per 100 people)	65	100	111	124	135
Utilization (transport by mode)					
Road					
Passengers (number)	—	100	105	112	121
Freight (tons)	—	100	117	136	150
Rail					
Passengers (number)	—	100	99	107	98
Freight (tons)	—	100	100	109	109
Sea					
Passengers (number)	—	100	89	89	78
Freight (tons)	—	100	88	125	125
Air					
Passengers (number)	—	100	71	106	123
Freight (tons)	—	100	88	125	125
Real GDP	74	100	107	114	119

— Not available.

Source: World Bank estimates and SIDES 1995.

Infrastructure services: Provision and maintenance

Infrastructure capacity actually grew faster than GDP between 1990 and 1993 in telecommunications, transport vehicles, and electricity distribution (table 2.3).[1] Particularly striking is the growth in road cargo vehicles after the government permitted private companies to enter the sector in 1989/90. Utilization of all parts of the transport network increased faster than GDP with the exception of sea passengers and rail transport (table 2.3). A recent survey analyzing different factors that foreign businessmen consider in deciding where to invest ranked Tunisia's infrastructure base (Tunis and Sousse-Monastir areas) as adequate or good. The main area with less favorable ratings was advanced telecommunication services.[2] Although Tunisia's infrastructure services are generally good, the government can further improve efficiency and increase competition through:

- The deregulation of several state-run monopolies, enabling private sector entry and the more decentralized provision of some services;
- Improvements in pricing and regulation policies, which also have a positive effect on the environment; and
- Measures to improve expenditure allocations, particularly for operation and maintenance (O&M).

Deregulation and increased efficiency

The deregulation of the merchandise transport sector began in 1985 with a law opening regional merchandise transport to the private sector. The law, however, was not enacted until four years later. Since 1989 progress has been swift, with the share of private regional carriers in total merchandise transport growing from 0 percent to 65 percent by 1993, with over 100 private carriers operating at the regional level. Transport fees have been lowered on average by one-third compared to the maximum fees charged by the public regional enterprises before deregulation, and some tariffs have been cut by as much as half. The experience has been positive, but the intense competition has put the public transport enterprises under increasing financial and managerial difficulties. The Government is beginning to privatize these companies (four out of sixteen have been sold).

The Government has been more hesitant to liberalize other transport activities, even in cases where productivity has been low and costs very high, such as cargo handling and maritime transport. In maritime transport, the public sector Compagnie Tunisienne de Navigation (CTN) still holds monopoly powers in Tunisia over the most important regular lines (Tunis-Marseille), resulting in transport costs between Tunis and Marseille that are higher than between Singapore and Marseille. Likewise, the state-owned cargo-handling firm STAM holds a monopoly in the Tunis ports (Tunis, la Goulette, and Radès). The government is well aware of these shortcomings and is in the process of exploring all options, including privatization, to improve the situation.

Air transport (noncharter) is a monopoly of the public company Tunis Air. The current option under consideration is to sell 10 percent of its equity on the stock market, which falls short of privatizing the company. Deregulation of public bus passenger transport has been limited to two bus licenses that have been granted on a restrictive basis for transport within Tunis and a few authorizations granted to taxi operators. A major opening of bus activity to the private sector is not envisaged, because the government uses revenue from its profitable lines to compensate for losses on its more unprofitable lines. One option to explore is the possibility of deregulating the less profitable lines first.

Telecommunications is a monopoly of the state, and the government places a high priority on the provision of reliable phone services. Although new public investment increased from TD 43.4 million to TD 123.2 million between 1987 and 1994, the Government is unable to keep up with the backlog of connection requests (125,000 in 1993) and the continued strong growth in new demand for phone connections (table 2.4).

Recent international studies point to the dramatic expansion in the number and sophistication of new communications tools to use and access information. Technological change has stimulated the sustained growth of demand by reducing costs and prices while increasing the range and

TABLE 2.4

Demand for telephone connections

(Thousands of requests)

	1991	1992	1993
New demands	76.7	85.8	92.5
New connections	45.5	54.7	63.4
Waiting[a]	141.1	143.4	125.0

a. Stock and unsatisfied new demand.
Source: SIDES 1995.

quality of services available. As the average cost of telecommunications services comes down to near zero, major shifts in telecommunications patterns will accelerate, having a profound impact on business practices, infrastructure development, training needs, and the demand for new skills. New opportunities for developing countries are already beginning to emerge: the subcontracting of computer programming to India; the export of clerical and data entry tasks (telemarketing) from the United States and Canada to the Caribbean and India and from the United States, the United Kingdom, and other parts of Europe to Ireland (box 2.1).

These developments offer Tunisia opportunities (higher skill employment, business expansion, enhanced attractiveness for foreign investors) and challenges (ensuring that the policy and institutional frameworks are in place to promote free competition in the provision of services, removal of monopoly pricing structures in local and long distance communications, and establishment of common global standards for connection, services presentation, network interconnection, governance, and regulation).

The Philippines has opened its sector to foreign companies, India is opening up cellular and basic telephone services to foreign competitors. Viet Nam hopes to catch up more rapidly by combining state investments with regulatory guidelines on standards that allow foreign and domestic private sector companies to compete in the provision of services. The United States opted several years ago for deregulation, the United Kingdom privatized British Telecom and deregulated, and now Germany intends to privatize Deutsche Telekom by selling 60 percent of its shares to the public and to deregulate the market.

BOX 2.1

Telemarketing in Ireland

Ireland has exceptionally high unemployment (30 percent of the work force), high rural to urban migration (Dublin), and few opportunities to emigrate to the United Kingdom or the United States because of job scarcities in those countries. But Ireland does have several characteristics (weighted in order of relative importance) that make it attractive for the expansion of telemarketing activities from the United Kingdom and the United States: a high speed, low-cost telecommunications network based on fiber optic trunks (25 percent); a surplus of workers with office and personal computer skills (20 percent); relatively low wages with an average starting annual salary of US$11,000 (20 percent); vocational schools that provide training in office technology and computing (15 percent); language capabilities (15 percent); and finally openness and encouragement of overseas companies to set up businesses in Ireland (5 percent).

One American insurance company set up an office in an Irish village of 3,500 inhabitants, employing 80 workers who process paperwork from patients, doctors and corporate clients in the United States. Results are transmitted back via leased lines on a transatlantic cable to the company's headquarters in Delaware. The US paperwork is physically flown to Shannon airport, but soon it will be transferred as images.

Source: Cambridge Strategic Management Group 1995.

Other measures

Price incentives provide the strongest measure to encourage demand management of utility services and other resources. During the Eighth Plan period (1992–96), electricity and the other utility rates are all increasing with the objective of covering the full cost of operations and part of investment costs by the year 2000. Water (availability, mobilization, and pricing) is a key long-term resource issue facing Tunisia (see the environment section in this chapter). Average potable water prices were about 40 percent below the long-run marginal cost of production during the 1980s, and about 30 percent below in the early 1990s. Irrigation water rates, which carry the highest subsidy, have been going up since 1987, but increases have sometimes been less than the planned 9 percent per year due to drought conditions in various year. Annual increases are to continue with the objective of achieving full recovery of O&M (but not investment) costs for irrigation water by 1997. In the past, water delivery for irrigation concentrated more on supply mobilization, but with irrigation water price increases, demand management is playing a greater role in agricultural planning and development. Several different types of water use management systems are evolving from regulated public authorities to decentralized public and private contractual arrangements.

The Government is exploring the possibility of opening infrastructure projects in electricity, treatment of solid waste, highways, and water purification to private concessions, hoping to attract foreign investment. They will soon convert a new highway to a toll road which will be managed by a private company. SONEDE and ONAS already use private subcontracting for much of their O&M and connection works. SONEDE intends to phase out the use of public sector force account completely by the year 2000, relying fully on private contractors. ONAS is negotiating a contract with a private firm to manage an entire sewage network in Tunis on a pilot basis and is studying the feasibility of using private concessions for new sewage treatment facilities. Private subcontracting for O&M has not been used in the transport sector as much as it has for other infrastructure services. Recurrent road maintenance is still largely done by public sector force account, even though there are cost-efficient opportunities for private sector contracts in road rehabilitation and network strengthening. Chile, following Canada's example, uses global maintenance contracts, whereby a series of works is consolidated under a single private contract. Private contractors offer competitive prices and the global nature of the contracts reduces the costs of managing and supervising numerous small contracts.

Social policies and expenditures

Since independence, the state has devoted higher public expenditures for social policies than most middle-income countries. The legacy of the Bourguiba era and the present government's continued recognition of the importance of social measures has helped Tunisia realize an improved standard of living. Literacy rates increased from 35 percent at independence to 65 percent today, life expectancy went from sixty-three years in 1980 to sixty-eight years in 1992 and the population growth rate has fallen from about 2.4 percent a year to under 2.0 percent a year Income distribution has been continuously improving: the Gini coefficient fell from 0.43 to 0.40 between 1985 and 1990, and average per capita expenditures for the lowest decile of the population moved closer to mean expenditures for the country as a whole.

The level of government's budgetary expenditures for social policies has remained consistently high even during the years of stabilization and adjustment, amounting to 5–6 percent of GDP for education and 2.2 percent of GDP for health. The Poverty Assessment Report (1995) identifies poverty as a rural phenomenon. A comparison of social indicators by region (1988) shows significant disparities: fertility rates and child mortality rates in the central west and south are roughly double those in Tunis, and the share of married women with no education is two times higher in the northwest and central west than in Tunis. Every study on the subject demonstrates the strong and beneficial links between more years of schooling and better basic health care with reduced fertility rates and poverty alleviation. Tunisia's success at reducing fertility rates and reducing the rate of absolute poverty from 11.2 percent in 1985 to 7.4 percent in 1990 is due in part to its social expenditure policies. The key challenge now, is to further improve the targeting of expenditures for the poorest groups.

Education policies

As knowledge-intensive production technologies displace the old methods, education systems need to be redesigned to support the education and permanent training of the labor force. Education is also a decisive factor in halting the declining wages of unskilled workers, and it is an area where government policies and expenditures play a critical role, particularly at the primary level.

Assessing how much progress has been achieved in a country's development of human capital is difficult, because authorities often report the number of students registered at the beginning of each school year (enrollment rates), even though the actual number that attend and complete school during the year may be much lower (completion rates). Table 2.5 presents the most recent data available and indicates the level of human capital of the adult population across regions in the mid-1980s by evaluating education attainment rates.

TABLE 2.5

Trends in educational attainment by region, 1985

(Level attained by percentage of population over age 25)

Region	No school	Primary completed	Secondary completed	Higher completed	Average years of school
Middle East and North Africa	52.8	26.5	16.0	4.8	3.51
Tunisia 1985	66.3	18.9	12.0	2.8	2.1
Sub-Saharan Africa	48.1	41.7	9.3	1.0	2.67
Latin America and Caribbean	22.4	56.6	13.9	7.1	4.47
East Asia and Pacific	23.6	51.3	18.8	6.3	5.19

Source: The 1985 data for Tunisia are from Barro and Lee 1993. Comparative data for the age group 15 to 25 was not available across regions. Tunisia's attainment averages are lower than the average for the region, due to the higher attainment rates of such countries as Turkey, Israel, Syria, and Jordan. (Egypt and Morocco were not included in the group due to data problems.) Tunisia has, however, made tremendous progress in reducing the share of "no school" from 94 percent in 1960 to 66 percent in 1985.

Basic education

The Government has made a minimum of nine years education compulsory—according to each student's ability. Quality education is available at all levels, but the system is highly selective. Consequently, drop out/failure rates are a serious problem. The Eighth Plan's Education Reform Program is trying to increase primary level completion rates significantly for all Tunisian children for primary grades 1–6 and lower secondary (defined as upper primary under the Reform Program) grades 7–9. Grades 7–9 are important, because children begin more advanced math skills and in some cases another language—in addition to Arabic and French. Considerable progress has been achieved in increasing completion rates through grade 6, but the current level of drop-outs between grades 6 and 7 pose a major challenge for the Government (table 2.6).

High drop-out/failure rates are due to: (1) the traditional dual role of teachers as educators and quality-controllers, ensuring that only the best students pass to the next class; (2) higher completion rates through grade 6 puts pressure on the physical capacity (schools, teachers, materials) for grades 7–9 which also encourages selectivity (the Government is addressing this constraint through its investment program); and (3) parents, particularly from poorer families, who are not convinced that school is as important as alternative uses of the student's time and the families' resources. The Government is trying to convince parents and teachers that all children must enroll and complete a minimum of nine years of basic education by making it compulsory for those who have the capability.

As of 1993, the national exam at the end of grade 6 was replaced with school-based exams under provincial (and less selective) control. Teacher qualifications and curriculum development for grades 7–9 are being upgraded and additional school facilities are under construction to expand physical access which the Bank is supporting under the Secondary Education Project. Pedagogical retraining efforts need to (1) show teachers how to bring children along who are having difficulties and (2) make teachers accountable for each student's success. The Government should also take advantage of advances in education technology to improve the way knowledge is transmitted. Even though Government expenditures on primary education are high (41 percent of total recurrent expenditures compared to 59 percent for secondary/tertiary education), higher levels of public funding needs to be allocated to basic education to achieve these objectives. A solid primary education base (years 1–9) provides the cognitive, language, and analytical skills to improve employment and earning opportunities for young people.

TABLE 2.6
General education attainment rates, 1992

Level of schooling	Number of students
Begin grade 1	100
Reach grade 6	78
Complete grade 6	62
Begin grade 7	32
Begin grade 10	23
Complete grade 13	12
Obtain baccalaureate	5

Source: Post-Basic Education 1994.

Vocational training

The Government recognizes vocational training needs to respond to the continual training and retraining needs of today's work force and should not be used as a means of occupying unemployed youth. At the same time, the Government is confronted with large numbers of students that have not been able to complete the basic education stream (see above). The Government is using vocational training to serve two functions: (1) to upgrade the minimum skills of those who have not completed the basic education stream and (2) to improve the quality of professional skill training, retraining, and technical upgrading of the labor force through a more market driven approach. To achieve the first objective, it would be more cost efficient to reduce drop-outs and keep these students in the basic stream rather than use costly vocational training for students that are not even equipped with the basic education needed to make good use of this training. Regarding the second objective, the Ministry of Vocational Training and Employment is trying to improve the quality and commercial relevance of vocational training by using part-time teachers from the business community and by having businessmen well-represented on the schools' boards, guiding the curriculum. The more successful government-assisted professional training programs generally use a combination of tax incentives to encourage private firms to offer training and voucher schemes, whereby individuals can use government-issued vouchers to select appropriate training in the private sector or in the public sector. The Bank is undertaking additional studies to determine how to: (1) reduce selectivity in basic education, (2) upgrade the professional vocational training system, and (3) create an enabling environment that encourages the private provision of vocational training.

Tertiary education

The Government's education and vocational training reform program as well as its broader reform objectives for the civil service and private sector development are causing the country to rethink the objectives, financing, and study emphasis of its tertiary education system. Tunisian higher education has a strong administrative and legal tradition, but a greater emphasis needs to be placed on training civil servants in how to analyze different tax regimes, trade, fiscal and monetary policies, and to train lawyers in business-related regulations, for example, contract law, bankruptcy laws, property rights, copyrights, and financial disclosure laws. As the private sector expands, entrepreneurs need training in business administration. The new advances in teaching methods and the expansion of higher level primary education requires more teacher training. For example, Portugal, Malaysia, and Chile have anywhere from 3 to 4 times more students enrolled in business administration, 2 to 3 times more in engineering, and 2.5 to 4 times more in teacher training, architecture, and town planning than in Tunisia (table 2.7). The Government needs to consider ways to encourage study activities (in Tunisia and abroad) which closely correspond to the country's development objectives. Many governments reserve state scholarships to finance specializations that have the most economic relevance for the country, while activities considered less important are financed through private resources.

There is considerable room for nonprofit private sector expansion in tertiary education in Tunisia, where at present virtually all (97 percent) of higher education is provided and financed by the state. This contrasts with several Asian countries, where private financing covers a larger share of higher education costs (Malaysia 35 percent, Indonesia 49 percent, Korea 77 percent, and the Philippines 86 percent).[3] The Government can promote the private sector's expansion by regulating the quality of education and by using official accreditation policies which the Government is currently trying to put into place. It can open up opportunities for the development of high standard private institutions (possibly set up in affiliation with foreign universities) and encourage greater private sector financing through corporate tax incentives and fee based cost recovery measures which would reduce the state's financial burden and promote a better allocation of public resources.

TABLE 2.7

Comparison of enrollment in tertiary education by field of study

(Percentage share of total enrollment)

Field of study	Tunisia 1990–92	Malaysia 1989–90	Portugal 1990–91	Chile 1990–91
Education and teacher training	5.0	23.0	13.1	12.1
Humanities	24.7	8.6	8.9	3.0
Law	12.8	1.9	8.9	4.1
Social sciences	19.8	28.0	30.4	32.2
(Commerce and business administration)	6.5	20.5	18.9	22.9
Natural sciences	13.4	10.6	7.5	3.5
Medicine	10.6	2.7	5.6	5.9
Engineering	9.4	13.4	18.0	31.1
Architecture and town planning	0.7	1.6	2.0	5.0
Other	1.7	8.2	3.1	2.0
Total	100.0	100.0	100.0	100.0

Source: UNESCO Education Statistical Yearbook 1994.

Health care and social security

The Government has secured good quality and nearly universal access to health care through the public provision of health services. Currently 90 percent of the population resides within one hour's walking distance of a health facility. The ratio of population to doctors is still quite low for a low-middle income country, but it has improved considerably from 0.17 doctors per thousand people in the 1970s to 0.67 per thousand today. For nurses, the number has gone from 1.06 to 3.33 per thousand. Public health facilities are available to everyone and are organized at three levels: (1) university structures (specialized institutes and tertiary hospitals), (2) regional or "second line" structures (secondary hospitals), and (3) "first line" or provincial structures (district hospitals and primary health care centers). The health sector priorities in Tunisia combine the concerns facing developing as well OECD countries:

- Securing a sustainable system for financing growing health care costs and needs;
- Meeting the demands of a growing population which, according to the 1994 census, is estimated to be increasing

at around 2 percent a year This rate is lower than the region's average (2.8 percent), but is still higher than other low-middle income countries (1.4 percent) and requires continued strengthening of preventive medical care and family planning efforts; and

• Adapting services to the changing age structure and geographic distribution of the population, as declining fertility and reduced mortality rates produce an older population with an epidemiological profile with more chronic and degenerative diseases that are more expensive to treat.

The Government is the main provider and financier of health care. The private sector's role is growing, even though the Government provides nearly half the population with free or highly subsidized care. In addition, the public insurance funds and the Social Security Fund (CNSS) do not compensate private health care providers (Social Protection System Study, 1993). Nevertheless, the private sector's role is growing, particularly for ambulatory health services (table 2.8a). Government budgetary expenditures on health care as a share of GDP have remained virtually constant at 2.2 percent since the 1980s, but health care costs have gone up considerably, and these increases have had to be picked up by households (table 2.8b). The increase in household expenditures is also a reflection of higher private sector participation.

TABLE 2.8A

Main providers of health care

(Percentage of services provided, 1992)

Provider	Hospital services	Ambulatory health services
Ministry of Health	90	50
Social security	0	3
Private sector	10	47
No access	0	0
Total	100	100

TABLE 2.8B

Health expenditures

(Percentage of total expenditures)

Source of expenditure	1980	1992
Government budget	51	36
Social security[a]	11	15
Households	37	48
Enterprise practices	1	1
Total	100	100

a. The expenditure share of the social security funds covers its own ambulatory clinics but only part of the services provided by the public sector (MOH).

Source: Ministry of Health and World Bank estimates, 1994.

The public sector's financing of health care comes partly from general tax revenues to support a national system and partly from public health insurance funds that receive contributions from compulsory payroll deductions shared between employers and employees. The public system is facing difficulties generating sufficient revenues to cover the operational and investment costs needed to meet the quality expectations of the population and to compete with growing competition from the private sector. Part of the reason for insufficient financial resources is because the lump sum provided by the CNSS to the public health care system covers only an estimated 40–50 percent of the cost of services provided by public health care providers to the CNSS affiliates (a Government study is underway to determine this share more precisely). The public health system is also providing free or highly subsidized care to a larger share of the population than is warranted based on income levels. The government needs to: (1) increase CNSS payments to health care providers commensurate with the use of its affiliates; (2) limit the coverage of free assistance to the really needy and raise health care service fees for those who can pay, as a means of encouraging people to affiliate with and contribute to the Social Security System; and (3) link pension and health insurance benefits more closely to contributions.

The Tunisian authorities have a commitment to equity in health care, yet resources are scarce and the system is suffering from growing demand, insufficient funds, and constraints in maintaining quality. Mobilizing private resources in addition to public funds and encouraging the private provision of services are necessary to increase and maintain the quality of services available. A greater role for the private sector can be realized only if the government actively reduces its widespread provision of free or highly subsidized care, and more explicitly targets its provision of subsidized services. A variety of options could be considered: increasing user selected fees; privatizing certain services; and increasing the regulatory role of the state. A combination of state supervision with private provision of services would diversify the supply of health services, maintain quality, and promote the efficient use of resources.

The environment: Growth and sustainability

Environmental protection has long been of general concern to the government, but it is only in recent years that environmental issues and their relation to development have been approached in a more systematic way. Markets often fail to account for the environmental impact of business, agricultural, and industrial activities, opening a critical role for government to correct for possible failures. But many governments have fallen short of fulfilling this important role, either because they were unaware or did not understand the economic costs of coastal, urban, or agricultural development without some form of environmental management. The Government recognizes that its growth objectives in irrigated agriculture, industry, and tourism, combined with shifts in the population to the entire coastal area (where already 77 percent of the population are concentrated in less than 25 percent of the total land area) place pressures on the natural resource base and pose potential pollution and other environmental problems which can only be addressed in an integrated fashion. The Government is undertaking a strategic study of the environment and natural resources for the preparation of the Ninth Plan. The main environmental problems facing the country today are:

- Land degradation, due to desertification, drought, flooding, and other climatic changes, inappropriate agricultural practices, and urban encroachment. It affects over 60 percent of the country's usable land resources and is leading to the permanent loss of the equivalent of 24,000 hectares of agricultural land (about 0.5 percent of cultivated land) a year;
- Water scarcity that puts increasing pressure on existing water resources. The Eau 2000 study (1994) and the World Bank's Water Sector Review (1994) estimate that almost all of Tunisia's available water resources will be fully developed by the year 2000, causing competing demands for scarce supply and imposing constraints to long-term growth; and
- Coastal degradation, from pollution and overdevelopment of urban, industrial, and tourist areas at or near the coastline. By the year 2010 Tunisia's population is estimated to grow by between 3–4 million people, the majority of whom will live along or near the coast, increasing pressures on marine and coastal resources.[4]

Problems of water and air pollution, and solid waste disposal are still manageable in Tunisia, and Tunisian authorities understand that it is far costlier to pay the clean-up bill for these problems than it is to avoid them in the first place. Consequently, the Government is acting now to put in place regulations and enforcement institutions designed to avoid costlier pollution problems in the future.

Environmental institutions and policies

Since the 1960s the Government has been implementing environmental policies through a variety of institutions, but by the late 1980s the Government recognized that it needed to focus its somewhat diffused institutional efforts more effectively. In 1988 the Agence Nationale de Protection de l'Environnement (ANPE) was created to: (1) analyze and monitor the state of the country's environment and (2) to combat all sources of degradation to the natural environment. In 1990, with the help of international experts, the Government prepared a National Environmental Action Plan. Environmental management also became a central objective of the current Eighth Development Plan (1992–96), the first plan to devote a chapter specifically to the environment. In 1991 the government created the Ministry of Environment and Regional Planning (MEAT), giving it oversight of the ANPE and responsibility for implementing the government's three part strategy:

- Prevention through environmental impact assessments (ANPE) for any new project, publication of pollution standards, public awareness campaigns, training and environmental education;
- Inspection and monitoring of compliance with environmental and pollution control regulations using research laboratories, monitoring stations, and technical staff; and
- Curative actions in areas where serious damage has already been done.

The main emphasis is on prevention, and MEAT has launched seven programs described in the background paper to implement the strategy. In addition, MEAT intends to consolidate all environmentally related legal codes (there are some 350 existing legal texts related to environmental issues) into a coherent and integrated environmental policy framework. The Government budget allocation for environmental protection has increased over the past decade from less than 0.2 percent of GDP to around 0.4 percent of GDP (0.2 percent for MEAT alone) by 1993. This level rises to nearly 1 percent of GDP when municipal and water, soil, and forest safeguarding activities are included. The majority of these budgetary funds comes from foreign assistance (bilateral grants, METAP, GEF, and loans).

Despite Tunisia's well-organized institutional framework, environmental monitoring and enforcement capacity needs strengthening. Meteorological services should also be improved. Many countries in Latin America and Sub-

Saharan Africa are taking advantage of technological advances in meteorological capabilities to improve the prediction of weather patterns, which is also important for Tunisia, in view of the highly variable rainfall pattern and its impact on the economy. The need for trained manpower, financial resources and adequate facilities make these measures expensive, but a necessary element of their prevention strategy.

Paying the price for resource use and degradation

Pricing policies are the least expensive and most effective means to promote the sustainable use of scarce or fragile resources. There has been considerable progress on implementing price increases for water, sanitation, and energy. The government has also introduced unleaded gasoline, and the 1994 prices per liter for premium gasoline range from US$0.52 to US$0.30 for diesel oil compared to cif prices in the range of US$0.15–0.13 on the world market.

Water prices, particularly irrigated water and urban/rural potable water, are currently subsidized at a level of about TD 94 million per year based on the difference between the average cost/price of water (table 2.9). Irrigated agriculture contributes about 30 percent of agricultural GDP (on only 6 percent of agricultural land), but it is allocated 80 percent of mobilized water resources and still receives a sizeable water price subsidy of TD 52 million a year. Because the country's water balance is becoming increasingly small, gains in water use efficiency have to be achieved through price adjustments and attention to the economic efficiency of water uses. Trade-offs need to be made which require: an integrated strategy for water and land use that is more community based; changes in crop mix patterns that maximize the return to water as an input; stricter control of water losses; investment in water mobilization, treatment, and reuse; and greater demand management between water users in agriculture, industry and tourism. The Government has begun moving away from a centralized government approach to conservation to one that provides incentives for individuals and local communities to reduce waste and degradation.

TABLE 2.9

Water prices in 1994

Use	Price of water (TD/m³)	Cost of water (TD/m³)
Agriculture	0.04	groundwater: 0.24–0.52 surface water: 0.15–0.39 treated wastewater: 0.25
Domestic		
Urban	0.32 (SONEDE)	0.45
Rural		0.86
Industry	0.59	0.45
Tourism	0.59	0.45

Source: Bouzaher and Forster 1995.

Tunisia's useful land resources are subject to different forms of degradation due to the combined effects of natural processes (climatic changes, irregular rainfall, drought, wind erosion, salinity, hilly topography) and human activity that exacerbates natural erosion processes (population pressure on vegetative cover, cultivation of marginal lands, land tenure, and inappropriate agricultural practices, table 2.10). Correcting problems related to human activity will take time and will require a reassessment of which activities are economically and environmentally sustainable. Dryland cereal production may not be economically or environmentally feasible in areas of unfavorable climatic and soil conditions even though cereal production plays an important and traditional role in the subsistence and economic conditions of small farmers. Government price supports for cereals may be encouraging this behavior (see chapter 3, section on reforming agriculture). The government's policy of self-sufficiency in livestock products has led to subsidy schemes for feed which support a larger herd size than the land is able to support, placing pressure on rangeland resources and contributing to an annual 2 percent decline in rangeland productivity. Feed subsidies are being phased out, which should help correct the situation.

Industrial pollution

Until 1990 the Government had no homogeneous industrial pollution policy. Since 1992 a significant effort has been made to clean up "hot spots" and institutionalize the use of impact assessments. Action plans have been developed for

TABLE 2.10

Sources of soil erosion

	Productive hectares lost per year
Water related	11,000
Desertification	8,000
Urban encroachment	4,000
Salinization	1,000
Total	24,000

Source: Bouzaher and Forster 1995.

several industrial zones. Despite these efforts, the cost of pollution control and prevention has yet to be integrated into the concerns of industrialists, since monitoring is weak, there are no pollution taxes, and most industries regard pollution control as a burden that undermines profitability. The Government has avoided imposing pollution taxes and the Unified Investment Code introduces incentives whereby a firm can receive up to 20 percent of the investment cost for depollution activities. An antipollution fund (FODEP) gives an additional subsidy for pollution abatement investment. This approach does not follow the "polluter pays principle" used in many OECD and Eastern European countries, whereby the government raises funds from pollution taxes, reducing the need for investment subsidies.

Although the Government supports the concept of making the polluter pay, at this stage it is trying to promote compliance through establishing industry norms of energy efficiency and a broad-based prevention framework. These efforts combine regulations with incentives to use renewable energies, natural gas and solar for final energy use, monitoring and enforcement, and negotiated agreements between specific enterprises to clean-up polluted areas and promote clean industrial growth. Even stronger efforts are needed to make full use of the most cost-effective means of controlling pollution—cost recovery and pollution charges.

The estimated cost of health problems in Tunisia (loss of life, disability, and health care costs) caused by air pollution is US$595 million per year, and the estimated investment requirement to provide drinking water, sanitation, industrial pollution abatement, and natural resource management is in the range of US$190–260 million per year over the next ten years. By charging prices that fully recover the costs of water and energy provision, the Government could generate an estimated additional US$484 million per year. Pollution charges would generate US$152 million per year, and the elimination of remaining subsidies in agriculture, industry and tourism, another US$20 million. Even if these recovery costs and pollution charges are introduced gradually, the potential revenue generated would help cover the anticipated health and investment costs and would contribute to the objective of lowering such costs in the future.

Tourism and coastal zone management

Tourism development has had a positive impact on heightening environmental concerns in Tunisia. But the desire to develop the industry resulted in policies that did not appropriately price the economic value of tourism assets. The country learned from the mistakes of haphazard planning during the early years of development (1965–80), when the Government provided fiscal and financial advantages for seaside developments built along coastal dunes that caused serious long-term erosion problems. After initially neglecting adequate infrastructure (water and sanitation), during the 1980s, the Government (under ONAS) developed a system for wastewater treatment for coastal areas superior to that in many Mediterranean countries. Since the early 1980s, environmental concerns have gradually become more integrally linked with tourism development. The Unified Investment Code (1994) makes further progress in correcting incentive distortions (see chapter 3, sections on domestic and foreign investment liberalization).[5] The new code removes preferential interest rates for tourism and encourages hotels to introduce technologies that improve energy efficiency. Tourist establishments must now pay the full cost of water, energy, and land, and pay a 0.5 percent tax on tourist revenues to finance projects to clean up and improve tourist towns and coastal areas.

Despite these efforts, tourism development plans face environmental and social constraints to growth: (1) lack of water resources and insufficient sanitation infrastructure; (2) ecologically fragile areas; and (3) haphazard urban development, which frequently results from large-scale tourism development and the rapid migration of workers to the area. To limit the mass tourism development that has degraded so many other coastal areas around the Mediterranean, the Government will need to reduce the physical size (number of beds) of its development plans, particularly in areas that are erosion-prone and pose problems in terms of water and sanitation. From the environmental and social point of view, it is preferable to develop fewer tourist sites that attract one visitor spending TD 120 per day rather than three visitors spending TD 40 per day. High value tourism (characterized by smaller and fewer sites and fewer people) places less stress on fragile areas, and it requires a more skilled work force that increases the value-added of the sector to the economy. To develop luxury tourism successfully, Tunisia may need to cooperate more closely with foreign partners who have the know-how and expertise to design and construct luxury resorts, manage them properly, and market them effectively among a more discriminating clientele.

Conclusions

Progress has been made in reorienting the government's development strategy from one heavily dominated by the state and government-owned enterprises, to one that encourages more decentralization, local initiative, and a greater role for the private sector. The public sector's share in total output and investment is slowly coming down. The Government has improved the efficiency of many state-owned enterprises and agencies and reduced capital transfers to these enterprises, which is an important step in the right direction. But the presence of the state in both productive, commercial, and service-oriented activities is still significant. Recent studies show that even in spite of the improved performance, ownership does matter. The global integration of trade and production requires enterprises to react quickly to international market signals. For a variety of reasons (political, economic, and social), PEs are generally not profit maximizers, and they have more difficulty adapting to an open, competitive, and rapidly changing environment.

Privatization and deregulation of public sector monopolies have not played as strong a role as they could have in the Government's restructuring and "competitiveness upgrading" efforts, which has slowed down the adjustment process and hindered a more rapid expansion of the private sector in the economy. More concerted efforts are needed to refocus the role of government away from direct control and ownership to a role that enforces regulations, protects the public and the environment, and encourages profitable activities. The benefits of selling public enterprises are increasingly well-documented in other countries—in both absolute and relative terms (higher profitability, improved productivity, higher quality, and more appropriate pricing of goods and services). The deregulation and on-going privatization in the merchandise transport sector in Tunisia also support these findings. It would be useful for Tunisian authorities responsible for the country's privatization program to prepare similar case study evaluations in order to enhance the discussion and increase the understanding of deregulation/privatization measures in Tunisia.

Tunisia is in the fortunate position of being able to build on its strengths under conditions of relative prosperity, stability, and the absence of severe environmental degradation. At the same time, it cannot afford to be complacent in moving forward, to deepen and accelerate the pace of its reforms, and take full advantage of the rapid progress underway throughout the world. The relatively young profile of its population and its closer integration with Europe should facilitate the country's absorption of new technologies and new methods of doing business, provided the Government creates an environment that encourages competition and actively expands the role of the private sector in most aspects of economic activity—from the traditional competitive sectors to services including health, education, and infrastructure.

Infrastructure services: global integration, efficiency, and dynamism

Quality infrastructure services improve the country's foreign investment prospects and have a decisive impact on the competitiveness and export performance of enterprises. Tunisian authorities need to think carefully about how the different components of the sector should develop in the years ahead. Several economies in Asia are moving aggressively to offer the best services: highly rated airline services; well-connected transport networks; the fastest and most efficient port and cargo-handling facilities in the world; a wide range of well-integrated financial services and; low cost, state-of-the-art information technology and telecommunications. In order for Tunisia to take advantage of the changes taking place in the global integration and provision of services and to respond to increasing international competition, it needs to encourage:

- Further deregulation and a more active role for local private and foreign investors for example, in such sectors as telecommunications, port handling, and maritime and air transport; and
- Continued improvements in efficiency through appropriate pricing policies and a larger role for private companies in O&M.

Social services: quality, access, and financing

Reducing some state activities and increasing the private provision of selected services in health care and higher level education should help to maintain (and in some areas improve) quality and link the cost of services more closely with the ability to pay. By ensuring the sound financial management of the health care system, achieving higher universal literacy and numeracy, and making secondary, higher and vocational education more relevant to the country's development needs, the government can promote quality services and equitable access in a financially responsible manner.

Environmental management: analyzing trade-offs

Issues of sustainability (like those in health and education) require analyzing costs and benefits with a long-term horizon, which contrasts with the more short-term considerations of business and opens a vital role for government. The natural beauty of the country, its vulnerability to climatic conditions and variations, and the important role of such an environmentally sensitive activity as tourism in the economy have heightened the need to coordinate cross-sectoral growth objectives. Tunisia is already quite advanced in the complicated process of integrating its economic growth objectives with sound environmental management. Maintaining competitiveness as trade opens up is a major economic goal, therefore applying strict environmental standards and internalizing costs needs to be done carefully. Nevertheless, there is a need to enhance the role of incentives and penalties in reducing pollution, which would also mobilize additional resources.

The types of environmental problems that Tunisia will face in the twenty-first century include natural resource scarcity, solid and industrial wastes, and water and air pollution in selected areas. Tunisia's current expenditures on environmental management are the highest in the region, but to tackle the next generation of problems would require additional resources (through pollution charges), and a reallocation of expenditures, for example away from municipal waste water treatment, which is already 70 percent of total expenditures (a higher share than in either the EU or the US). Tunisia's environmental program can be strengthened by: (1) ensuring that the costs of environmental degradation are borne by resource users and polluters, (2) promoting community-based actions and developing the central and local capacity to monitor progress, and (3) ensuring that the government's development strategy in agriculture, industry, and tourism is based on the economic value of natural resources, including, in particular, those of land and water. A Bank study is following up on environmental priorities and natural resource constraints by looking more closely at the economic valuation of land and water use.

Notes

1. Sources for this section include World Bank 1994a, b; SAR 1994a, b; and SIDES 1995.
2. See FIAS 1995. The study compares Tunis/Sousse-Monastir, with Tangiers (Morocco), Mersin (Turkey), Marseille (France), and Bari (Italy).
3. Tan and Mingat 1992.
4. Bouzaher and Forster 1995.
5. World Bank 1994a found that the tourism sector had been the largest direct and indirect recipient of subsidies in the economy, which contributed to the sector's dominance of private investment funds that might otherwise have gone to agriculture or manufacturing.

Chapter 3

Strengthening market forces

To complement its strategy of reducing the role of the state, the Government initiated numerous reforms to enhance competition in the domestic economy. The objective was to provide clearer "rules of the game" that would induce the private sector to focus on productivity increases instead of rent-seeking, to in a sense "privatize the private sector." The shift in incentives has been gradual, but significant, particularly since the bulk of Tunisia's private enterprises had been established in an environment characterized by subsidies, investment, financial and price controls, high protection from imports, and constraints on hiring or firing workers. This chapter reviews the Government's policies to open up the economy through trade and investment liberalization, and introduce competition through: price decontrol; the removal of subsidies; deregulation of distribution markets; and financial sector reforms.

Creating an open, competitive economy

Because of its small market and proximity to major markets and capital suppliers, the importance of trade in Tunisia's economy has historically been high and stable (the ratio of imports and exports to GDP is about 70 percent).[1] Under its Structural Adjustment Program, the government launched an ambitious trade liberalization plan in 1987, with the objective of removing all quantitative import restrictions (QRs) and achieving a lower and uniform rate of protection by the end of 1991. Accordingly, tariff rates were reduced after 1987, the dispersion rate narrowed, and a few import restrictions were removed. But the pace of reform slowed down when it began to affect locally produced goods.

Trade liberalization

As late as 1990, QRs were estimated to cover 60–70 percent of domestic agriculture and manufacturing production (mineral and energy imports are the monopoly of two state-owned enterprises). While considerable progress in removing QRs has been made, at the end of 1994, the Bank estimated the share of domestic production covered by QRs at about 25 percent. Three sectors in particular appear to have significant QR protection: agriculture, processed foods, and textiles. It seems that many of the QRs could be replaced with tariffs, since the estimated tariff equivalents of many of the QRs fall within Tunisia's legal tariff range (table 3.1). The legal tariffs would therefore offer the same level of protection to domestic producers as the QRs.

Other critical elements of Tunisia's trade reform have been its accession to the GATT in 1990, its participation and signature to the Uruguay Round agreement in 1993, and its membership in the newly created World Trade Organization (WTO) in 1994. The 1994 GATT review of Tunisia's trade policies estimates the unweighted average legal tariff rate (including surcharges) at 33 percent, and the range 0–73 percent (table 3.1). This compares to ranges prior to reform of 5–236 percent and an average tariff rate of 36 percent for the period 1981–86. The reason the average tariff rate has fallen very little is because the removal of many QRs after 1990 was offset by temporary surcharges of up to 30 percent. The actual value of import duties collected relative to the total value of imports amounts to an average applied rate of only 10 percent. The applied rate is much lower than the average legal rate because of numerous duty exemptions provided mainly to offshore companies, while the domestic market remains protected by the higher average tariff rate (33 percent). The GATT report

TABLE 3.1

Average tariff rates, 1994

Selected sectors	Average rate (percent)	Range (percent)
Agriculture	40.3	10–73
Processed food	43.0	15–73
Textiles	43.0	20–73
(Clothing)	43.8	20–73
Pottery and china	46.7	10–73
Iron and steel	24.6	10–57
Electrical machinery	33.4	10–73
Total	33.0	0–73

Source: GATT 1994 for unweighted average tariff rates and ranges.

also showed high effective rates of protection and considerable tariff escalation between primary and finished goods for several sectors (textiles, clothing, leather goods, wood, paper and rubber products, and nonferrous metals).[2]

Trade administration remains cumbersome. Liberalized imports still require import certificates, which impose an administrative burden on commercial banks and the customs authorities and impose additional costs for enterprises. There are more than twenty-two tariff rates and about thirty-five categories of exonerating regimes. The complexity and lack of transparency of the rate structure and the number of exemptions hinder the formulation of an effective tariff protection system.

Impact of trade liberalization

Table 3.2 shows how the structure of trade has changed since the early 1980s, due partly to the impact of trade reforms. The biggest shift in imports was the increase of consumer goods (including semifinished goods which are further processed and reexported) once trade restrictions on these goods were lifted, while capital goods imports have remained virtually unchanged as a share of total imports (about 25 percent) and increased only slightly as a share of gross domestic investment (GDI) from 34–38 percent. The size of capital goods imports relative to total imports and investment is one indicator of enterprise trends in upgrading technology. Tunisian enterprises may be delaying investments to upgrade production due to the slower pace of trade reform. By contrast, Malaysia and Morocco implemented trade reforms during the same period and their capital goods imports as a share of total imports increased significantly (Malaysia from 41 percent to 50 percent—half of total imports—and Morocco from 19 percent to 27 percent).

TABLE 3.2

Share of total imports and exports

Imports	1980–84	1990–93
Consumer goods[a]	29.4	37.2
Capital goods	25.6	24.5
Percentage share of GDI	34.3	38.0
Intermediate goods	45.1	38.3

Exports	1980–84	1990–93
Agriculture	2.8	5.1
Manufacturing	30.1	52.5
Textiles	12.7	28.3
Fuel	32.9	9.7
Nonfactor services	32.9	31.9
Tourism	18.5	16.8

a. Some of the increase is due to the increase of imported inputs for offshore processing activities.

Source: World Bank Trade Data.

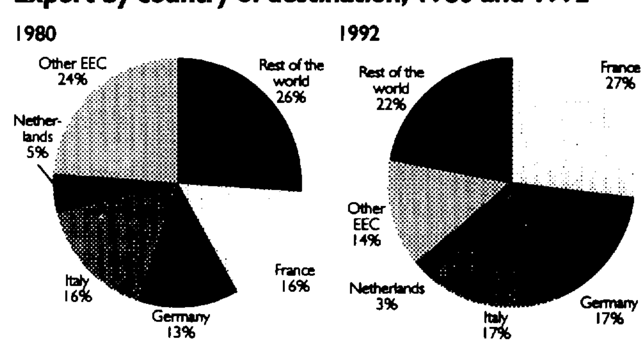
The Tunisian economy has nevertheless become more open. Non-oil/non-phosphate exports as a share of GDP have increased from about 25 percent to 35 percent between the early 1980s and early 1990s, with the manufacturing sector now accounting for Tunisia's largest share (half) of export earnings. Textile exports grew the fastest, with the bulk (about 70–80 percent) coming from the offshore companies that are exempt from customs duties and taxes. Tunisia's tourism sector accounts for roughly the same share of total factor and nonfactor services export earnings as in the early 1980s.

A free trade agreement with the European Union

Parallel to its trade liberalization reforms and its membership in the Maghreb Customs Union, on July 17, 1995 Tunisia became the first country in the Middle East and North Africa region to sign a free trade agreement (FTA) with the European Union (EU). As its main trade and commercial partner (75 percent of its total imports and exports—see figure 3.1 and box 3.1), this agreement will set the stage for Tunisia's future trade and development agenda. In addition to the phased removal of tariff and nontariff barriers, the agreement covers market access for manufactured goods, trade rules, harmonization of standards, and financial and technical assistance to upgrade Tunisian industries and services. Discussions on access to the EU

FIGURE 3.1

Export by country of destination, 1980 and 1992



Source: United Nations Trade Reporting System.

BOX 3.1

Tunisia-European Union free trade agreement: Estimated benefits and costs

Tunisia already enjoys relatively open and preferential access to the EU market. Nevertheless, the static trade and dynamic benefits to the Tunisian economy from an FTA with the EU are significant—an estimated 4.5 percent of GDP a year (TD 720 million), provided Tunisia removes the high tariffs on the most protected sectors in the short-term and follows appropriate exchange rate policies. It would, thus, be beneficial for Tunisia to compress the schedule of QR eliminations and tariff reductions currently agreed with the EU. If Tunisia undertakes full liberalization with the rest of the world, the gains would increase to an estimated 5.3 percent of GDP a year (TD 850 million) and possible trade diversion costs would be diminished or eliminated.[a] The benefits from the accord with the EU come almost equally from three sources: (1) the preferential reduction of Tunisia's remaining tariff and nontariff barriers with the EU; (2) the harmonization of product standards with European requirements; and (3) reduced costs in trade administration from improved transportation and telecommunications.

Lowering tariffs reduces government revenues. To keep the real value of government revenues unchanged, the IDF study estimates that the uniform VAT rate must increase from an average of 20 percent to 26 percent. The problem, however, is that Tunisia does not apply the VAT in a uniform manner across sectors. The study estimates that if the Government eliminated exemptions and moved to a uniform VAT rate, it could lower the current average VAT rate (even if the Government lowered tariffs), and the revenue welfare impact would be even greater than the benefits from tariff reductions under a free trade agreement with Europe. The Government needs to undertake the necessary fiscal reforms which will ensure that tax revenues from improved collection and wider application of the VAT compensate for reductions in tariff revenues (see chapter 1).

The estimated labor adjustment costs are based on the assumption that about 2 percent of the labor force will have to change jobs within the next three years. There are also estimated short-run capital adjustment costs, due to changes in relative prices as some plants and equipment become redundant and unadaptable for use in other industries. Total short-term costs are estimated at less than TD 150 million, while the welfare benefits are larger (TD 720 million).

a. See A. Panagariya, "Rethinking the New Regionalism," 1994, for discussion of trade diversion costs.
Source: IDF 1995; Rutherford, Rutström, and Tarr 1995.

market for services and agricultural goods have been postponed for four years, except for the olive oil quota, which will be enlarged by 3 percent a year over the next four years. The EU market already grants preferential access to most Tunisian manufactured goods, while Tunisia still has high tariffs and some QRs against EU products.

A preliminary review of the agreement shows that all remaining QRs (except for some agriculture, processed foods, and some textile items) will be removed as soon as the agreement takes effect. Tariff protection is to be removed gradually, with imports that are most likely to compete with (and potentially disrupt) domestic production, being phased in over several years. Safeguard measures have also been included in the agreement in case of dumping or other internal disruption, permitting reinstatement of the original tariff rates or the introduction of additional tariffs of up to 25 percent for up to five years, for industries suffering damage from the liberalization. Table 3.3 shows the share of total manufactured EU imports to Tunisia that will be liberalized in a given time period and gives a rough indication of the magnitude and pace of the liberalization process.

The main drawbacks to the gradual implementation of trade liberalization are that (1) the adjustment of domestic industries—closing down some activities and opening new activities and investments—takes longer (and is therefore more costly) and (2) the slower pace often increases the likelihood of reversals, as those parties opposed to the trade liberalization have more time to block changes. Nevertheless, this agreement with the EU marks a critical step in Tunisia's liberalization program, and offers the coun-

TABLE 3.3

Tunisia-EU FTA tariff liberalization schedule of industrial products

(percent)

Number	Category of liberalization products	Percent share of 1992 domestic production[a]	Percent share of 1994 EU imports[b]
1	in 1996	14	12
2	5 years, starting in 1996	20	28
3	12 years, starting in 1996	22	30
4	8 years, starting in 2000	43	29.5
5	Exempted	1	0.5

a. World Bank calculations, 1995.
b. Government calculations, 1995.

try an opportunity to accelerate a series of reforms which should contribute to the improved competitiveness and dynamism of the Tunisian economy. An Institutional Development Fund (IDF) grant study constructed a general equilibrium model to estimate the expected impact of the agreement on the Tunisian economy.

The total long-term gain in value added is substantial, as resources are reallocated to more productive activities and as Tunisia receives EU assistance to upgrade standards and services. The unquantifiable gains in terms of providing increased security and momentum to strengthen the implementation of Tunisia's reform agenda are equally important. The EU's policy support and technical assistance should speed up the transfer of technology and enhance investment opportunities that will help Tunisian enterprises compete more effectively in international markets. Preferential and guaranteed access to the EU market, at least for the next ten years,[3] should enable Tunisia to increase its exports and attract foreign investment. For the EU, the cost of promoting a closer trade and investment relationship with Tunisia would be modest—the total value of Tunisia's non-oil merchandise exports represents less than 2 percent of the EU's annual outlays for agricultural subsidies alone. The expected benefits to the EU include not only enhanced political and social stability in the region, but also an opportunity to integrate EU manufacturers with a lower cost producer, and thereby improve the EU's competitiveness. The FTA with the EU is a major step, but in order to succeed, the agreement needs to show rapid progress in removing all trade barriers, ensuring access to the EU market for all Tunisian goods and services, and in integrating the production and investment patterns of the two parties.

Domestic investment liberalization

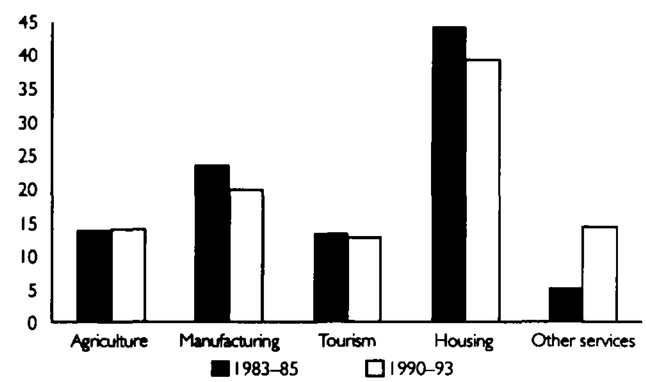
The ratio of private investment to GDP dropped sharply between 1982–87, and then began increasing after 1987 (surpassing the level of public enterprise investment), but even by 1992/93, it had still not reached its 1982 level (figure 2.1). In 1987 a manufacturing investment law was introduced that abolished capacity licensing and removed prior government investment authorization for all projects not requesting investment incentives. This was an important step toward investment liberalization, but since most private investors wanted fiscal and financial incentives, Government approvals continued to play an important role. The 1987 law offered generous incentives on a sectoral basis, and two sectors also benefited from preferential interest rates: tourism and agriculture. The incentives were large (exceeding 1 percent of GDP), they created distortions in the allocation of investment resources, and—in the case of agriculture and tourism—encouraged debt as opposed to equity financing. Figure 3.2 compares private investment patterns in the early 1980s and 1990s. Except for transport services, which grew from a low base in the early 1980s, the pattern has not changed significantly. The decline in manufacturing investment may be due to high positive real interest rates, incentives that encouraged the misallocation of resources, and uncertainties stemming from the preparation of reforms in investment regulations and incentives.

In December 1993 Parliament passed the Unified Investment Code which replaced sectoral investment incentives with common, horizontal incentives: promotion of exports; regional development; technological upgrading; protection of the environment; and enlargement of the entrepreneurship base (*les jeunes entrepreneurs*). The 1993/94 law provides that no approvals are necessary for investments seeking only the common incentives, it reduces incentive distortions (preferential credit for tourism has been replaced by grants), and it strengthens the investment liberalization commitment begun in 1987. However, prior government authorization is still required for numerous domestic activities, particularly in the services sector: fishing; tourism; handicrafts; transportation; telecommunications; education; vocational training; cultural activities; health and real estate development. Investments in other

FIGURE 3.2

Tunisia: Private Investment

(Percent composition)



Note: Other services include transportation and trade.
Source: Ministry of Economic Development, INS and World Bank estimates.

sectors (not specified under the new code) remain regulated (restaurants, financial services, mining, energy) so that about 40 percent of total investment (those specified in the code and these other sectors not specified) still requires prior Government approval.

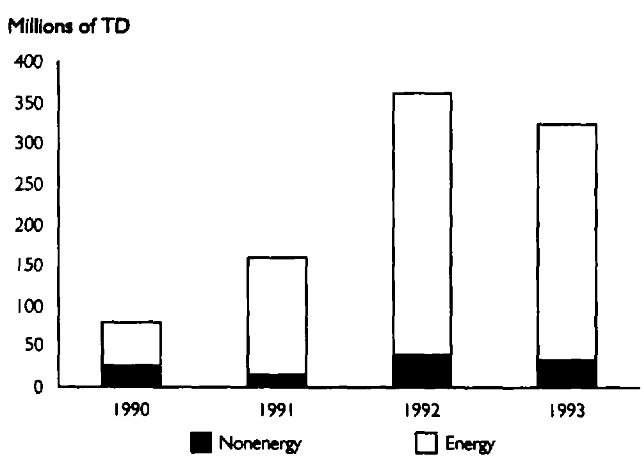
Foreign investment liberalization

The largest share of Tunisia's FDI comes from Italy (40 percent), followed by France and the United States (roughly 15 percent each). Historically, Tunisian authorities' views on foreign direct investment (FDI) have fluctuated between concerns of foreign domination to a recognition that FDI creates jobs, transfers technology and know-how, and provides a critical impetus to higher growth. In spite of the generous incentives provided to export firms, the current account convertibility of the dinar, easy transfer of invested capital, and the stable economic environment, FDI flows to non-energy activities have been very low in recent years (figure 3.3). Until recently, several activities have been mainly reserved for state ownership, effectively precluding private foreign investors: chemicals and petrochemicals; cement; mining; electricity; telecommunications; transport (railroads, airlines, and maritime); water/wastewater treatment and distribution; and insurance.

The Unified Investment Code makes FDI for all export activities (except agriculture) unrestricted. Foreign companies or individuals can now lease agricultural land, but they still cannot own agricultural land. These changes represent a significant opening to foreign investors compared to the previous system, but restrictions on investment in many support services remain in place. Under the new code, foreign investors need the approval of the Investment Commission for many service activities when foreign participation exceeds 50 percent of the share capital. The "Guide du Promoteur," August 1994, provides a list of activities requiring approval: transportation; telecommunications; tourism; educational and cultural establishments; construction, maintenance, and public works; real estate development; computer services and information technology; consulting and auditing companies; and other services. Strong foreign investment in many of these areas, including software development, auditing and consulting (such as international marketing, technology, and quality upgrading firms), telecommunications, and transportation would be highly beneficial in terms of the quality of services provided and as a means of exerting competition on local firms.

FIGURE 3.3

Tunisia: Foreign direct investment



Source: Ministry of International Cooperation and API (Industrial Promotion Agency).

Offshore companies

Another measure used to attract foreign investment since 1972 is the offshore company law which gives incentives (for example, duty free access to all inputs, tax free status) to export-oriented (80 percent) companies. On balance, offshore companies have had a beneficial impact on the Tunisian economy. The growth of manufactured exports over the past decade is due in large part to the offshore companies, which account for between one-third and half of Tunisia's merchandise exports. At the same time, the offshore sector's integration with the domestic economy and its contribution to total FDI in Tunisia have been limited, since most foreign companies rent facilities (bonded warehouses), and have strong incentives to import their capital equipment and inputs from parent companies (box 3.2).

The Unified Investment Code attempts to place domestic producers on a more equal footing with export companies, but important differences in treatment remain: access to the local market for exporting companies; tax treatment; and the inefficient duty refund procedures for local companies. The Government could increase domestic tax revenues by fully integrating the offshore companies into the domestic tax base, which would also ensure their equal treatment with domestic companies that are partial exporters. The government's continued efforts to improve infrastructure services, rationalize tax laws and investment incentives, and make the tariff regime more neutral between

BOX 3.2

Free trade zones: Maximizing host country benefits

Most free trade zones (FTZs) around the world report three key benefits: (1) acquiring managerial, marketing, and technical know-how; (2) obtaining access to established overseas market networks; and (3) building local capabilities to package points (1) and (2). This transfer of industrial export know-how was cited as the most important ingredient to export development—more important than capital flows. The area most frequently mentioned as a problem was the development of backward linkages. The "newly industrializing economies" (NIEs), such as Taiwan, Hong Kong, Singapore, and Korea succeeded in integrating FTZ export operations with local input suppliers. Two critical elements reinforced the deepening of their industrial structures and increased the domestic value-added ratio of their exports.

- FTZs may be the most feasible instrument to introduce free trade quickly into a protected economy, but the NIEs recognized from the beginning (the early 1960s) that they must achieve equal footing export policies inside the rest of the economy—extending duty drawback and restriction-free status to indirect exporters. A "level playing field" was critical to the development of backward linkages.
- The NIEs made sure that infrastructure and other export related services were as good or better than what foreign competitors could offer which benefited the domestic as well as the foreign companies.

The NIEs are now important investors in FTZs in other industrializing countries (Malaysia, Indonesia, Mauritius, Latin America). They are aiming at the European and American markets, but unlike European (or American) firms that have strong incentives to source inputs from their parent companies, the NIEs are prepared to purchase and develop local inputs—provided local supplies meet international quality standards and are price competitive. The successful export boom and strong backward linkages of FTZs in Mauritius stem from the country's conducive environment for NIE and other foreign investors. Its bilingual (English/French) population, its strong equal footing export policies, and well-developed infrastructure and export services have all contributed to its success. There are no NIE investors in Tunisia's offshore sector (perhaps because of language barriers or Europe's content requirements which grant easier access to the EU market depending on the country origin of the product's value-added). Today, half the companies are owned 100 percent by Tunisians, and the remainder are joint ventures or foreign owned, mostly from the EU countries.

Source: Rhee, Katterbach, and White 1990; discussions with Yung Whee Rhee, World Bank.

direct and indirect exporters should contribute to a closer integration of domestic companies in offshore activities and promote higher levels of private investment.

Pricing, labor, and industrial policies

In 1993/94 the manufacturing sector accounted for 20 percent of employment and 19 percent of total value added (compared to 14 percent of value added in 1984), and the sector grew faster than average GDP for the 1991–94 period (averaging nearly 6 percent a year compared to 4.6 percent a year for GDP). Nearly 70 percent of manufacturing production is concentrated in three sectors: textiles; agroindustries; and machinery and equipment. Textiles and agroindustries have experienced the fastest growth rates (7 percent and 6 percent a year). Since 1987, the Government has been gradually introducing competition policy reforms (deregulation, the reduction of preferential credit, open enterprise entry policies, and price decontrol), but the combination of the remaining distortions imposes constraints to competition in the productive sectors (table 3.4).

Price liberalization

During the 1970s and 1980s, prices in Tunisia were regulated by a law dating back to 1970. Until 1982, state intervention was pervasive and price controls covered over 80 percent of all goods and services. Between 1982–86, the Government began liberalizing prices at the producer stage, but distribution margins continued to be regulated. In July 1991 the Parliament passed the Competition Law which

TABLE 3.4

Policy distortions by industry

Industries	Quantitative restrictions	Parapublic agencies	Public enterprise dominance	Price controls
Agroindustries	X	X		X
Textiles, clothing, leather	X			
Machinery and equipment	X		X	X
Construction materials			X	X
Chemicals/ fertilizers			X	

Source: Lahouel 1995; Lakhoua 1995; and Mink 1995.

accelerated the pace of price liberalization and expanded the liberalization reforms to include distribution margins. Progress has been steady, even though the law specifies certain circumstances where the Government can intervene in price setting: (1) whenever the Government thinks necessary, but for a period not exceeding six months; (2) to protect the purchasing power of low income groups; and (3) in cases where there is an excessive market concentration (monopolistic or oligopolistic structure). Price liberalization applies to agricultural and manufactured goods which do not fall into categories (2) and (3).

Between 1991 and the end of 1994, producer price controls were reduced from 30 percent of agricultural and manufactured goods to 13 percent and the regulation of distribution margins was reduced to less than 30 percent (table 3.5).[4] Two subsectors (agroindustries and construction materials) account for most of production (and distribution) still affected by price controls. In agriculture, for example, regulated distribution margins for fresh fruit and vegetables could be removed given the extent of domestic competition in the subsector. As the Government improves its targeting of the poorest families, the need for subsidized food products should decrease. The closer integration of the Tunisian economy with Europe should eliminate remaining QRs and facilitate the decontrol of prices for virtually all goods and services.

Labor markets

Because of the predominantly young age structure of Tunisia's population, it is expected that it will take at least a decade before the flow of new entrants to the labor force begins to subside.[5] In addition to demographics, two other factors contribute to the steady growth of the labor force: the entrance of more women and rural to urban migration flows, increasing the labor force in urban areas by 5 percent a year The growing size of the urban work force is putting pressure on the authorities to increase economic growth and create more jobs.

In 1989 Tunisia's official unemployment rate (ages fifteen and above) was estimated at a very high level (around 16 percent). If the actual rate is as high as the officially reported rate, it could constitute an important constraint to labor market mobility which would hinder possible layoffs needed for industrial restructuring, company closures, and privatization. High unemployment and labor market immobility are the two most frequent causes undermining the implementation of adjustment reforms. A closer investigation of the figures and trends in Tunisia indicates that the 16 percent rate is an overestimate (table SA.5).[6] By following consistent (and internationally accepted) definitions to measure employment creation and the size of the labor force, the unemployment rate is estimated to have declined during 1966–89 from 15 percent to 11.2 percent (compared to the official unemployment figures which estimated that the rate remained stationary over that period at around 15–16 percent). Also using the more consistent definition, the unemployment rate—excluding first time job-seekers—was only 2.7 percent, and the unemployment rate of heads of households was as low as 1.4 percent in 1990, compared to 7.2 percent ten years earlier. These findings support the view that the key problem of unemployment is for first-time job seekers.

Table 3.6 highlights the activities which created jobs faster than the average for the economy as a whole between 1989 and 1993. Job creation in services grew 2 percent above the estimated average rate and accounted for the

TABLE 3.5

Price controls by sector

(Percent share, end of 1994)

Sector	Production stage	Distribution stage
Agriculture and fishing	—	31
Agroindustries	44	47
Construction materials	56	37
Mechanical and electric	9	41
Chemicals	2	21
Textiles	—	1
Other	—	19
Total (weighted)	**13**	**30**

— Not available.

Source: Lahouel 1995.

TABLE 3.6

Job creation, 1989–93

(Percent)

Sector	Average growth rate	Share in total employment
Agriculture	0.2	24.0
Manufacturing	2.8	20.0
Machinery	4.0	2.0
Textiles	2.5	10.0
Nonmanufacturing	0.1	14.0
Services	4.3	24.0
Tourism	5.9	2.0
Government administration	3.2	18.0
Total	**2.1**	**100.0**

Source: Hakim 1995.

largest share of total employment (24 percent). Other subsectors that created jobs faster than the average were tourism and machinery, with particularly high job growth rates, but they accounted for a small share of total employment. Employment in government administration grew faster than the average at 3 percent a year, and its share in total employment remained at about 18 percent.

Average wages declined by 0.1 percent per year in real terms over the past decade, with the sharpest declines in 1986–87. Since 1988 real average wages have started to climb back, and by 1993, reached the same level in real terms as in 1983. Minimum wages eroded considerably since the early 1980s and are now relatively low in Tunisia: the minimum wage for manufacturing (SMIG) is around 6 TD per day and for agriculture (SMAG) is about 4.6 TD. Recent analysis also indicates that the minimum wage does not represent a major labor market distortion, having only a modest and temporary effect on average wages (Azam 1995).

Every three years, Tunisia uses sectoral collective bargaining agreements (*convention collective*) to determine wages and benefits for some forty-six different sectors. The most recent three year (1993–96) wage agreement increases wages by 6 percent a year and is binding for all firms with four workers or more, regardless of whether these workers are permanent or temporary and regardless of whether they are unionized or not. Experience in other countries shows that wage moderation is generally best achieved through either decentralized (firm-level) or centralized (nationwide) wage negotiations, rather than the sectoral approach used in Tunisia. The Government, the unions, and the employer associations recognize the importance of maintaining international competitiveness, in part by ensuring that wage agreements do not put undue pressure on inflation and do not raise unit labor costs significantly above Tunisia's main competitors. Continued liberalization of product markets (through trade and price liberalization) along with some increased decentralization in the collective bargaining process should help keep wages and prices in line with international trends (see Rama 1995).

TABLE 3.7

Wage differentials

(permanent workers, 1990)

	Higher level	Unskilled worker	Skilled worker
Public sector	1.16	1.60	1.73
Offshore private	0.96	1.07	0.78
Domestic private	1.00	0.97	0.99
Average wage	1.00	1.00	1.00

Source: Hakim 1995.

Because of its size and importance in the economy, the public sector's wage and employment policies play a critical role in Tunisia's labor market and merit closer review. An INS Survey shows that wages for permanent workers in PEs are higher (and the disparity has grown since 1985) than in either the domestic or offshore private enterprises, particularly for unskilled and skilled workers (table 3.7). Part of the reason for lower wages in the offshore sector may be because it employs a high share of women at low salaries. There may also be some data and sampling problems with the INS survey.

Legislation concerning layoffs for economic reasons may be the most important government-induced distortion in the Tunisian labor market. The Government has strong administrative capabilities to enforce labor regulations in Tunisia. Difficulties in laying off stem from the need to submit a request to the Inspection du Travail which has one month to review the request. If no solution is found, the employer needs to obtain the consent of a tripartite body (Commission du contrôle des licenciements) before any retrenchment takes place. In practice, this turns out to be difficult. In 1994 for example, 505 firms wanted to retrench a total of 60,390 workers (which corresponds to an average job destruction of 3–4 percent compared to 10–11 percent in Germany or the United States). Out of the total, 346 respected the legal procedures, 151 retrenched unilaterally (and are subject to sanctions), and 8 firms reached an agreement with their workers. Of the 346 requests, the tripartite commission was able to reach an agreement for only 182. In the end, less than 26 percent of the workers included in the requests for retrenchment were actually laid off (Rama 1995). The Government is currently reviewing labor legislation and is preparing a strategic study for the Ninth Plan on labor legislation, the relationship between productivity and wages, and labor costs. The preliminary analysis prepared for this report raises several issues for further study: (1) enterprise flexibility to adjust the size of the labor force to a changing commercial environment, (2) the impact of public sector wage and employment policies on the private sector, (3) the possibility of introducing greater flexibility into the sectoral collective bargaining process, (4) improving the measurement of unemployment through annual labor surveys in conformity with internationally accepted definitions and practices, and (5) severance packages and unemployment insurance policies.

Policies to promote innovation and quality: *"la mise à niveau"*

The most important way Tunisia can innovate and improve the quality of its products and services is through global linkages, mainly between private parties, rather than governments.[7] Stronger competition from trade liberalization will promote higher productivity and encourage a stronger outward orientation. The process of achieving international competitiveness is an effect of trade liberalization and not a prerequisite for it. Tunisia, like other industrializing countries, uses four main channels to obtain new technology:

- Imports of capital goods and components that embody a significant amount of technology that is often accompanied by foreign technical assistance to set up and operate the equipment;
- Foreign technology licensing, where companies buy the design specification and technical assistance on how to use the technology. The use of this channel is growing as technology gets more complicated and other methods of obtaining it (such as FDI) become more difficult;
- Foreign direct investment, which transfers capital, technology, management, access to global networks of information, and access to markets; and
- Foreign education and training of students who become part of an overseas network that can be a valuable source of information to their home countries.

While government and state-owned agencies may not be the best providers of technical assistance to enterprises, government can create the appropriate environment and provide practical support to private entrepreneurs. Examples include state-funded grants to promote the establishment of private productivity centers (possibly in a joint venture with a foreign firm) and partial grants to help small firms finance the cost of hiring international experts. Tunisia's promotion of bilateral technical assistance programs with donor governments (GTZ of Germany) is showing beneficial results. Passing laws on standards and metrology (but using private laboratories for quality certification) provides enterprises with a credible means to document quality performance. Tunisia's standards and patents agency, INNORPI, has been very useful in applying European standards to Tunisian firms, but many more private laboratories need to be set up. The government of Slovenia, also concerned that its small enterprises must adapt to the more dynamic and competitive environment resulting from its integration with the EU, is trying to encourage this upgrading with minimal government involvement (box 3.3).

Tunisia's more recent efforts to liberalize investment procedures and open more activities to the domestic and foreign private sectors should help promote a wider range of contacts between Tunisians and foreign entrepreneurs. The benefits of government creating a policy environment that promotes competition, foreign contacts, efficient infrastructural support and human resources to adopt new technologies are well-documented. There is less understanding of what are the best means to help local enterprises respond to these incentives.

Research in several African countries on the impact of structural adjustment measures on the performance and enhanced competitiveness of small enterprises shows

BOX 3.3

Upgrading the competitiveness of small and medium-size enterprises: The case of Slovenia

The Slovene program supports the improved competitiveness of small and medium-size enterprises (defined according to assets, turnover, and number of employees) and includes two main components: diagnostic evaluations (paid for mostly by government and a small fee from the companies) and the formation of an equity fund to help recapitalize the enterprises (made up of capital from EBRD, IFC, Harvard Business School Alumni Organization, two local banks, and USAID). The most important feature of Slovenia's competitiveness program is the trade liberalization agreement with the EU, which provides the driving force of the upgrading process, as virtually all import barriers will be removed over the next five years. The role of government is limited to well-defined development objectives targeted at small enterprises, such as (1) introducing smaller firms to modern financial, marketing, and management systems by helping to pay for an initial "diagnostic" evaluation that smaller companies would otherwise not be able to afford and (2) promoting the transfer of technology by requiring the foreign consultants to transmit their state of the art analytical methods to local consulting firms. It will be up to the firms' owners to decide if they want to go to the market for additional capital or loans, and for the private investment funds and banks to decide independently whether to lend to or invest in a company.

Source: Slovenia, discussions with USAID officials.

encouraging results and provides useful lessons and recommendations (see World Bank Discussion paper 271, "Small Enterprises Adjusting to Liberalization in Five African Countries").

• Unlike many large enterprises, which generally suffer from trade liberalization and other measures to enhance market-based competition, small enterprises tend to thrive under increased openness because they rely more on local resources and inputs, and the dynamic, better-educated, profit-motivated entrepreneurs adapt well to changing incentives and economic conditions and can grow in market niches.

• Self-help groups, cooperatives, local nongovernmental organizations, and manufacturers' associations are potentially the most effective intermediaries to raise the probability of survival and expansion among small enterprises by providing a support network (with clear cost-effectiveness criteria) to help deal with individual problems and communicate with policymakers to address systemic problems.

Levy and others (1994) also investigate these issues, showing similar conclusions for four very different countries (Colombia, Indonesia, Japan, and the Republic of Korea). This report emphasizes that the best means for SMEs to improve their quality and efficiency are through transactions with buyers and suppliers, by having access to a network of specialized consultants, and through formal technology transfer agreements. The most successful methods to help companies include: (1) decentralized technical and export marketing support that can respond to the diversity of enterprises across subsectors, (2) private industry associations that develop and diffuse sector-specific knowledge and skills that cannot be obtained by individual small enterprises, and (3) joint efforts between industry associations and government.

Reforming agriculture

The agricultural sector employs roughly one-third of the labor force and accounted for 16 percent of GDP and 11 percent of export earnings in 1993/94. The sector is highly vulnerable to drought. For example, average growth for the 1990–94 period was 8 percent a year, but fluctuated from an increase of about 30 percent in 1990 to drought-induced declines of –5.3 percent and –9.9 percent per year in 1993 and 1994. Irrigated agriculture covers 6 percent of arable land, but accounts for 30 percent of agricultural output.

The Government has been undertaking reforms in the agriculture sector since 1989, supported by two Bank adjustment operations. Progress has been substantial on the reduction of input subsidies, while efforts have been more modest on the reduction of price supports and the deregulation of state-run marketing monopolies and farm extension services.

Increasing the role of market forces and strengthening private initiatives

On the input side, since 1989 subsidies have been substantially reduced for fertilizers, animal feed, pesticides and herbicides, seed, irrigation, and mechanized services (Mink 1994). In addition to the remaining input subsidies, the Government makes direct grants available to private investments in agriculture, and lending interest rates in "priority" activities like agriculture are fixed at 10–11 percent, or about 2 to 3 percentage points below market rates for commercial activities. Although these fixed, preferential rates have increased considerably since 1986, the costs and risks associated with lending to small and medium-size farmers are quite high, and this interest rate policy still provides a significant element of subsidy. The total value of the credit and investment subsidies (and price supports) as a share of budgetary expenditures could not be estimated for this report but should be assessed to determine their full extent.

The Government is increasingly opening up the provision of agricultural support services to the private sector. The supply of farm inputs, collection of produce, provision of mechanized plowing and harvesting, and fishery port services have all been privatized. Extension, veterinary, and laboratory services are still essentially provided by the state, but there is a growing recognition that the private sector should be permitted to play a much stronger role in these activities. The few private extension agents and veterinarians who have recently begun providing services have been extremely successful. The Government can play an instrumental role in promoting further private sector expansion of these services through accreditation policies and by removing subsidies on its own delivery of these services.

Progress towards reducing the state's dominance in food marketing has been slower. In cereals marketing, the National Agency for Cereal Marketing (OC) import monopoly is being relaxed. The size of its operations, however, combined with its storage facilities, make effective private competition difficult. In addition, the Government offers support prices to domestic producers, through the OC, that are on average 30–40 percent above international prices (1991–94), which ensures OC's effective control of the cereals market (the Bank and the Government had agreed that 15 percent above the farmgate import price was reasonable). Olive oil exports were opened to the private sector in 1994, but private sector activity remains limited because the National Agency for Edible Oil (ONH) controls edible oil imports and olive oil exports to Tunisia's main export market (the EU) through an agreed quota arrangement with the EU. Meat and powdered milk imports were liberalized in 1990/91, but state-owned enterprises (El Louhoum for meat and STIL and Tunisie-Lait for reconstituted milk) subsidize their domestic sales, which makes it difficult for the private companies to compete. The Office du Commerce de Tunisie has a monopoly over the import of coffee, sugar, tea, and tobacco, and two parastatal enterprises monopolize the collection, refining, and distribution of sugar. The Office du Vin controls the import of all wine and alcohol and dominates domestic production of wine.

As part of its ongoing reforms, the Government should reassess its agricultural policies that effectively hinder private participation in marketing agroindustrial products and those that entail price supports and credit subsidies to maintain or increase cereal production. For the farms growing cereals on marginal land with the poorest yields, it may be more efficient to replace price supports and subsidies with targeted income support. Tunisia's closer integration with Europe and its commitments under the Uruguay Round will promote the further liberalization of the agricultural sector. One outcome may be that Tunisia will import more cereals and export more higher value fruits and vegetables.

The land tenure system

The land tenure system has hindered the use of market mechanisms as a means of ensuring that land and agricultural inputs are used as efficiently as possible.[8] Inheritance laws in Tunisia guarantee that a farmer's descendants all have equal claim to his land after he dies. Consequently, almost everyone—those who have left the countryside and those who remain—have a claim but not a legal title to a given piece of land. In practice, the system has led to an informal and inequitable division of the land, resulting in small, fragmented plots, limited access to credit, and inadequate family income. As much as 75 percent of all farmers in the country own less than 25 percent of total cultivable land while 1 percent of farmers own 35 percent.

The lack of security of tenure, fragmentation of holdings, and the poor management of resources by absentee landowners are problems which affect the majority of Tunisian farmers. The Tunisian authorities recognize the severity of the situation, but progress in finding and implementing an acceptable solution has been difficult. Rural population trends suggest that the number of farm households should begin to decline in the next fifteen years, increasing pressure for farm consolidation. Consequently, the Government needs to improve the transparency of land markets by introducing a simple system of titling and registration that will enable land to be bought, rented, or sold. The Government established a Ministry of State Lands and Land Tenure in 1991 and is trying to improve the land registration system. The Ministry of Agriculture (MOA) is defining a land consolidation program and a plan for land exchange that would result in larger and more manageable parcels. These efforts represent the first steps toward establishing a land market.

The state is also a major land-owner, with 600,000 hectares of prime crop land under its control (11 percent of total cultivable land). Most of this land is managed by state co-operatives and other state entities. In 1991, the government began leasing out some of this land. About 10 percent of state holdings are leased to the private sector and another 2 percent are leased to agricultural technical staff from the MOA. The experience so far has apparently been extremely successful (more intensive cultivation, diversified production, exports, and profits). Leases were originally set at forty years and are being lowered to twenty-five years. The authorities may wish to consider expanding the leasing program and reassessing the costs and benefits of selling state lands to the private sector as another supporting measure in the establishment of an agricultural land market.

Financial sector reform

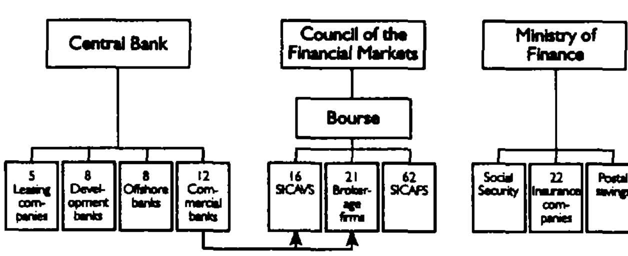
Beginning in 1989 the government undertook an ambitious banking and financial sector reform program to complement its structural adjustment effort. The objectives were to bring the banking system under internationally accepted methods of supervision and prudential regulation, to create a treasury bill market and to modernize the legal and institutional structure of the financial system. As of March 1995 the financial system could be divided along the lines of the three main supervisory institutions: (1) the Central Bank, (2) the Council of Financial Markets, and (3) the Ministry of Finance. The main financial institutions include: twelve commercial banks (two of the largest and three of the medium-size banks are government-owned and account for roughly 70 percent of total credit and 55 percent of deposits); eight government-owned development banks; eight offshore banks that deal mainly with offshore companies providing trade finance, foreign exchange operations, and medium-long-term loans; five private leasing companies; the bourse; twenty-one privately owned brokerage houses; seventy-eight mutual funds; the social security fund; twenty-two insurance companies (half of which are state-owned); and the postal system (see figure 3.4). Commercial banks are the largest financial intermediaries in the Tunisian economy with assets of TD 10.6 billion at end 1993, the state-owned development banks have assets of TD 2.4 billion, and the insurance industry has total assets of TD 600 million (1992). The total stock market capitalization of the twenty listed companies on the Tunis stock exchange grew very rapidly between 1991–94 from TD 543 million to TD 2.4 billion.

The banking sector

Since 1991 the Government has reinforced strict prudential regulations (making them more consistent with international standards), including stringent capital adequacy requirements, and has strengthened the Central Bank's supervisory role and capabilities. High standards for external audits and reporting requirements have been established. Provisioning and capital adequacy standards have been brought into compliance with international standards, and the quality of bank supervision has improved. The banking law was amended in 1994, lifting restrictions on long-term lending by commercial banks, and interest rates have been further liberalized, although several informal practices still remain that limit competition among the banks on the basis of interest rates (*accord de place*). The most notable feature of the banking system, however, is the predominance of the public sector banks, whose performance is significantly weaker, by most measures, than that of private banks, due in large part to the public sector banks' efforts (and obligation) to follow or implement government development programs during the past three decades.

FIGURE 3.4

Structure of Tunisia's financial system



Note: Central Bank, Council of the Financial Markets, and Ministry of Finance are the three supervisory bodies of the financial institutions.
Source: Central Bank of Tunisia.

The private banks generally have (1) stronger loan portfolios (as measured by the percentage of classified loans requiring provisioning as a proportion of the gross loan portfolio), (2) larger deposit bases as a percentage of total liabilities, (3) lower cost/income ratios (for private banks, these ratios are comparable to those of commercial banks in OECD countries), and (4) a higher percentage of their revenues generated by fee income from commercial services than do the public sector banks in Tunisia. By these measures, the private banks are clearly more efficient, especially those with strategic foreign partners that bring technology, management know-how, and international standards of prudence.

For the past two years, the Government has been making an effort to recapitalize the public sector banks and improve the quality of their portfolios by issuing guarantees on public sector enterprise debt weighing most heavily in the banks' portfolios and by restructuring several of the larger, loss-making public enterprises. The Government still retains controlling interest, however, in the five largest commercial banks. Gradual divestiture has virtually no impact on the policies, composition of the Board of Directors, management practices, or salary scales of the staff in these key banks. Divestiture through sales of shares to the public would be an ineffective substitute for selling a controlling interest to a single shareholder. The Government needs to find a core shareholder that will appoint key Board members and fill senior management positions to run the banks after divestiture.

The recent developments in the financial sector and the past financial performance of the government-owned development banks raises critical issues for these specialized banks. Their assets are one-fifth those of commercial banks, their combined capital and reserves are significantly higher—more than half of the total capital and reserves of the whole banking system. The development banks have capital adequacy ratios ranging from 8–54 percent, however, the return on their capital is negative in real terms (table 3.8). In addition, now that the commercial banks are becoming full service banks and lenders of long-term credits, the development banks are at an increasing disadvantage in their ability to attract clients. With the deepening of the financial system, development banks will need to enlarge their activities and the Government may need to amend laws and regulations to enable them to expand their activities. The Government (in agreement with its bilateral Arab country partners) has several options, including: reorienting their activities toward investment banking, closing some, or linking some of them up with commercial banks.

Financial markets—stocks, bonds, mutual funds, and institutional investors

Since 1987 the Government replaced rediscounting, which had been the primary means of regulating the banks' liquidity, with an interbank money market. It has eliminated mandatory placements in banks of below-market Treasury bonds and replaced them with an auction of negotiable Treasury bills; and certificates of deposits (CDs) and commercial paper have been introduced with maturities of up to five years. Instruments have thus been put in place for the proper functioning of a modern monetary policy and the development of a money market. In practice, however, the Central Bank fixes the money market rate and arranges the exchange of liquidity on a bank by bank basis. The auction of Treasury bills is arranged with the banks, so that each bank takes its "share" of bills at a "negotiated" price and resells them to their clients. There is no secondary market for the "negotiable" bills, and the interest rates on CDs and commercial paper remain stable in a fixed relationship to the money market rate, which also remains fixed at a given level for many months at a time.

TABLE 3.8

Comparison of commercial and development banks, 1993

(Billions of Tunisian dinars)

Indicator	Commercial banks	Development banks
Total assets	10.6	2.4
Capital/reserves	0.5	0.7
Return on equity (percentage)	16.0	4.7

Source: Burabreis and Brun 1995.

Considerable progress has been made in the creation of monetary instruments and the establishment of a legal and regulatory framework for a more liberalized financial market. Nevertheless, interest rates remain rigid. In the absence of a market-driven yield curve, the Government cannot assess the liquidity in the economy nor carry out an efficient debt management strategy. Likewise, private investors have no measure of the risk for different maturities, and companies seeking to raise capital in the market have no benchmark for pricing their debt instruments (bonds). Further steps are needed to liberalize the money market rate, liberalize the interest rates on other monetary instruments (CDs and commercial paper), allow the market to determine the yield on Treasury securities, and promote a secondary market in these Treasury securities (chapter 1).

The stock market

The Tunis stock exchange (bourse des valeurs mobilières) was founded in 1969 and remained dormant until 1989 when the authorities passed a law defining its main features and rules of functioning. The 1989 law had shortcomings that discouraged the issue of new securities: it concentrated regulation and management in one public sector institution, it did not provide for a modern settlement system, and brokerage activities were under the control of the banks. In 1994 another law was passed that included most features of OECD stock markets (a private bourse, private brokerage firms, and a modern settlement system and regulatory framework).

Between 1990 and 1994 the stock market index increased by 350 percent and stock market capitalization grew from 5 percent to 16 percent of GDP. The capitalization of the twenty listed companies jumped from TD 543 million to TD 2.4 billion during 1991–94. Despite the dramatic growth in capitalization, only five initial public offerings took place, and the demand for stocks exceeded the supply by 200 percent to 500 percent. The increase in stock market activity is due mainly to the relatively high yield offered by stocks (compared to OECD standards), as companies distribute a high share of their profits through dividends, or issue free shares. In 1990 and 1991, the average return on stocks was estimated at 40 percent and 31 percent, respectively, compared to a return on stocks in most OECD countries of about 10 percent. The average price/earnings ratio of about 25 in the Tunisian stock market is high compared to average ratios in other emerging markets which range from 15 to 20. The most recent surge in the stock market (end 1993–95) has been due primarily to a 2 percent drop in the money market in November 1993 and a similar drop in term deposit rates, driving investors to seek higher returns on the small stock market.

Two reforms that the Government should consider are: (1) speeding up the privatization program to increase the supply of stock offerings, thereby helping to satisfy the excess demand that is now pushing stock prices up and (2) removing the fiscal distortion that now exists in the form of the sizeable tax benefit for investors, which encourages investors to oversubscribe to initial stock offerings and thereby help to push the prices up.[9] These reforms would serve to restore a greater balance between supply and demand in the stock market. But the fact remains that in Tunisia, as in many other developing countries with emerging markets, many of the family-owned companies are reluctant to go public.

The bond market

The bond market (primary issue) has also grown rapidly over the past four years, from total bond issues of TD 176 million in 1991 to TD 322 million in 1994, as a result of several factors. On the demand side, tax incentives have prompted the creation of open-end mutual funds (SICAVs), which are investing in bonds, stocks and T-bills. On the supply side, private companies no longer require prior authorization (not automatic under previous regulations) from the Treasury on the timing and pricing of bond issues, although they still require a bank guarantee. This gives rise to the risk of moral hazard, as banks may be willing to guarantee the bond issue of a mediocre client, thereby transferring its on-balance sheet risk to off-balance sheet, but the Government intends to eliminate this requirement within the next two years when independent rating agencies will have been established.

Insurance and pension funds

Government authorities are now turning their attention to insurance and pension fund reform. With total assets of TD 600 million in 1992, the insurance industry is important for the modernization of the financial system and the development of capital markets. About half of the insurance sector is state-owned, with the remainder joint stock or mutual companies. The industry has long been subject to restrictive regulations that have limited its ability to engage in technical risk and financial management. Several companies (public and private) report cumulative deficits that exceed their authorized capital. In fact, the capital shortfalls of these companies exceed the capital of all the other companies so that the industry as a whole suffers from negative equity. The Government is working to prepare and implement a program that would reduce the extensive cross subsidization on types of insurance, revise regulations and strengthen supervision, restructure the capital-deficient companies, modernize financial management, and improve the financial condition and public image of the insurance industry. The Government is also beginning to undertake fundamental reforms of the pension system, by improving the returns on investments of the social security funds and by taking measures to redefine pension benefits and possibly introducing individual capitalization accounts. The objective is to provide basic coverage through compulsory social security contributions, while additional coverage could be provided through the insurance industry. These reforms in the insurance and social security systems will have a substantial impact on the availability of instruments and long-term resources for the financial system.

Conclusions

The implementation of competition policies—trade, price and investment liberalization, the integration of FDI with the domestic economy, and the deregulation of numerous state controlled activities—is critical to ensuring the future competitiveness of the Tunisian economy. The authorities are strengthening the role of market forces throughout the economy, but the removal of the controls that remain and a more rigorous application of the legal changes recently put in place pose major challenges.

An open, competitive economy

Tunisia's membership in the GATT, the WTO, the Maghreb Customs Union, and an FTA with the EU should ensure Tunisia's continued outward orientation. The implementation of trade reforms will be influenced by the pace of commercial integration with the EU. The costs of adjustment occur only once, while the benefits of free trade with the EU are large and recur annually, provided the remaining trade barriers are reduced in the short term (less than five years). The tariff reductions require the provision of funds to cover labor and capital adjustment costs and the application of a more uniform VAT to compensate for duty-revenue losses. The removal of QRs on textile products was scheduled for 1993/94 or even earlier, but has been postponed to the end of 1995. The draft FTA agreement with the EU postpones the reduction/elimination of some tariffs (the highest ones) for as long as 5 to 12 years. The costs of delays include continued misallocation of resources and uncertainties which depress investment or direct it to less economic activities. Over the medium term, the authorities should simplify the tariff structure around a maximum uniform rate and should replace the issuance of import certificates with an automatic transmission of the necessary import information from the customs authorities to the statistical office (INS or Ministry of Commerce).

Achieving higher levels of private investment—both domestic and foreign—is a priority. The reduction of interest rate subsidies is an important reform introduced under the Unified Investment Code. Investment has been significantly deregulated for most activities. Incentives are clear and are based on common objectives. Approval requirements have been reduced, and whether those that remain impose undue constraints on local or foreign private investment will depend on how the Government applies the regulations. A reduction in the size of the state—through divestiture and deregulation measures—is necessary to allow the private sector to expand its activities.

FDI and other foreign contacts between Tunisian and foreign firms are the most important ways for the country's enterprises to innovate, acquire new technology, and improve the quality of their products and services. The spirit of the new code reaffirms Tunisia's increasing openness to FDI in a wide range of activities that were previously closed to private (local) and foreign investors. Continued efforts to ensure that the tax laws, duty rebate systems, and investment incentives place domestic and offshore companies on an equal footing should contribute significantly to the greater integration of their activities. These efforts combined with a credible privatization program will improve investor confidence and promote investments.

Pricing, labor, and industrial policies

Progress has been made in many areas, however, continued efforts are needed to encourage competition in the productive sectors: the elimination of all QRs and the neutral application of the tariff code; a decisive reduction of public or parapublic ownership in several subsectors; the removal of remaining price controls; and improvements in labor regulations to increase employer flexibility in adjusting the size of the labor force. Creating an open and competitive environment is the most important contribution the government can make to upgrading the competitiveness of Tunisian industry. In addition, the government can provide practical support by facilitating foreign contacts among firms and using decentralized technical and marketing support through private industry associations, private consulting firms, or joint private/public associations. By accompanying an open trade regime with measures to facilitate the setting up, the operation, and the closure of businesses, the Government can enable adjustment to take place.

Reforming agriculture

Input subsidies have been reduced significantly, but the Government should reassess its agricultural policies that effectively hinder private participation in marketing some agroindustrial products and those that entail continued price supports and credit subsidies to maintain or increase cereal production. Tunisia's closer integration with the EU and its commitments under the Uruguay Round should promote the further liberalization of the agricultural sector and may result in Tunisia importing more cereals and exporting more higher-value fruits and vegetables. The Government needs to improve the transparency of land markets by introducing a system of titling and registration that will enable land to be bought, rented, and sold. The Government's efforts at land registration and land consolidation are critical first steps. The government should also consider expanding its program to lease state-owned lands in view of the favorable results obtained so far and reconsider the costs and benefits of selling state agricultural lands to the private sector.

Financial sector reform

The significant banking reforms taken by government have strengthened the banks and increased competition among them. The fundamental problem with the commercial banking system is the predominance of the public sector. The Government's efforts to recapitalize the banks may not achieve their intended objectives if the bank management does not change and if the policy environment does not promote competition. Although modest divestiture (through selling some shares to the public) has taken place, the government needs to find core shareholders that can appoint critical board members, fill senior management positions, and run the banks after divestiture. With the deepening of the financial system, the Government (with its other government partners) needs to either reorient the development banks' activities, close some, or link some of them up with commercial banks.

Tunisia's financial sector is becoming increasingly sophisticated. Recent reforms have encouraged investors and the development of longer-term financial instruments in the creation of SICAVs and in the growth of the stock and bond markets. The preparation of reforms for institutional investors is also underway. This basis, along with a more active privatization program, will further promote the development of a modern, diversified financial system. To deepen and increase the efficiency of the capital markets, the further liberalization of interest rates, the development of a secondary market in Treasury securities, and the establishment and functioning of appropriate settlement systems are all necessary.

Notes

1. Sources for this section include: Lahouel 1995; GATT 1994; IDF Grant Study "Free-Trade Agreement Between Tunisia and the European Union" 1995, Rutherford, Rutström, Tarr; and Stanton 1994.
2. Under its full membership to the GATT and its participation in the Uruguay Round, Tunisia enlarged its tariff binding coverage from 15 percent to 53 percent of total tariff lines. All items of agriculture have been bound at tariff rates varying between 25 percent and 200 percent. About 50 percent of all nonagricultural headings are bound with the range of 27 to 43 percent (excluding textiles which applies a uniform rate of 90 percent beginning in 1996 and declining to 60 percent in 2005. According to the GATT TPRM, bound tariffs are still very high for agriculture and textiles, and effective protection rates are much higher than what nominal rates imply. Wearing apparel will continue to enjoy effective protection rates exceeding 100 percent (Lahouel 1995 and GATT 1994).
3. The Uruguay Round and the Multifiber agreements (of which the EU is a signatory) will reduce Tunisia's preferential access to the EU market for most agricultural products, and textiles, over the next ten years, as the EU reduces its tariffs on all industrial products and converts its NTBs for agricultural imports to lower tariffs (see Rutherford, Rutström, and Tarr and Lahouel 1995).
4. These percentages apply to the manufacturing and agriculture sectors which together account for only about 35 percent of total GDP. Cereal prices, while not officially controlled, are determined by the state's support price. The prices of most services and nonmanufacturing goods continue to be regulated, although price increases in these activities have significantly reduced the underpricing of many goods and services (chapter 2 and Lahouel 1995).
5. This section is based on Rama 1995, Hakim 1995, and Azam 1995.
6. The criteria used to measure unemployment in Tunisia differ from those commonly used in other countries, and they have changed over time, leading to an overestimation of the growth rate of the labor force. Since the growth rate of employment is probably underestimated, the more recent "unofficial" unemployment estimates include a significant upward bias. See Rama 1995.
7. This section draws on Dahlman 1994a, b; Levy 1994; and Bell and Pavitt 1992.
8. The cumbersome regulations governing nonagricultural land titles also pose problems to the functioning of property markets and the ability to use land as collateral for loans. Less than 5 percent of properties have legal titles.
9. The Government allows a tax deduction for the full amount of the investment for new issues of equity, up to a maximum of 35 percent of net taxable income provided the equity is held for five years. This represents a huge tax benefit for investors and a loss in tax revenue for the Government. At the same time, the tax code does not specify that the benefit is available only to investors of publicly traded stock. Privately held companies have therefore created subsidiary closed-end mutual funds (SICAFs) to invest in their own companies and at the same time reap the tax benefit. At a minimum, this is a loophole that should be closed.

Chapter 4

Policies for higher growth

As a result of the adjustment program and structural reforms initiated in 1986, the Tunisian growth performance improved considerably. This chapter analyzes such improvement. First, it describes the sectoral contribution to aggregate output growth. Then, after a brief exposition of the insights and evidence provided by the new growth academic literature, it quantitatively examines how the enhanced growth performance is related to objective measures of various reforms. The medium-term outlook section presents moderate and high growth scenarios and the chapter concludes by proposing a further liberalization of trade and the concentration of government's actions on the provision of public goods as necessary steps to achieve higher sustainable growth in Tunisia.

Growth performance, 1987–94

Tunisia's growth performance improved during 1987–94 with respect to 1984–86. Real GDP grew at an average rate of 4.52 percent in the latter period, compared to 2.63 percent corresponding to the previous three years (table 4.1). This improvement was stronger in terms of per capita GDP growth due to a reduction in average population growth from 2.6 percent in 1984–86 to 2.1 percent in 1987–94. This large difference is also due partly to the unusually poor performance during 1984–86 and to the sound macroeconomic management and the program of structural reforms started in 1986. The 1981–86 period is more representative of the prereform period.

Except for agriculture and fishing, most sectors in the economy participated in this improvement (table 4.1.) The agricultural sector, including fishing and agroindustry, decreased its contribution to GDP growth from an average of 0.89 percent during 1984–86 to 0.68 percent for 1987–94. On the other hand, the nonagricultural sectors increased their contribution to GDP growth from 1.67 percent to 3.89 percent over the same period. Among the nonagricultural sectors, it was the service sector that experienced the highest rise in the contribution to GDP growth (from 1.35 percent to 2.02 percent). The contribution of the nonmanufacturing sector to GDP growth also rose (from –0.09 percent to 0.20 percent), whereas that of the manufacturing sector slightly increased. The nonmanufacturing sector increased its contribution to GDP growth mainly because of the strong recovery in construction and the slowdown of the decline in fuel.

Regarding the sectoral composition of GDP (table 4.2), the respective average shares of the agricultural, manufacturing, and service sectors were higher during 1987–94 than in 1983–86, whereas those of the mining, fuel, and construction (particularly public works) sectors were lower in the second period.

TABLE 4.1

Contribution to real GDP growth

	1983–86	1987–94
Agriculture and fishing	0.89	0.68
Agriculture	0.86	0.62
Fishing	0.03	0.07
Industry	0.78	1.08
Industry, excluding fuel	1.02	1.16
Manufacturing	0.89	0.92
Agroindustry	0.15	–0.02
Construction materials	0.08	0.11
Machinery	0.21	0.11
Chemicals	0.00	0.16
Textiles	0.28	0.40
Other	0.18	0.14
Nonmanufacturing	–0.09	0.20
Mining (excluding fuel)	0.01	–0.03
Fuel	–0.22	–0.07
Gas and electricity	0.06	0.07
Water	0.05	0.00
Construction	0.02	0.23
Total services	1.35	2.02
Transport and communication	0.07	0.36
Tourism	0.29	0.16
Financial services	0.12	0.29
Commerce	–0.10	0.19
Other	0.38	0.44
Government services	0.59	0.59
Adjustment factor	–0.16	–0.10
Net indirect taxes	–0.40	0.88
GDP at market price	2.63	4.52
GDP at market price excluding agriculture, agroindustry	1.67	3.89

Source: Data from Ministry of Economic Development and staff calculations.

TABLE 4.2

Sectoral share in GDP at market price

(Percent)

	1983–86	1987–94
Agriculture and fishing	13.85	14.68
Agriculture	13.16	13.92
Fishing	0.69	0.60
Industry	32.31	29.23
Industry, excluding fuel	20.23	23.03
Manufacturing	14.97	16.77
Agroindustry	3.90	3.64
Construction materials	2.02	1.89
Machinery	2.45	2.36
Chemicals	1.03	1.58
Textiles	3.64	5.06
Other	1.94	2.25
Nonmanufacturing	17.34	12.47
Mining, excluding fuel	1.10	0.89
Fuel	8.67	5.52
Gas and electricity	1.44	1.42
Water	0.73	0.62
Construction	5.40	4.00
Total services	44.17	46.83
Transport and communication	6.39	7.23
Tourism (hotel, cafe)	4.40	5.24
Financial services	3.36	3.47
Commerce	8.28	8.79
Other	8.31	8.74
Government services	13.44	13.37
Adjustment factor	3.57	3.24
GDP at factor cost	86.76	87.51
Net indirect taxes	13.24	12.49
GDP at market prices	100.00	100.00

Source: Ministry of Economic Development.

The Tunisian economy, however, was subjected to large fluctuations mainly due to sudden changes in agricultural production (which in turn depended heavily on weather conditions) and to a lesser extent due to shifts in external demand for Tunisian goods and services, particularly tourism (figure 4.1). The effect of weather conditions on output growth is clearly seen in 1988, when a severe drought caused agricultural output to decrease by 30 percent, which in turn led real GDP to virtually zero growth. In 1990, when weather conditions markedly improved, agricultural production and real GDP grew strongly (by 32.2 percent and 7.3 percent, respectively). Agricultural production will remain strongly dependent on weather conditions as long as irrigated agriculture covers only a small fraction of arable land (currently 6 percent). By affecting the demand for Tunisian exports, the Gulf crisis was also an important cause of output variability during the early 1990s; after a fall in the real GDP growth rate to 4.1 percent and a contraction of the tourism sector by 15.2 percent in 1991, the end of the crisis brought about an 7.6 percent real GDP growth rate in 1992, led by an impressive 24.1 percent growth rate in the tourism sector. The vulnerability of the Tunisian economy to external conditions will be minimized as the structure of production becomes more diversified and domestic relative prices (which still face some controls) and wages (which, given the current labor legislation, are rather rigid) become sufficiently flexible to accommodate sectoral demand and supply shifts.

Structural reforms and growth

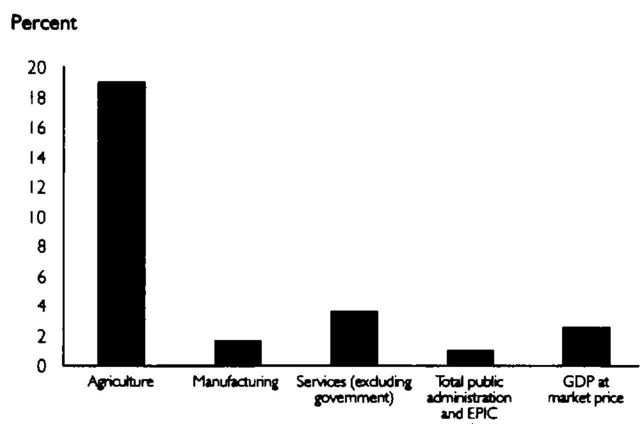
By the mid-1980s, a series of professional journal articles revived the academic interest in economic growth as a subject for both theoretical and empirical research. Although this subject has always been of prime interest to policy makers, the "new growth literature" is giving them a fresh and more accurate perspective on the kinds of policies and reforms that best promote economic growth.

The determinants of economic growth

In their contributions to the new growth literature, prominent economists explain how long-run growth is enhanced by socioeconomic developments and government policies. The following is a list of some of the most important contributions to this literature. Paul Romer (1986, 1990) points out the importance of technological research and development; Robert Lucas (1988) emphasizes the role of human capital formation; Robert Barro (1990) highlights the

FIGURE 4.1

Standard deviation of the annual growth rate, 1983–94



Source: World Bank calculations; data from Ministry of Economic Development.

importance of tax-financed public goods and infrastructure as well as the need to minimize the distortionary effects of taxation; Ann Krueger and D. Orsmond (1990) argue for trade openness; Robert King and Ross Levine (1993) underline the importance of financial innovation; William Easterly (1993) points out the importance of flexible, market-determined relative prices; and Stanley Fischer (1993) emphasizes the role of macroeconomic stability.

Originally developed to furnish evidence for testing the theoretical models, empirical studies using cross-country data provide policy makers with a wealth of information on the extent structural reforms promote economic growth. Some of the most widely cited empirical studies are those conducted by Robert Barro (1991), Robert Barro and X. Sala-i-Martin (1994), William Easterly (1993), and the analysis undertaken by a team of economists for *The East Asian Miracle* (World Bank 1993a). In general terms, their main conclusion is that economic growth is maximized when the incentives to invest in physical and human capital as well as in technological innovation are determined by free-market forces. Governments assist this process by providing an environment of macroeconomic and political stability and the appropriate public infrastructure.

These empirical studies provide estimates for the effect of various economic variables on the growth rate of per-capita GDP. Since it is very difficult to directly assess the importance of broadly defined reforms, such as improvements in "human capital investment" or "price distortions," researchers have used readily observable variables as proxies for these reforms. Table 4.3 reports some of these estimates.

The first variable, the ratio of investment to GDP, represents physical capital formation across all sectors in the economy. The next three variables proxy for the level of human capital in the country. Average years of secondary education in the adult population (aged twenty-five and over) and life expectancy at birth represent measures of educational attainment and health conditions, respectively; government spending on education, as a ratio to GDP, roughly accounts for quality of education and public involvement in working-force training programs. The variable M2/GDP is a proxy for the state of development of the financial system. The black-market exchange rate premium over official rate is a proxy for government-induced price distortions in the economy. The ratio of government consumption (net of spending on education) to GDP proxies for nonproductive public expenditures and the associated tax burden. The average tariff rate represents protectionist policies and price distortions not only in the tradable sector but in the whole economy as well. Finally, the ratio of exports to GDP accounts for outward orientation and the degree of competitiveness in international markets.[1]

Structural reforms and growth in Tunisia

In 1986 the Tunisian government initiated a comprehensive program of structural reforms. Their accomplishments and shortcomings, as well as their necessary next steps, have been analyzed in the previous chapters. Mostly as a result of these reforms, the per capita GDP growth rate increased significantly from an average of 1.15 percent during 1981–86 to 2.44 percent for 1987–94. Using the estimates provided in table 4.3, the contributing factors of this enhanced growth performance can be assessed quantitatively.

The prereform period is represented by the years 1981–86, and the reform period consists of the years 1987–94. Given that particularly during the first three years of the reform (1987–89) the economy underwent a rather

TABLE 4.3

Determinants of economic growth

An increase in:	of:	will change per capita GDP growth by:
Investment/GDP	1 percentage point	0.1 to 0.2 percent
Average years of secondary education	1 year	0.8 to 1.2 percent
Government spending on education/GDP	1 percentage point	0.2 percent
Life expectancy at birth	10 percentage points	0.7 percent
M2/GDP	10 percentage points	0.2 to 0.4 percent
Black market exchange rate (premium over official rate)	10 percentage points	–0.4 percent
Government consumption (net of education spending)/GDP	10 percentage points	–1.2 percent
Average tariff rate	10 percentage points	–0.2 percent
Exports/GDP	10 percentage points	0.6 percent

Note: Some caution must be taken when applying the estimated effects presented in this table to the experience of a particular country. The variables considered to explain growth performance are useful proxies for but not exact measures of underlying socioeconomic conditions. For specific countries, some other variables may represent such conditions in a more direct and comprehensive way (for example, a measure of consumption subsidies is better than the black-market exchange rate premium as a proxy for price distortions); however, these other variables are usually not available for a large group of countries, which is needed to obtain reliable econometric estimates. The accuracy of the estimated effects of changes in the explanatory variables on the growth rate is highest when the country in question is representative of the world sample and when the considered changes are small relative to the size of the variables.

Source: Barro 1991; Easterly 1993; and Barro and Sala-i-Martin 1994.

costly process of adjustment, the average GDP growth rate for the whole 1987–94 period may understate the benefits of reform. If this is the case, the average GDP growth rate during 1990–94 may better reflect the impact of the reform measures. Table 4.4 presents the actual growth rates for the reform periods 1987–94 and 1990–94, as well as that for the prereform period 1981–86.

Most importantly, table 4.4 reports the contribution of the relevant proxy variables to the improvement in the per capita GDP growth rate. The increase in the growth rate predicted by the change in the proxy variables (1.19 percentage points) is quite close to the actual increase (1.29 if the improvement is measured with respect to 1987–94, or 1.58 if with respect to 1990–94.) Advancement in the level of human capital (progress that in fact was initiated before the adjustment program of 1986), financial deepening, abatement of price distortions, decrease of nonproductive public expenditures, and higher openness to international competition and trade, all contributed significantly to the increase of the per capita GDP growth rate. Had the average investment-to-GDP ratio remained the same in the second period, the growth rate would have increased by 1.97 percentage points. This increase implies an improvement in the efficiency of capital investment. However, the average ratio of gross domestic investment to GDP was 5.22 percentage points lower in the period 1987–94 than in 1981–86. According to the estimates presented in table 4.3, this large fall may in principle cause a decline in the per capita GDP growth rate anywhere from 0.52 to 1.04 percentage points. Given that in Tunisia most of the reduction in domestic investment was related to public enterprises with low productivity, a growth-rate reduction of 0.78 percentage points (the midpoint estimate presented in table 4.4) may overstate the adverse effect of the investment/GDP decline in the latter period. This partially explains why the predicted growth-rate improvement in table 4.4 falls short of the actual improvement and represents targets for economic policy.

TABLE 4.4

Determinants of growth improvement in Tunisia

Variable	Average 1981–86	Average 1987–94	Contribution to the improvement in the per capita GDP growth rate (percent)[a]
Investment/GDP[b]	29.30 percent	24.08 percent	–0.78
Secondary education[c]	0.52 years	0.73 years	0.21
Government spending on education/GDP	5.56 percent	5.84 percent	0.06
Life expectancy at birth	63.61 years	66.36 years	0.34
M2/GDP	43.86 percent	48.57 percent	0.14
Black market exchange rate (premium over official rate)	10.60 percent	1.80 percent	0.35
Government consumption (net of education spending)/GDP	10.87 percent	10.49 percent	0.05
Average tariff rate[d]	40.00 percent	33.00 percent	0.14
Exports/GDP[e]	24.63 percent	36.00 percent	0.68
Growth rate of per capita GDP[f]			
1981–86	1.15 percent		
1987–94	2.44 percent		
1990–94	2.73 percent		
Actual growth improvement			
In 1987–94 with respect to 1981–86		1.29 percentage points	
In 1990–94 with respect to 1981–86		1.58 percentage points	
Predicted growth improvement		1.19 percentage points	

a. The estimated effects on growth given as a range of values in table 4.3 are used as the midpoint for this table's calculations.
b. Excluding the Gazoduc and Miskar projects.
c. The figures correspond to the years 1980 and 1985, respectively.
d. The figures correspond to the years 1986 and 1993, respectively.
e. Exports of nonpetroleum, nonphosphate products.
f. Average growth rates are calculated using the least-squares method.
Source: World Bank calculations.

Key macroeconomic indicators: Medium-term outlook

Table 4.5 presents medium-term projections for key macroeconomic indicators under two alternative scenarios, namely, moderate and high growth. The two scenarios presume a continuation of both macroeconomic stability and structural reforms. The moderate-growth scenario represents, to a large extent, an economy similar to that of the last eight years. The high-growth scenario, on the other hand, assumes an acceleration of the pace of reform implementation and represents targets for economic policy.

At the sectoral level, the main sources of growth under both scenarios are the manufacturing and service sectors. In the high-growth scenario the manufacturing sector grows at an average of 8.5 percent per year. The service sector, especially financial services, transport, and telecommunication will have to satisfy the demand stemming from this higher level of economic activity growing more than 6 percent per year. In the moderate-growth scenario, manufacturing value added grows in line with past years at between 5 percent and 6 percent, whereas the service sector remains under 5 percent per year. Within the service sector in the high-growth scenario, tourism is projected to slightly decrease its weight following a policy toward the luxury market segment of the tourism industry; this would render both more value added per visitor and less strain on natural resources. In the moderate-growth scenario, the drop in the growth rate of tourism from the first to the second period is larger than under the high-growth case because a continuation of the old policy would eventually lead to environmental constraints on tourism. The estimate of growth in agricultural value added is conservative, reflecting environmental restrictions facing Tunisia (particularly regarding water supply) and the likely reallocation of resources to more sustainable sectors. Also, with closer trade integration with the EU, it is expected that agricultural imports would replace part of domestic production, freeing up resources for other sectors of the economy.

The difference in the GDP growth rates between the two scenarios is due to both higher investment and enhanced total factor productivity. This difference is larger in the second period (2000–03) because it is assumed that most of the transition costs of completing the reform program are paid for in the first period (1995–99) and that some of its benefits materialize in the economy with a time lag. Using the estimates provided in table 4.3 on the determinants of economic growth, it is calculated that higher investment explains about 30 percent of the growth difference between the two scenarios. Enhanced total factor productivity, which explains the remaining 70 percent, is generated by both stronger market incentives for private activity (through deregulation and privatization) and more efficient public services, particularly in infrastructure.

The larger investment requirements under the high-growth scenario do not lead to a deterioration of the current account balance because national savings, both public and private, are correspondingly higher under such a scenario. Private savings as a ratio to GDP are projected to be slightly larger in the high-growth scenario (particularly during the latter period, 2000–03) because of two reasons: first, the marginal propensity to save rises with national income; and second, the reform of the financial sector, by offering better savings instruments, induces a higher rate of private savings. Similarly, public savings are higher, as the government deficit as a ratio to GDP is smaller under the high-growth scenario mainly because of a further rationalization of current expenditures and transfers to public enterprises. (The high-growth scenario assumes that trade taxes decrease as part of the liberalization program; however, government revenue is projected to remain at around 27 percent of GDP as VAT and income taxes rise to offset such a decrease.)

Under the high-growth scenario, accelerated trade liberalization, higher competitiveness in international markets (achieved, among other things, through a market-driven exchange rate and flexible domestic wages and prices), and improved total factor productivity lead to an outwardly ori-

TABLE 4.5

Medium-term outlook

(Percent per year)

Rate of change	1989–94 Actual	1995–99 High growth	1995–99 Moderate growth	2000–03 High growth	2000–03 Moderate growth
GDP market price	4.6	6.0	4.6	6.4	4.1
Net indirect taxes	5.7	8.2	6.6	8.5	6.2
GDP fc	4.5	5.7	4.3	6.1	3.8
Agriculture	7.2	5.0	3.1	4.0	2.5
Industry	3.9	5.3	4.0	6.7	3.6
Manufacturing	5.8	7.7	5.6	9.4	5.1
Mining	–2.3	–2.1	–2.1	–5.6	–5.6
Hydrocarbons	–2.2	–2.5	–2.6	–6.9	–6.9
Phosphate	–2.7	0.8	0.8	0.0	0.0
Other industry	6.0	4.0	4.0	4.0	4.0
Services	4.4	6.2	4.8	6.3	4.2
Tourism	4.1	6.5	6.5	5.0	4.0
Other services	4.5	6.2	4.6	6.5	4.3
Gross domestic investment	7.0	9.4	6.2	9.0	5.5
Imports	5.4	9.0	7.2	8.4	6.2
Exports	5.1	6.8	4.9	8.1	5.0
Icor (five years)	6.5	5.0	5.5	4.3	5.8
Ratios to GDP (percent)					
Gross investment	26.6	26.0	24.9	28.6	25.7
Public	4.9	5.0	5.0	5.0	5.0
Private	21.7	21.0	19.9	23.6	20.7
National savings	22.1	23.0	21.6	26.3	22.5
Current account balance	–5.1	–3.0	–3.3	–2.2	–3.2
Government revenue	27.7	26.9	26.7	27.1	27.3
Government expenditure	31.2	29.0	29.8	27.7	29.7
Government deficit/GDP	3.4	2.2	3.2	0.7	2.4
External debt	60.5	46.3	46.4	32.2	35.5
Debt service (percent of export)	21.6	16.0	16.3	14.4	16.3

Source: World Bank projections.

ented economy. The growth of exports is about 50 percent higher in the high-growth scenario than in the moderate-growth case, and the growth of imports about 35 percent larger. The corresponding higher share of exports to GDP, together with a greater reliance on both national savings and foreign direct investment to finance the current account deficit, renders Tunisia's external position under the high-growth scenario even more secure than that of the moderate-growth case.

Conclusions

In the mid-1980s, several prominent economists began focusing their attention on how long-run growth is enhanced by socioeconomic developments and government policies. This theoretical and empirical research uses cross-country data to measure to what extent different structural reforms promote economic growth. Their main conclusion is that economic growth is maximized when the incentives to invest in physical and human capital as well as in technological innovation are determined by free-market forces. Governments assist this process by providing an environment of macroeconomic and political stability and the appropriate public infrastructure.

This work has been applied to the case of Tunisia, by comparing per capita GDP growth improvements during 1981–86 (the period prior to undertaking adjustment reforms) and 1987–94 (the period during which structural reforms have been under implementation). The analysis compares the predicted improvement with the actual improvement, and it estimates the growth impact of several policy measures, as determined by the cross-country empirical analysis. The main elements that contributed to improved growth in Tunisia were estimated to be: (1) an increased openness of the economy, (2) a reduction in price distortions, (3) improvement in population health indicators, (4) advancement in the level of education, and (5) financial deepening. All these elements significantly increased the economy's total factor productivity. Given that physical capital investment as a ratio to GDP was lower in 1987–94 than in 1981–86, the rise in total factor productivity was the main source of the improved growth performance in the reform period.

Conditional on a timely completion of the reform program, real GDP is projected to grow at an average of 6.2 percent in the next nine years. It is estimated that about one-third of the growth improvement during 1987–94 would be explained by a larger investment rate. Thus, most of the growth improvement would come through a further rise in total factor productivity, generated by both stronger market incentives for private activity and more efficient public services. Given the environmental constraints facing Tunisia, agriculture's share in total production is projected to decrease in the coming years at the same time as manufacturing and nongovernment services (with a slightly decreased role for tourism) become the leading growing sectors. Tunisia's external position would remain sustainable, particularly under the high-growth scenario, as private savings respond favorably to financial sector reforms and as the share of exports in GDP rises due to Tunisia's enhanced international competitiveness.

Chapter 5
Challenges of globalization

In the mid-1980s, Tunisia chose to adopt a market-oriented development strategy. Since that time, the Government has undertaken deficit reduction measures, tax reforms, some trade liberalization, and structural reforms in the areas of pricing policy, deregulation, and financial market development. Tunisian leaders have followed a consistent direction, building up credibility over time. Their gradual, yet timely approach has resulted in an impressive macroeconomic performance and significant social advances which are critical ingredients for higher long-run growth.

This report has focused on the policies that will influence the future growth and development of Tunisia. The report analyzes the areas expressed by the government as being strategic for Tunisia's future: achieving higher rates of growth in the context of sustainable environmental management and the enhanced competitiveness of the economy in a global market environment. In addition, the report includes key issues raised by other groups in Tunisia (the private sector and members of the academic community) on the role of the state in the economy, the development of the financial sector, and the adequacy of the education system in meeting the human capital requirements of the twenty-first century.

Strategic choices in the 1990s

After nearly a decade of reform, and as the country embarks on a closer commercial relationship with Europe, the Tunisian authorities should consider undertaking a more decisive and clear completion of reforms. The next one or two years may well provide a unique opportunity for Tunisia to use the momentum (and financial assistance) from the trade agreement with the EU to absorb higher transition costs and promote a real international integration of the Tunisian economy. Three key messages emerge from the report's analysis that present Tunisian authorities with important choices:

- The pace of structural reform needs to move forward more decisively, particularly in the areas of trade and investment liberalization. Although the Tunisian economy has become stronger and more sophisticated since the late 1980s, the external environment has not stood still. The rest of the world is also changing rapidly, so that countries like Tunisia need to liberalize their economy with determination and in a timely manner to maintain their growth prospects and enhance their international competitive position.
- The state needs to decrease further its size and role in the economy, strengthen its actions in the provision of public goods, and encourage a higher level of private investment—domestic and foreign. Further deregulation of public sector monopolies and an acceleration of the privatization program would promote productive and allocative efficiency in the economy and enable the Government to focus on the enforcement of regulations that encourage profitable activities, protect the public, and preserve the country's natural resources.
- Environmental constraints mean that further adjustments in growth plans must take place, particularly in agriculture and tourism. By undertaking the necessary adjustments now, the Government will be in a better position to implement these reforms gradually.

Pace of reform

A general recommendation throughout the report is to implement the remaining reforms in a timely manner. This is consistent with the government's stated objective of increasing the GDP growth rate from 4–5 percent to 6–7 percent. A slow approach to reform is more consistent with keeping the growth rates at the respectable current levels. Gradualism, however, has two problems that make even maintaining growth at its current rates difficult. The first problem is related to international markets. Many developing countries are experiencing rapid reform, thus becoming formidable contenders with whom Tunisia will have to compete in export markets and in attracting capital flows from the developed world. The second problem refers to the domestic economy. Further reform will benefit the country as a whole, but the related transition costs will be higher for some groups than for others. Lessons from the political economy of reform around the world show that interest groups hurt by policies designed to increase competition (for example, public enterprises, heavily protected private enterprises, traders with import monopolies) will exert an increasing pressure on the government to delay and even stop the reforms. Reversals can be extremely costly in terms of the government's credibility and the public's expectation that improvements in the standard of living will actually materialize.

As an illustration, consider the following simple exercise. Assuming that the average per capita GDP growth rate in the last five years, around 2.4 percent, remains in the future, it will take sixty-six years for Tunisia to reach the per capita GDP level of France in 1994. However, if because of an acceleration of the pace of reforms, the per capita GDP growth rate rises to 4.5 percent in the medium term (say, in five years) after having decreased (by, for example, 1 percentage point) due to transition and implementation costs, it will take thirty-nine years for Tunisia to reach the same objective.

Decisive trade and investment liberalization

The process of achieving international competitiveness is an effect of trade liberalization and not a prerequisite for it. The argument for protection as a means of helping enterprises upgrade their products has been discredited by international experience, and there is no reason to believe it is any different in Tunisia. The report argues strongly that the best way for Tunisia to respond to the challenges and reap the benefits of globalization is by liberalizing trade rapidly and decisively and by significantly reducing impediments to foreign investment. One of the primary objectives of trade liberalization is to use competition and efficient resource allocation as an engine of growth. Increased openness to international trade and foreign investment promotes domestic competition, enhances the marginal product of capital, and speeds up growth. International competition and liberalization of investment regulations will promote cooperation between Tunisian and foreign companies that will encourage the technological upgrading of Tunisian industries and the reallocation of resources to more productive activities.

The free trade agreement with the EU is a major step, but in order to succeed, the agreement needs to show rapid progress in both resource reallocation and closer integration between the production and investment patterns of the two parties. Several East European countries are moving quite rapidly (within five to seven years) to remove their trade barriers against EU products and seek closer integration and wider access for their goods and services in the EU market. The Tunisian trade agreement with the EU is more gradual. For products that are sensitive to Tunisian producers, some tariff reductions will be introduced very slowly over twelve years and for other products, reductions will be postponed for four more years and then introduced gradually over eight years, thereby extending substantial protection for many domestic producers. The agreement also provides ample provisions (safeguard mechanisms in conformity with GATT regulations) enabling domestic producers to reverse the tariff reduction process. Discussions on improved access in the EU market for services and agricultural products has been postponed for at least four years (although the access for some agricultural products has been increased). These features could increase the likelihood of reversals, which slow down the reallocation of resources and delay the economy's ability to reap the benefits of reform. Reversals could also undermine the credibility of Tunisia's gradual reform strategy.

Tunisian authorities should (1) consider compressing the tariff reduction schedule from twelve years to at most eight years, (2) begin lowering tariffs on all manufactured goods in the first year (1996), and (3) apply reductions to all its trade partners. By making a clear schedule of trade reform well-known to key groups (labor unions, the academic and business communities) and by adhering to the different reform schedules, the government will demonstrate its strong, irreversible political commitment to competition.

Refocusing the role of the state

Privatization, including the dismantling of government monopolies, is central to the structural reform of the economy and to the process of refocusing the role of the state in the economy. Ownership does matter, because it determines the incentive structure of the enterprise, which, in turn, is the force that promotes productivity in a competitive environment. The deregulation of public sector monopolies is also critical to increasing competition and improving productivity. In the cases where these measures were undertaken in Tunisia (merchandise transport, some services, tourism), the outcomes have generally been very positive. It is difficult to show precise efficiency measurement changes for Tunisia, because privatization has been limited, but extensive work has been done in other countries which strongly supports positive results. Widespread private ownership combined with property laws, clear land titles, transparent regulations, and a well-functioning financial system provide the building blocks that make market-oriented economies function.

A key finding from studying structural reform and growth (chapter 4) is that economic growth is maximized when the incentives to invest in physical and human capital as well as in technological innovation are determined by free market forces. Governments assist this process by providing macroeconomic and political stability, a clear regulatory environment, and public/social infrastructure. In Tunisia, regulatory reforms, including accreditation and supervisory policies, can speed up the entrance of private investors in many different service activities that have been traditionally dominated by the public sector (for example, higher education, vocational training, medical services, agricultural extension, and veterinary services). Shifts in public/private financing policies need to be introduced so that limited public funds are used to finance priority areas with high social and economic returns, for example, increasing completion rates of nine years of basic education and further improving preventive health care. Private financing needs to increase in areas where private benefits are high, such as medical expenses (with public/private insurance policies) and tertiary education (with loans and scholarships for the poor).

Privatization and deregulation

Refocusing the role of the state through an acceleration of the restructuring and privatization of public enterprises accompanied by deregulation measures will have a critical impact on efforts to upgrade the productive and allocative efficiency of the Tunisian economy. Undertaking these measures in three strategic areas of the economy (transport and telecommunications services, banking, and agriculture) is an integral and critical part of any strategy to enhance the country's competitiveness.

- The public sector's traditional control of telecommunications, maritime and air transport, and port services needs to be opened up to local private and foreign investors that can bring state-of-the-art technology, competitive prices and reliable services enabling faster and cheaper communications and transport links with the rest of the world.
- Commencing the divestiture process of the public sector banks (which account for 70 percent of the banking sector's assets) will speed up the restructuring of these banks and help ensure fundamental changes in the way the banks and enterprises conduct business. Private ownership will improve the banking sector's efficiency—provided core private shareholders are found that can appoint key board members and fill senior management positions to run the banks after divestiture.
- Further public sector disengagement in agriculture is needed, particularly in the trade and marketing of, for example, meat, milk, sugar, wheat, and olive oil. The size of the state's operations in these activities, combined with its storage facilities (and some continued price controls), make effective private competition difficult. With the expansion of commercial agriculture, many services currently provided by the state (extension, animal health, and research) take on a private good character for which private extension and cost recovery are more suitable. The state, as a major landowner, should also expand the program of leasing state agricultural lands and rethink the costs and benefits of selling state land to the private sector (in conjunction with agricultural zoning regulations).

Growth and environmental sustainability

Tunisia has already made good progress in incorporating environmental concerns in its development plans and growth objectives. The Government is putting in place several policies, including pricing policies, that incorporate the economic value of resources, minimize haphazard coastal zone planning, and take into account the fiscal and financial consequences of erosion, water scarcity, and pollution. The government needs to take the lead in integrating growth objectives with sound environmental management by balancing the trade-offs between different activities through appropriate pricing policies, using incentives and penalties to reduce pollution, decentralizing monitoring and enforcement activities, and promoting the economic analysis of the costs and benefits (including externalities) of natural resource use—particularly of land and water.

Land degradation and water scarcity pose fundamental constraints to the sustainability of Tunisia's macroeconomic and rural income growth. Water, in particular, is a scarce resource. Tunisia has perhaps reached the stage where it must plan on low rainfall as the norm, rather than the exception. Gains in water use efficiency have to be achieved through price adjustments and attention to the economic efficiency of water uses. Several countries with water constraint problems are developing water markets, whereby users can buy and sell their water "rights" or allocations to the highest bidders (western United States, Chile, Peru, Zimbabwe). Tunisia needs to explore these options.

Sectoral impact from resource constraints

Water constraints will have important effects on agriculture in Tunisia. Cropping patterns that maximize the return to water as an input would result in the reallocation of scarce water away from lower-value uses in agriculture (cereals, for example) towards higher-value uses in agriculture, industry, or residential areas. The agricultural sector may shrink in size relative to other sectors in the economy and change its composition, but the social impact of water reallocation would be manageable, since irrigated agriculture employs a relatively minor share (roughly 15 percent) of the agricultural labor force (irrigated agriculture covers only 6 percent of arable land, but utilizes between 70 percent and 80 percent of mobilized water resources in the country). The social impact of these adjustments can be minimized by beginning price and land titling reforms now. The Government recognizes that a shift in its strategic focus from conventional water supply mobilization to demand management is long overdue, particularly in irrigation.

Tourism development plans must also adjust to environmental and social constraints to growth. In order to limit the mass tourism development that has degraded so many other coastal areas around the Mediterranean, the Government needs to regulate the tourism industry to reduce the physical size (number of beds) of its development plans, particularly in areas that are erosion-prone and pose problems in terms of water and sanitation. For the future, luxury tourism may be the only environmentally acceptable option to obtain higher value-added growth rates in this sector.

Creating an adaptable, agile, flexible economy

Successful economic performance will be increasingly determined by a country's adaptability to accelerating change in the rest of the world. A strong human capital base, transparent rules and regulations, and private sector-dominated management structures offer Tunisia its best chance to compete successfully in the global economy. The government plays an enormous role in creating an environment that promotes entrepreneurial agility, strong human resources, and labor force flexibility.

Transition from public to private sector–led growth

There seem to be strong doubts in Tunisia (and throughout the region) on whether the private sector will be able to take the lead in growth and development. But the private sector's performance needs to be judged in light of the incentives and environment it is responding to. If high protection, limited domestic competition, and government subsidies and controls have guided the private sector's past rent-seeking behavior, it follows that increased competition and a vastly reduced public sector role should produce different behavior in the future. Tunisia's experience so far is reinforced by that of other countries that have undergone (or are undergoing) a transition and are beginning to realize productivity gains, improved export performance, and stronger growth.

Labor issues pose some of the most difficult transition obstacles that all governments need to address in a program of structural reform. It is easier to manage the economy's transition when the economy is growing, so that the creation of new and more productive activities can open opportunities for those that have lost their jobs in declining industries. For this reason, workers need to be adaptable (which reinforces the importance of a solid basic education). For those workers with narrower skills, experience has shown that specialized skill retraining by the private sector offers the best prospects for obtaining the necessary new skills to get another job. The more successful government assistance retraining programs generally use a combination of tax incentives to private firms to offer training and voucher schemes whereby workers can use government-issued vouchers to select appropriate training in the private sector. Cash transfers are also used in many countries to compensate workers affected by downsizing. Eastern European countries, for example, are spending as much as 1 percent of GDP for compensation transfers. International experience offers several options to help governments compensate workers and promote the smooth adjustment of the economy: early retirement, cash transfers, annual payments, retraining schemes, subsidies to new employers, or transfers within the public sector.[1]

Proposed reforms

Tunisia has been liberalizing its economy for nine years, and in many respects it has gone quite far. But past sources of growth are diminishing or face growing environmental resource constraints (hydrocarbons, mining, agriculture, tourism). New investments and new sources of growth need to be developed with the private sector taking the lead in a competitive environment. At this advanced stage in the adjustment process, the remaining reforms that need to be undertaken are all important and complement each other, and therefore should, ideally, be pursued concurrently. This report focuses on how the remaining reforms complement each other. Although undertaking numerous reforms simultaneously may be the most economically optimal approach, it may be politically difficult. For this reason, the report places a particularly strong emphasis on trade liberalization measures, since the pressure of international competition will require Tunisia to follow a comprehensive adjustment strategy to respond to that pressure. Table 5.1 groups together the priority reforms and table 5.2 presents the reforms that complement and support the overall structural adjustment process.

The measures proposed in these tables are fairly broad and are based on the analysis from this report. There are several measures that would have significant benefits and can be undertaken in the short term, while more complicated measures (those which require significant political capital, or entail high transition costs) may require a longer implementation period. But even the more difficult measures need to be planned and implemented according to a timetable and initiated now, to enable a gradual phasing in of the necessary adjustments. By adhering to well-known and straightforward reform timetables, the government shows strong political commitment to competition, and economic agents—entrepreneurs, local and foreign investors, civil servants—become convinced that the system has changed irreversibly.

Note

1. *Claiming the Promise: A Long Term Perspective Study for the Middle East and North Africa.* World Bank 1995, draws upon regional and international experience to address transitional issues. Also see *World Development Report 1995: Workers in an Integrating World.* World Bank 1995.

TABLE 5.1

Priority reforms

Policy objectives	Short term (one to two years)	Medium term (one to five years)
Trade liberalization • A tariff system that promotes competition and efficient resource allocation as an engine of growth.	• Replace QRs with tariffs, eliminate surcharges. • Replace import certificates with automatic information transfer to Statistical Office (INS). • Consolidate the tariff rates and reduce the number of exonerating regimes. • announce a timetable for tariff reductions applicable to all trade partners; begin to reduce tariffs on heavily protected sectors in the first year.	• Follow schedule and complete reform over the next 5–8 years to obtain a low, uniform rate structure.
Foreign investment liberalization • Higher levels of FDI facilitate access to technology, improve management, strengthen domestic competition, provide financing, diversify the risk structure, and promote growth. • Closer integration of foreign investment (offshore activities) to increase domestic value-added contribution.	• Increase automaticity in granting approvals, facilitate procedures. • Open new areas up to local and foreign investors; increase number of activities allowing majority foreign share, such as commercial banking, telecommunications, insurance companies, transportation, information technology, computer services, and luxury tourism. • Remove any restrictions on technical licensing.	• Ensure level playing field between offshore and onshore companies by reducing offshore fiscal tax incentives. • Provide excellent infrastructure and trade services to attract FDI, promote competitiveness; assess results.
Privatization • Demonstrate Government commitment to a private-sector-based strategy as a central element of structural reform in order to promote higher productivity in a competitive environment.	• Consolidated public sector accounts. • Identify PEs (those directly owned by state and those indirectly owned); assess financial performance. • Announce program, timetables, objectives; decide on a management strategy, such as management centralized under a high-level group and implementation decentralized.	• Promote privatization with information campaigns and discussion of results.
Freedom of entry • Promote competition by opening up opportunities to private sector in areas previously reserved for public sector, such as production, services, and distribution.	• Remove public sector distribution, import/export monopolies. • Prepare legal reforms opening telecommunications; transport (shipping, air); port services to private sector; expand private subcontracting for O&M. • Complete accreditation and supervision policies to promote private establishment of universities, health, and agricultural services.	• Prepare medium-term strategy for infrastructure competitiveness upgrading with time-bound goals and monitor results. • Expand private sector in education, vocational training, healthcare, and agricultural services.
Environment • Growth and development objectives well integrated with sound environmental management and the sustainable use of natural resources.	• Adopt a "polluter pays" principle; strengthen local capacity to monitor and enforce; promote community-based actions. • Ensure development plans assess economic costs and benefits with longer-term horizon. • Regulate tourism industry, coastal degradation, water and sanitation limitations.	• Prepare strategy for sectoral adjustments (agriculture, tourism), phasing in price and policy changes; strengthen meteorological services and prediction capabilities. • Implement demand management for water; assess international experience with water markets.

TABLE 5.2
Complementary reforms

Policy objectives	Short term (one to two years)	Medium term (one to five years)
Macroeconomic policies		
Monetary policy		
• Full liberalization of interest rates to a market-driven yield curve. • Ensure that commercial banks compete based on interest rates and portfolio quality. • Monetary expansion with system-wide, open-market operations of treasury bills whereby banks meet their specific liquidity needs in the system through the secondary market.	• Eliminate all preferential rates. • Remove requirements to lend to priority sectors; permit high quality paper (T-bills under two years) to be admissible at the *appel d'offres*. • Discourage the *accord de place*. • Remove restrictions in clearance and settlement procedures for securities; CBT refinancing on a system-wide basis. • Prepare a monetary programming framework for the formal estimation of the demand for money.	• Continue improving the deposit bases of the public sector banks in proportion to their credits.
Balance of payments exchange rate		
• Strengthen external position, prepare for full convertibility. Real exchange rate, as a relative price, must be allowed to react to changing market conditions. • Achieve stronger, socially efficient, sustainable external position.	• Strengthen the interbank foreign exchange market. • Encourage competition, stimulate flexibility of wages and relative prices, induce higher public/private savings, promote diversification. • Rather than relying on trade restrictions, demonstrate commitment to domestic, international competition. • Remove NTBs.	• Full convertibility. • Implement phased tariff reductions over eight years with complementary privatization and regulatory reforms.
Fiscal policy		
• A declining, market-financed central government deficit to ensure long-run macroeconomic stability. • Ensure a reliable revenue base to compensate for reductions in trade taxes and to maintain overall stability of fiscal position. • Transparent and effective tariff protection system that is clear and easy to administer, promotes competition and the international integration of the Tunisian economy.	• Monitor the government deficit, including central and local governments, social security, non-financial PEs and financial PEs (banks). • Generalize VAT. Overvalued VAT rate eliminated; revise products subject to 6 percent rate; reduce exemptions; and eliminate suspensive schemes. • Consolidate tariff rates, reduce exonerating regimes. • Replace QRs with tariffs; prepare a more compressed tariff reduction schedule than agreed under EU free trade agreement, applied to all trade partners.	• Prepare annual consolidated budget of revenues and expenditures. • VAT consolidated at single rate (17 percent). Reduce fiscal advantages in Unified Inv. Code. • Implement tariff reduction schedule over next 5–8 years.

TABLE 5.2

Complementary reforms (continued)

Policy objectives	Short term (one to two years)	Medium term (one to five years)
Strengthening market forces *Product and labor market liberalization* • Ensure that factor prices and markets are flexible so that labor and capital can flow to the most productive sectors. • The price system must function to transmit critical information to the market. • Functioning land, real estate markets.	• Remove remaining producer and distribution price controls; export controls. • Continue price increases for utilities, services. • Reassess cereal price support policies and meat and milk subsidies. • Adjust labor laws to facilitate hiring and firing of workers; reduce costs of lay-offs for economic reasons.	• Study international experience with retraining and vocational programs. • Prepare policy options to facilitate labor mobility. • Establish a land market, provide legally binding land and property titles.
Financial sector reform • Stable development and smooth functioning of stock and bond markets. • For banking sector, ensure a policy environment that promotes competition, improves efficiency and performance, reduces the costs of financing and increases national savings.	• Liberalization of interest rates; development of secondary market for fixed income securities (T-bills, corporate bonds). • Remove obstacles to the functioning of settlement system and procedures. • Remove fiscal distortion that encourages over-subscription in IPOs. • Ensure level-playing field, expand freedom of entry into banking activities and remove obstacles to growth for existing financial institutions.	• Expand privatization program to increase supply of stocks. • Restructure insurance and pension funds • Divestiture and transfer of control of public sector banks. • Regulatory reform to enable the restructuring or reorientation of development banks.
Refocusing the role of the state		
Education policies • Priority use of public financing to ensure universal literacy, numeracy and coherent social, cultural values. Achieve high completion rates of basic education (nine years) and higher enrollment in upper secondary education to strengthen the skills and adaptability of workforce. • Higher education should respond to market driven demand with a financing structure that reflects high private returns. • Vocational training demand-driven, providing skills needed in the market.	• Strengthen pedagogical training of teachers; make teachers accountable for student success; expand use of educational technology; abolish selective examinations. • Provide adult education centers for drop-outs; reinforce education campaigns, especially for females; target financial assistance to poor. • Institute cost recovery for higher education; Target financial assistance based on both the economic needs of the country and financial needs of poorer families. • Institute a voucher system enabling individuals to select private vocational training; promote public-private cooperation, management and financing, and monitor employment success rates.	• Monitor performance with national exams, following international standards. • Restructure state controlled vocational training centers—close some, transfer control to private sector; expand voucher schemes; generalize dual training; placement and recycling program. • Introduce private provision of higher education (in conjunction with foreign universities), accompanied by state supervisory policies.
Health care • Promote quality services and equitable access and ensure a financially sound system which promotes the efficient use of resources.	• Limit free or subsidized care to needy. • Increase user fees and CNSS payments; privatize some services; • Link pension and health insurance benefits with contributions.	• Improve state supervision, regulatory policies. • Public funds mainly for preventive care, population control, target financial assistance.

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Statistical Annex

TABLE SA.1

External sector indicators

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Annual percentage changes														
Export (f.o.b.) in dollars	2.5	−19.4	−6.0	−3.2	−4.0	2.2	20.8	12.2	22.3	20.0	5.5	8.2	−6.5	23.6
Import (f.o.b.) in dollars	4.3	−10.3	−8.4	4.2	−15.2	5.9	4.4	21.9	12.1	25.5	−5.7	20.3	−4.2	7.5
Import (f.o.b.) in dollars[a]	4.3	−10.3	−8.4	4.2	−15.2	5.9	4.4	21.9	12.1	25.5	−5.7	24.2	−3.9	6.2
Export volume	4.3	−8.9	3.2	1.2	−1.0	11.7	8.9	8.7	18.8	4.5	4.4	3.1	0.3	18.1
of which: nonenergy	19.2	3.1	5.1	2.7	0.8	11.8	14.6	12.1	17.1	10.0	6.3	0.4	5.0	20.8
Import volume	11.7	−0.9	−3.4	5.9	−15.2	1.5	−3.4	17.0	10.1	8.9	−7.4	12.6	3.6	4.3
of which: nonenergy	17.5	9.3	−4.1	5.8	−17.5	0.7	−5.9	20.5	7.8	10.0	−6.8	12.4	2.4	3.7
Import volume[a]	11.7	−0.9	−3.4	5.9	−15.2	1.5	−3.4	17.0	10.1	8.9	−7.4	16.2	2.6	3.0
of which: nonenergy	17.5	9.3	−4.1	5.8	−17.5	0.7	−5.9	20.5	7.8	10.0	−6.8	12.4	2.4	2.2
Terms of trade deterioration (−)	5.3	−2.2	−3.9	−2.7	−3.0	−12.3	2.8	−1.0	1.1	−0.4	−0.7	−2.1	0.4	1.0
Nominal effective exchange rate	2.3	−3.4	−2.2	−1.3	−2.6	−16.2	−17.2	−5.2	−4.2	−4.6	−2.3	0.6	−1.8	−1.1
Real effective exchange rate	−1.1	−1.1	−2.0	−0.4	−0.9	−14.5	−14.0	−2.6	−1.8	−2.7	1.0	2.0	−1.2	0.3
In millions of dinars														
Changes in trade balance (actual)	−156.5	−179.0	−11.2	−268.1	267.9	−55.9	161.5	−373.0	−34.3	−326.8	375.3	−559.1	−238.8	452.3
Changes in trade balance (calculated)	−140.9	−174.0	−18.9	−253.9	240.0	−34.2	131.8	−349.9	−47.7	−311.4	344.3	−548.9	−282.8	383.6
Due to volume	−130.1	−91.8	104.6	−109.8	368.2	135.3	202.9	−273.0	67.0	−224.3	472.5	−464.6	−178.3	512.1
Due to term of trade	−10.8	−82.1	−123.5	−144.1	−128.2	−169.5	−71.1	−76.9	−114.7	−87.1	−128.2	−84.3	−104.5	−128.5
Ratio; in percent														
Trade balance/GDP	−15.7	−17.3	−15.4	−17.8	−12.2	−12.8	−9.2	−12.8	−12.0	−13.6	−9.1	−12.1	−12.9	−9.1
Trade balance/GDP[a]	−15.7	−17.3	−15.4	−17.8	−12.2	−12.8	−9.2	−12.8	−12.0	−13.6	−9.1	−13.3	−14.3	−10.0
Current account balance/GDP	−7.7	−9.4	−7.4	−10.9	−7.1	−8.0	−1.0	1.0	−3.1	−5.5	−4.4	−5.8	−6.7	−1.8
Current account balance/GDP[a]	−7.7	−9.4	−7.4	−10.9	−7.1	−8.0	−1.0	1.0	−3.1	−5.5	−4.4	−7.0	−8.0	−2.7
Debt service /XGS	15.2	16.2	19.2	22.5	24.7	28.2	28.4	21.9	21.8	24.3	23.8	20.1	20.6	19.0
Total debt/GDP	42.8	46.4	50.1	51.0	59.0	67.2	70.6	67.2	69.5	61.5	61.9	54.9	59.5	56.4
Gross official international reserves (months of imports)	1.8	2.2	2.2	1.5	1.1	1.4	2.1	2.8	2.6	1.7	1.8	1.6	1.7	2.6
In millions of dollars														
Overall balance of payments	−649.1	−767.4	−603.3	−875.4	−588.6	−704.9	−98.5	96.5	−310.8	−679.0	−577.4	−897.3	−973.7	−284.1
Overall balance of payments[a]	−649.1	−767.4	−603.3	−875.4	−588.6	−704.9	−98.5	96.5	−310.8	−679.0	−577.4	−1,089.4	−1,147.4	−456.6
Gross official international reserves	559.8	606.5	567.2	406.9	232.7	305.3	525.5	899.3	961.9	794.8	789.9	852.0	853.8	1,461.6
External debt	3,607.3	3,771.7	4,058.3	4,094.0	4,883.7	5,942.9	6,816.9	6,799.4	6,973.9	7,554.9	8,037.8	8,540.2	8,701.3	9,099.6

a. Including Gazoduc and Miskar.

Source: Ministry of Economic Development and World Bank calculations.

TABLE SA.2

Fiscal indicators

(Percentage of GDP)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Total revenue	28.8	29.3	32.0	31.6	34.0	31.9	31.8	29.6	30.0	30.1	27.7	26.5	26.7	27.7	27.4
Current revenue	28.7	29.2	31.7	31.2	32.2	31.3	31.2	28.4	28.2	27.2	26.5	25.3	25.7	26.7	26.0
Tax revenue	21.6	21.7	22.6	23.6	23.5	22.7	23.1	20.5	20.3	21.1	20.8	20.2	20.2	20.8	20.4
Taxes on income and profit	4.6	5.0	5.1	4.7	4.6	4.3	5.4	4.1	3.7	3.8	3.7	4.2	4.1	4.8	4.6
Taxes on goods and services	12.2	12.3	13.0	14.2	14.3	13.5	16.6	15.3	15.5	16.2	16.0	16.0	16.1	16.0	15.7
Taxes on international trade	2.9	3.3	4.2	4.8	4.9	4.7	4.6	4.1	4.5	4.8	4.6	4.4	4.2	4.2	3.7
Other	0.4	0.4	0.4	0.4	0.5	0.7	1.1	1.1	1.1	1.1	1.1	0.0	0.0	0.0	
Non tax revenue[a]	7.1	7.4	9.1	7.6	8.7	8.6	8.1	7.9	8.0	6.1	5.7	5.1	5.5	6.0	5.6
Petroleum sector	4.9	5.4	6.9	4.9	5.6	5.5	4.5	4.4	4.5	4.1	3.6	2.1	2.7	2.2	1.9
Others	2.2	2.0	2.2	2.6	3.1	3.1	3.6	3.5	3.5	1.9	2.1	3.0	3.2	3.8	
Total expenditure	32.2	34.6	37.9	39.2	40.7	36.9	37.3	32.7	33.6	34.0	33.4	30.5	29.9	30.2	28.8
Current expenditure	19.9	22.2	25.0	25.3	25.8	24.7	25.3	23.5	23.3	26.2	24.1	23.4	22.7	23.4	23.1
Wage bill	9.7	9.5	10.6	10.9	10.4	10.4	11.1	10.5	10.5	11.1	10.6	10.9	10.8	10.9	11.2
Goods and services	3.7	3.5	4.0	3.8	4.0	4.1	4.0	3.7	3.5	3.8	3.6	3.5	3.3	3.3	3.2
Total interest payments	1.6	1.6	1.8	1.9	2.1	2.3	2.7	2.9	2.9	3.1	3.0	2.9	3.2	3.5	3.5
Subsidies and transfers	4.9	7.7	8.6	8.7	9.3	8.0	7.5	6.4	6.4	8.2	6.9	6.1	5.4	5.6	5.2
of which to enterprises	3.1	5.6	6.3	6.6	7.0	5.6	5.2	4.2	4.1	5.6	4.5	3.7	3.1	3.2	2.7
Capital expenditure	12.4	12.4	12.9	13.9	14.9	12.2	12.1	9.1	10.3	7.9	9.2	7.1	7.2	6.8	5.7
Central government investment	4.5	4.2	4.0	4.7	4.4	4.5	4.1	3.5	3.6	4.0	4.7	4.2	4.1	4.3	4.3
Capital transfer and subsidies	3.6	4.0	4.9	5.6	5.3	4.2	3.9	2.9	2.0	2.1	3.0	2.0	1.8	2.0	1.5
of which equipment to public enterprise	3.1	3.9	4.5	5.1	4.7	3.7	3.6	2.6	2.0	1.8	2.6	1.3	1.6	1.6	1.2
Net loans	0.8	1.5	2.2	2.4	2.4	0.7	2.0	0.6	0.4	–0.5	0.3	–0.4	–0.1	0.0	-0.3
Other capital uses	3.5	2.5	1.6	0.8	2.5	2.2	1.4	1.1	3.3	1.0	0.7	0.5	–0.7	–0.2	-0.8
Current balance	8.8	6.9	6.7	5.9	6.3	6.6	5.9	4.9	4.9	1.1	2.3	1.9	2.3	3.4	2.8
Primary balance	–1.8	–3.7	–4.1	–5.7	–4.6	–2.7	–2.8	–0.1	–0.7	–0.9	–2.6	–1.1	0.7	0.8	
Overall deficit	–3.4	–5.2	–6.0	–7.6	–6.7	–4.9	–5.5	–3.1	–3.6	–4.0	–5.7	–5.3	–2.8	–3.3	–2.7
Total financing	3.4	5.2	6.0	7.6	6.7	4.9	5.5	3.1	3.6	4.0	5.7	5.9	2.8	3.3	2.7
Net foreign financing	0.9	2.3	3.7	5.0	3.6	2.4	3.0	1.0	2.0	1.0	2.9	1.2	0.5	1.2	1.3
Net domestic financing	2.5	2.9	2.2	2.6	3.1	2.6	2.5	2.1	1.7	2.9	2.7	4.7	2.3	2.1	1.3

a. Nontax revenue is defined as the sum of the oil revenue, interest and dividends, and transfers from social security to the Government.

Source: Ministry of Economic Development, Compte consolidé de l'Etat, table v–1 to v–8.

TABLE SA.3

Public sector accounts, 1992

	Percentage of GDP
Public sector	
Revenue	
Central government	26.7
Public enterprise	34.6
Expenditure	
Central government	29.5
Public enterprise	41.4
Central government	
Total expenditure	29.5
Current expenditure	22.9
Wages	10.6
Goods and services	3.4
Interest payments	3.2
Current transfers	5.8
Capital expenditure	6.6
Investment	4.4
Capital transfer	1.8
Others	0.4
Total revenue	26.7
Current revenue	25.5
Tax revenue	20.1
Direct tax	4.1
Indirect tax	16.0
VAT on production	7.7
VAT on imports	4.0
Import duties	4.3
Non tax revenue	5.4
Oil revenue	2.7
Budgetary balance	2.8
Public enterprises[a]	
Budgetary revenue	34.6
Oil company	9.9
Other public enterprise	24.8
Budgetary expenditure	41.4
Current expenditure	41.4
Wages and salaries	6.1
Interest payments[b]	8.7
Goods and services	26.6
Capital expenditure	n.a.

a. Taking in to account 167 enterprise balance sheets out of an estimated 200–250 public enterprises.

b. 1992 interest payments were calculated by summing total debt of the 167 PEs times TMM+ 3 points (average 11.3125 percent).

Source: Ministry of Economic Development and Ministry of Finance.

TABLE SA.4

Unemployment rates

	1966	1975	1980	1984	1989	1990
Official activity (thousands)						
A. Employed (age 15 and older)	927.3	1,366.5	1,576.9	1,786.4	1,978.8	—
B. Effective actives (age 15 and older)	1,093.7	—	1,793.3	—	2,229.1	—
C. Marginal actives (age 15 and older)	—	—	16.5	—	89.1	—
D. Effective + marginal (age 15 and older)	1,621.8	—	1,809.8	—	2,318.2	—
E. Potential actives (age 15 and older)	—	—	—	—	42.4	—
F. Total actives (age 15 and older)	—	—	—	2,137.2	2,360.6	—
G. First-time job seekers (age 18–59)	—	—	—	—	135.2	—
H. First-time job seekers (age 15–17)	—	—	—	—	54.8	—
I. First-time job seekers (age 15 and older)	40.8	119.1	89.8	—	190.0	—
Official unemployment rates (percent)						
Total	15.21	15.74	12.87	16.41	16.17	—
Household heads	11.74	—	7.23	—	—	1.40
Comparable unemployment rates (percent)						
(B–A)/B	15.21		12.07	—	11.23	—
(D–A)/D	—	15.74	12.87	—	14.64	—
(F–A)/F	—	—	—	16.41	16.17	—
Rates excluding first-time job seekers (percent)						
(B–A–I)/B	11.48	—	7.06	—	2.71	—
(D–A–I)/D	—	8.40	7.91	—	6.44	—
(F–A–I)/F	—	—	—	—	8.13	—

— Not available.

Source: Recensement général de la population et des logements, 1996; Recensement général de la population et des logements, 1975; Enquête population-emploi, 1980; Recensement général de la population et de l'habitat, 1984; Enquête nationale population-emploi, 1989; Enquête nationale sur le budget et la consommation des ménages, 1990 (tables processed for the World Bank); Institut de la Statistique, Tunis.

TABLE SA.5

Country data sheet

(Latest available data)

General	
Area (square kilometers)	164,000
Population (millions)	8.8
Growth rate (latest decade)	2.3
Density (per square kilometer)	54
Social indicators	
Population characteristics	
Crude birth rate (per 1,000)	30
Crude death rate (per 1,000)	7
Health	
Infant mortality (per 1,000 live births)	48
Population per physician	1,665
Population per hospital bed	516
Income distribution (percentage of national income)	
Highest quintile	30.7
Lowest quintile	5.9
Access to safe water	
Percent of urban population	100
Percent of rural population	70
Education	
Adult literacy rate (percent)	65
Primary school enrollment (percent of relevant age group)	117

Source: World Development Report 1994 and Social Indicators of Development 1993.

TABLE SA.6

GNP, output, and government finance

Annual growth rate of GNP (percent per year, constant prices)

	Millions of US dollars, 1994	Percentage of GNP	1981–86	1987–92	1993	1994
GNP at market price	14,970.08	100.00	3.36	4.65	1.34	3.65
Gross domestic investment	3,827.00	25.56	-4.39	6.32	0.00	-14.00
Gross national savings	3,542.89	23.67	-6.15	2.82	-4.74	5.61
Current account balance	-284.11	-1.90	—	—	—	—
Exports of goods and NFS	6,907.80	46.14	1.35	5.31	2.80	14.90
Imports of goods and NFS	7,087.95	47.35	-2.43	5.90	3.60	3.30
GNP per capita[a]	1,780.00	1.69	1.01	2.58	-0.60	1.70

Output, employment, and productivity, 1993

	Value added		Labor force		Value added per worker	
	Millions of US dollars	Percentage of total	Thousands	Percentage of total	US dollars	Percentage of average
Agriculture	2286.90	18.00	523.30	24.20	4370.16	0.74
Industry	4006.90	31.50	735.70	34.00	5446.30	0.93
Manufacturing	2460.90	19.40	443.10	20.50	5555.10	0.95
Non-manufacturing	1545.90	12.20	292.60	13.50	5283.60	0.90
Mining and fuel	670.90	5.30	34.60	1.60	19732.90	3.36
Construction	584.00	4.60	258.00	11.90	2263.70	0.39
Total services	6414.20	50.50	903.20	41.80	7103.20	1.21
Total	12707.90	100.00	2162.30	100.00	5877.00	1.00

Government finance (millions of dinars)

	General government			Central government (Percentage of GDP)			
	1991	1992	1993	1991	1992	1993	1994
Current receipts	—	—	—	25.3	25.7	26.7	26.0
Current expenditure	—	—	—	23.4	22.7	23.4	23.2
Current surplus	—	—	—	1.9	2.8	3.3	2.7
Capital expenditure	—	—	—	7.1	7.2	6.8	5.7

— Not available.

a. For 1993 calculated according to Atlas Methodology.

Source: Ministry of Economic Development.

TABLE SA.7

Exports, exchange rate, external debt, and IBRD/IDA lending

Exports (average 1987–94)

	Value (millions of US dollars)	Percentage of total
Agriculture	242.50	7.23
Fuel	513.40	15.31
Phosphate	45.50	1.36
Manufacturing	2,551.90	76.10
Total goods	3,353.40	100.00

Rate of exchange (annual average)

	1988	1989	1990	1991	1992	1993	1994
Dinars per US dollars	0.8287	0.8578	0.9493	0.8783	0.9246	0.8844	1.0037
US dollars per dinars	1.207	1.166	1.053	1.139	1.082	1.131	0.996

External debt, end of 1993

	Millions of US dollars
Public debt, including guaranteed debt	7,424
Nonguaranteed private debt	203
Use of IMF credit	285
Short-term debt	789
Total	8,701

Debt service ratio, 1993

	Percent
Public debt, including guaranteed (including IMF)	18.8
Nonguaranteed private debt	0.6
Short-term debt	1.2
Total outstanding and disbursed	20.6

IBRD/IDA lending, end of 1993

	IBRD	IDA
Outstanding and disbursed	1,595	54
Undisbursed	589	0
Total outstanding, including undisbursed	2,184	54

Source: Ministry of Economic Development, World Bank DRS.

TABLE SA.8

Money, credit, prices, and balance of payments

	1987	1988	1989	1990	1991	1992	1993	1994
Money and credit (millions of dinars outstanding, end of period)								
Money supply	3,712.7	4,430.7	5,163.8	5,541.0	5,835.2	6,271.1	6,512.4	7,244.0
Credit to government	721.4	676.8	721.9	807.7	852.7	939.3	936.9	876.1
Credit to economy	3,878.5	4,008.3	4,840.8	5,335.0	5,888.3	6,790.7	7,364.1	8,018.9
Money as percent of GDP	46.4	51.0	54.2	51.3	48.6	45.6	45.6	44.9
General price index 1980 = 100	179.2	190.5	205.2	218.5	236.4	250.1	260.1	271.8
Annual percentage change in:								
General price index	7.2	6.3	7.7	6.5	8.2	5.8	4.0	4.5
Credit to government	15.0	–6.2	6.7	11.9	5.6	10.1	–0.3	–6.5
Credit to economy	6.7	3.3	20.8	10.2	10.4	15.3	8.4	8.9
Balance of payments in millions of dollars with Gazoduc and Miskar								
Exports of goods and nonfactor services	3,376.86	4,242.25	4,480.88	5,190.82	5,112.16	5,972.98	5,776.23	6,916.81
Imports of goods and nonfactor services	3,472.79	4,205.88	4,814.81	5,985.77	5,655.63	6,977.61	6,762.68	7,201.91
(of which petroleum)	318.21	243.41	379.65	486.85	395.63	449.00	468.67	
Resource gap (deficit = –)	–95.93	36.37	–333.93	–794.94	–543.48	–1004.63	–975.08	–285.00
Net factor payments	–486.06	–497.79	–478.46	–496.98	–595.07	–654.34	–751.02	–850.47
Interest payments (DRS)	376.57	413.05	431.27	448.63	444.37	461.68	529.81	
Net private transfers	483.53	557.94	502.69	613.00	562.84	569.54	589.82	678.03
Current account balance excluding net official transfers	–98.46	96.52	–309.70	–678.92	–577.44	–1,089.44	–1,147.45	–456.64
Current account balance including net official transfers	–63.96	156.45	–104.92	–469.32	–455.77	–1,008.14	–1,043.93	–353.94
Direct private foreign Investment	92.31	110.17	144.21	185.24	165.80	487.11	593.11	393.04
Net medium long-term loans	34.46	236.12	197.07	152.26	353.89	358.78	280.77	372.36
Disbursements	695.41	840.67	830.26	988.05	1,115.31	1,182.63	1,087.74	1,288.80
Amortization	660.95	604.55	633.19	835.79	761.41	823.85	806.97	916.44
Other capital and capital NIE	77.93	–133.74	–129.14	55.93	–161.68	249.23	213.92	–213.96
Change in net reserves (increase in reserves = –)	–116.45	–378.29	–97.23	83.00	102.75	–81.98	–38.86	–197.51
Gross reserves (end of year)	616.03	976.02	1,033.20	866.80	865.92	923.65	937.79	1,544.41
Memo Item:								
Current account balance (without Gazoduc and Miskar)	–98.70	96.50	–310.80	–679.00	–577.44	–897.33	–947.89	–315.42

Source: Ministry of Economic Development, Central Bank of Tunisia.

TABLE SA.9

Macroeconomic balances, 1988–93

(percentage of GDP)

	1988	1989	1990	1991	1992	1993
Foreign savings						
Balance on current account						
excluding net official transfers	1.00	-3.10	-5.40	-4.40	-5.20	-5.90
Private sector						
Gross domestic investment						
Fixed investment	15.30	19.20	21.30	21.30	25.00	24.30
Change in stocks						
National savings	4.90	1.10	2.30	1.90	2.40	3.10
Investment minus savings	10.40	18.10	19.00	19.40	22.60	21.20
Public sector						
Gross Domestic Investment	4.10	4.50	5.40	4.90	5.10	5.00
Fixed investment	9.60	10.10	12.10	11.30	11.20	12.40
Change in stocks	0.10	1.60	2.70	0.60	3.20	1.30
National savings	15.50	19.50	18.80	20.00	22.40	20.40
Investment minus savings	-11.40	-15.00	-13.40	-15.10	-17.30	-15.40
Public and private						
Investment minus savings	-1.00	3.10	5.60	4.30	5.30	5.80
Memorandum Item:						
Share of gross domestic investment						
financed by foreign savings (percent)	19.40	13.10	20.70	16.40	17.70	20.10

Source: Ministry of Economic Development.

TABLE SA.10

Key economic variables, 1987–94

	1987	1988	1989	1990	1991	1992	1993	1994
Incentive indicators								
Real effective exchange rate								
Index (1990=100)	106.8	104.7	102.9	100.0	101.1	103.2	101.7	103.0
Annual change (percent, – denotes depreciation)	–13.6	–1.2	–1.7	–2.8	1.1	2.1	–1.5	1.3
Interest rates								
Short-term deposit rate	7.5	6.6	9.3	9.6	9.6	9.6	7.4	6.9
Short-term lending rate	13.0	11.6	13.8	14.8	14.8	16.5	14.4	13.8
Index of real wages (deflated by CPI)								
General wage index (1990=100)	98.3	96.2	97.3	100.0	102.3	104.6	104.6	104.0
Manufacturing, urban, and so on (1990=100)	96.0	92.8	95.7	100.0	100.4	100.5	100.5	98.2
Ratios of domestic agricultural prices to international prices								
Hard wheat	—	1.4	1.2	1.8	1.9	1.7	1.7	1.3
Soft wheat	—	1.6	1.3	1.8	1.8	1.8	1.8	1.7
Barley	—	1.5	1.4	1.6	1.5	1.6	1.6	1.5
External trade indicators								
Volume index of major exports								
Agriculture	85.9	84.3	85.9	100.0	138.7	104.8	122.2	144.8
Fuel	97.5	94.5	118.8	100.0	95.3	112.4	88.7	103.3
Manufacturing	66.7	76.0	90.5	100.0	103.4	106.8	110.9	121.9
Phosphate	123.8	135.0	137.1	100.0	103.3	113.8	123.3	110.0
Export shares in world trade	—	0.12	0.13	0.10	0.11	0.11	0.11	0.11
Manufactured exports								
Real growth rate (percent per year)	13.9	13.9	19.1	10.5	3.4	3.2	3.9	10.0
Value as share of total exports gnfs (percent)	42.2	42.1	46.9	50.5	52.0	52.7	53.0	53.0
Commodity terms of trade								
Index (1990=100)	96.6	99.3	100.4	100.0	99.3	97.2	97.6	96.8
Annual change (percent)	5.7	–1.0	1.1	–0.4	–0.7	–2.1	0.4	–0.8

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Source: Ministry of Economic Development, The Central Bank Report and IMF.

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