C O U N T R Y   B R I E F

Middle East & North Africa - Tunisia

Overall Context

Tunisia has made remarkable progress on equitable growth, fighting poverty and achieving good social indicators. It has sustained an average 5 percent growth rate over the past 20 years with a steady increase in per capita income and a corresponding increase in the welfare of its population that is underscored by a poverty level of 7% that is amongst the lowest in the region. The steady increase in per capita income has been the main engine for poverty reduction. In addition, public investment in infrastructure and human capital also played an important role in reducing poverty (about 60 percent of Tunisia's budget is allocated to the social sectors). Rural roads have been particularly important in helping the rural poor connect to urban markets and services. Housing programs improved the living conditions of the poor and also freed up income and savings to spend on food and non-food items with resulting positive impacts on poverty alleviation. Food subsidies, which have been targeted to the poor, albeit not optimally, have also helped the urban poor.

Tunisia is on track to reach the MDGs. As regards education, in 2007/08, 97.4% of both male and female 6 to 11 year olds were enrolled in school. Primary completion rates are high for girls at 91% and have been increasing for boys reaching 87% in 2007/08. If the pattern of lower repetition rates in primary continues, all students regardless of gender should complete primary school by 2015. Health outcomes are better than those found in other MENA countries with life expectancy reaching 74 years. Rapid progress has been made on infant and maternal mortality rates, malnutrition has dropped markedly and HIV/AIDS prevalence is very low. Coverage of health care benefits is provided through two national social assistance schemes which cover more than 80 percent of the population. Access to basic socio-economic services (water, electricity, sanitation) is near universal. Tunisia has one of the most equitable societies in the MENA region and is considered a leader as regards gender issues and strengthening women's role in society. With 64% of the population living in cities or towns, Tunisia is one of the most urbanized countries in MENA.

Increasing integration into the global economy has driven economic growth. Since the 1970s, Tunisia has undertaken an integration strategy that gradually has dismantled trade barriers and created an off-shore regime that has attracted FDI and led to the creation of new industries for export. As a result, the Tunisian economy is open: exports account for 47 percent of GDP and, together with FDI, are highly dependent on the EU. Tunisia has been able to penetrate new markets in manufacturing and engineering thanks to remarkable improvements in total factor productivity. However, the services sector, other than tourism, has not developed to the extent it could have and indeed Tunisia lags behind comparable countries in the development of services.

Good and effective macroeconomic management, especially since 1996, has underpinned the strong growth performance and helped moderate the impact of exogenous shocks on economic growth. A continued pro-active fiscal policy has kept fiscal deficits below 3% and prudent debt management has brought down the public debt ratio to 47.5% of GDP in 2008 (which has contributed to Tunisia's stable investment credit rating BBB/Baa2). Tunisia also has a good track record of keeping inflation under control at or below 3 percent.

T**unisia has achieved solid performance on governance rankings but business environment issues continue to be cited as constraints to growth.** Tunisia has consistently scored above its income category and the MENA average on most dimensions of comparative governance rankings and development indexes. In WBI's World Governance Indicators, Tunisia is far ahead in terms of government effectiveness, rule of law, control of corruption and regulatory quality. It achieves high scores on the CPIA measures, ranks 73rd on the 2009 Doing Business indicators (up from 81st in 2008) and 36th on the Global Competitiveness Index. Nevertheless, slow progress on strengthening the business environment in the on-shore sector – which is characterized by a heavy and pervasive intervention by the state in the economy – has defined the private sector in Tunisia to date. This has resulted in less competition, has served as a considerable impediment to the creation of jobs and is the likely reason why private domestic investment has remained intractably low (around 15% on average over the past 5 years).

This development model that Tunisia pursued over the past two decades has served the country well. However, despite the excellent growth track record, the Tunisian economy remains unable to generate sufficient jobs to employ the growing labor force. Unemployment has been persistently high in Tunisia –14.1% in 2008 – with the burden falling on young and educated individuals (it peaks to as much as 30% for individuals aged 20-24 years and 25% for young university graduates). Unemployment is characterized by three factors; (i) demographically, Tunisia is boasting a large number of higher education graduates entering the labor market (57% are graduates of tertiary education), thus swelling the labor supply of educated people. This has, in part, been driven by the country's success in putting a large number of people through school; (ii) the existing economic sectors (textiles and clothing, agriculture, agro-industry, automobile components, tourism, etc.) are predominantly intensive in low-skilled workers and do not generate sufficient demand for workers with a post-baccalaureate level of education/degree; and (iii) while greater trade integration and significant FDI inflows have allowed new sectors to emerge, the trend of business creation in newer, knowledge-intensive sectors is insufficient.

The broad challenge for Tunisia over the long-term is to produce and maintain a pattern of high economic growth that generates employment and incomes, contributes further social gains and preserves the valuable natural and cultural assets of the country. There is a broad consensus in the country and amongst international observers that the pattern of growth that has served the country well to date will not deliver on the expectations of the population to benefit from growing incomes and welfare and gradually converge on European standards. In this regard, Tunisia now stands at a critical stage because it is confronted with a difficult reality of why it did not perform as well as other emerging countries – such as Malaysia or Turkey – that undertook a similar growth model but achieved stronger results, particularly on critical issues such as productivity and private investment growth, which resulted in widespread job creation.

Addressing the employment challenge will require a comprehensive approach, dealing with constraints both on the supply and the demand sides. Essentially, reducing unemployment in the context of Tunisia calls for an acceleration of the structural transformation of the economy towards a higher value-added, knowledge-intensive economy. For that, (i) deeper trade integration, (ii) greater innovation and technological adaptation and (iii) professional reinsertion and retraining of workers in traditional sectors will be crucial. This core set of reforms will however be only effective with an adapted enabling environment. Accompanying reforms include better economic governance, financial sector reforms and a stronger functioning of the labor market. The latter includes improved active labor market policies; enhanced income support to facilitate labor mobility and investments in social services. Improved education sector responsiveness to labor market needs will also be necessary.

Recent Political Developments

Presidential elections were held on October 25, 2009 and the incumbent President Ben Ali was re-elected. This was despite last year's constitutional amendment which allows more candidates to contest the presidential elections. Leaders of any legal party, including those with no parliament seats, were able to run for the first time in these elections. Previously, only leaders of parties with parliamentary seats could run. Any participation in elections by opposition candidates is considered purely symbolic.

Recent Economic Developments

During 2009, Tunisia weathered the contractionary impact of the global economic downturn relatively well and the economy grew at 3.1 percent. Strong growth in agriculture and steady expansion in public and commercial services more than offset a contraction in manufacturing induced by a slump in exports (down by 22% in 2009). Consumer price inflation slowed to an estimated 3.7% mainly due to a decline in food and energy prices. The fiscal deficit increased to 3.3% (from1.2% in 2008) as public expenditures were increased (by 10%) to stimulate the economy. The current account deficit narrowed in 2009 to 2.8% against 4.2% in 2008. The improvement in the overall balance was due to a decreased trade deficit, increased tourisms receipts and workers' remittances which balanced the trade deficit on the services side. Despite a considerable fall (-32%) in FDI during 2009, Tunisia remains in a solid external position, with comfortable reserves level of US$ 9.8 bn (around 5.5 months of imports) thanks to a 43% increase in public and private overseas borrowing.

Real GDP is expected to rise by 4% in 2010 due to the lagged effects of stimulus measures undertaken in 2009-10 as well as the expected recovery in the EU, Tunisia's biggest trading partner. Inflation will reach 4.5% due higher imported inflation and internal pressures (such as the planned rise in public sector salaries). Tunisia's external position will remain positive and stable in 2010. The current account will remain around -2.9% of GDP, with a stable trade balance and an improvement in the capital accounts.

Tunisia's Development Strategy

Tunisia's 11th National Development Plan (NDP, 2007-2011) charts an ambitious course to transform its economy to a higher value-added, knowledge-intensive one that will allow it to consolidate and improve its strong progress to date. The NDP is being updated (as part of a "rolling plan" approach) and builds on a prolonged period of very solid economic and social development often in the face of unprecedented challenges and exogenous shocks. However, the worsening unemployment threatens the social achievements to date and the impact of the global crisis puts extra pressure on Tunisia to do better in terms of growth. Tunisia recognizes that it now needs to carry out a transformation to a higher value-added, knowledge-based economy through increasing further the integration of its economy, bringing about even faster improvements in productivity growth and carrying out deeper structural reforms in order to generate employment, particularly for its well-educated population. The NDP sets out this challenge well and highlights the areas where future reform efforts must focus. Some of the most critical of these areas are described in the box below.

Table 1: Areas of Future Reform

Further integration into the world economy: Several factors are limiting the integration of the on-shore economy into the global economy; import tariffs for non-EU trade are high; product standards are not aligned with those of potential markets. The challenges include reducing tariff dispersion created by the gap between tariffs on EU imports and imports from other sources. Likewise, there is the need to harmonize the numerous trade agreements Tunisia has signed.

Logistics: Improvement in logistics will benefit the overall economy. The challenge is to better integrate Tunisian services with international logistics networks, by blending openness and consolidation of local providers. Several areas need attention including trade facilitation at customs, improving port performance, encouraging investment in logistics platforms and reducing entry barriers and informality in the logistics sector. The government has launched investments in ports (Enfhida) and other infrastructure but there is still a way to go to bring about the needed logistics overhaul.

Competition and the business environment: Repeated surveys show that competition is weak in the on-shore economy. Weak transparency in relationships with the administration was underscored by the 2008 IEQ study where 60 percent of firms denounced anti-competitive practices such as implicit agreements, discrimination among clients and linked sales and 67 percent of firms cited at least one type of unfair competition in the domestic market. The private sector feels that success comes at the cost of non-transparent establishment and it expresses its frustrations with what it perceives as Government interference, poor implementation of policies and/or lack of true commitment to reform. The MENA region's flagship report on Private Sector Development emphasizes that the route to sustained private-led growth and job creation requires improving the credibility of reforms, the effectiveness of policies and their equal enforcement, all of which is pertinent for Tunisia. As Tunisia looks to the future, and if it intends to pursue a credible transformation of its economy, the role of the state needs to become more selective and much lighter with a smoother and more equal implementation of policies.

Financial Sector: Onshore firms need access better access to credit as do potential new entrants. Tunisia's IMF-World Bank Financial Sector Assessment Program (FSAP - 2006) presented a diagnostics with recommendations that remain valid. In line with the recommendations, the government has been improving the design of the public credit registry and promoting the creation of well-regulated credit rating agencies. A plan is underway to reduce the size of the non-performing loans, and provisioning them—only about half of them are provisioned in Tunisia. In addition to strengthening banking, and in line with the FSAP recommendations, the development of the non-banking financial sector is a priority, as innovative channels of financing are needed to encourage entry and innovation.

Innovation, Research and Development: Tunisia has followed an active policy to develop a national innovation system including scientific research, technological diffusion, education and industrial upgrade. It has achieved notable progress in terms of the public investment rate in R&D - including ICT and e-government, the proportion of researchers in the population and the education level of its work force (see Table 2). In addition to the investments made, a dense institutional infrastructure has also been put in place to support innovation and research with multiple research and promotion agencies active, often with overlapping mandates. Despite this progress, recent analysis shows that there is still a limited contribution of research in the economy, a developed technological base is still fledgling and the partnership between the productive sector and research institutions is weak.

Relationship with World Bank

The Bank's relationship with Tunisia is mutually acknowledged as being good and has emphasized the importance of responsiveness and flexibility to evolving needs. The Bank's engagement in Tunisia has focused on top quality analysis and global knowledge which has underpinned all lending operations. The Government has often expressed its appreciation for the knowledge services of the Bank and it considers the Bank's dialogue and analysis as critical inputs to their National Development Plans and sectoral strategies. The knowledge role of the Bank is especially valued because the Bank has undertaken economic and sector reports in a fully collaborative way, with strong ownership from Government. Equally important, the Bank has been able to mobilize rapidly its team and resources to respond flexibly when requested and to focus on providing just-in-time policy advice, most recently in responding to the Government's request for analytic and economic modeling support of the stimulus package, and in suggesting options for greening the stimulus.

Country Partnership Strategy

The CPS for Tunisia was discussed at the Board in December 2009. The strategy is aligned in timing and substance with the NDP update, and reflects the selectivity of the client because the Tunisian Government has been very clear where it wants the Bank to provide support and where it doesn't. The experience in Tunisia is that the Government only requests IBRD financing when it has carefully weighed the pros and cons of all alternatives and where it assesses that the Bank can add most value. This level of frankness helps the relationship immensely. The three strategic pillars of the CPS are: (i) Growth, Competitiveness and Employment; (ii) Sustainable Development and Climate Change: and (iii) Improving the Quality of Service Delivery.

Lending Volumes

The IBRD lending program for FY10 is well advanced with three projects scheduled for Board approval before the end of the fiscal year for a combined amount of about $150 million. All is on track for delivery of the 3 FY10 projects – Employment DPL ($50 million), Community Based Integrated Rural Development ($36-40 million, still to be confirmed during planned negotiations) and the Northern Tunis Waste Water project ($60 million). Beyond FY10, specific amounts for projects are not yet known with precision but the volume of the IBRD envelope is expected to be at a minimum $250 million per year (which would be a low-level scenario), with about a third – on average - expected to be delivered through development policy lending. This annual lending amount is based on the FY09 benchmark of $335.6 million which, in a sense, signals the materialization of the Government’s policy in its NDP to borrow more internationally rather than domestically (i.e. not an increase in the public sector deficit but rather a shift in the source of public sector debt). A protracted difficult global environment and an accelerated reform trajectory could propel significantly higher volumes, continuing the magnitude of FY09’s lending (i.e. in the order of $300 million or more). The Government has not asked us for a specific annual lending amount as they continue to monitor their overall macro situation and assess the NDP implementation. But the Bank needs to keep our financing capacity open to a higher amount.

On-Going Portfolio

The portfolio has continually remained large with 15 projects under implementation, yearly disbursements averaging $123 million and total commitments of $839 million. The portfolio performance is satisfactory with no long-term problem projects, good pro-activity and realism indicators, and an average disbursement ratio for FY05-09 of 21.4 percent, close to the Bank’s average. However, there are some operational factors that dog the Bank’s program and which are, for the most part, linked with procurement weaknesses. The cumbersome procurement procedures lead to slow disbursements and repeated extension of projects. The Bank’s team and the authorities are working on addressing these procurement issues through intensive technical assistance.

International Finance Corporation (IFC)

IFC Portfolio Information

<table>
<tr><th colspan="8">Tunisia</th></tr>
<tr><td rowspan="2">GDP per capita (US$)</td><td rowspan="2">Population (millions)</td><td colspan="4">Current IFC Portfolio</td><td colspan="2">Number of IFC Offices in Country</td></tr>
<tr><td>Debt (US$ mn)</td><td>Equity (US$ mn)</td><td>Quasi Equity (US$ mn)</td><td>Total (US$ mn)</td><td>Investment</td><td>TA</td></tr>
<tr><td>2,970</td><td>10.1</td><td>239</td><td>36</td><td></td><td>275</td><td>0</td><td>0</td></tr>
<tr><td colspan="6">Investment Business - Top Sectors and Clients</td><td colspan="2">TA Business – Top Sectors</td></tr>
<tr><td colspan="2">Sector 1</td><td colspan="4">Infrastructure ($181 m)</td><td>Sector 1</td><td>SME Bank Advisory</td></tr>
<tr><td colspan="2">Sector 2</td><td colspan="4">Financial Markets ($66 m)</td><td>Sector 2</td><td></td></tr>
<tr><td colspan="2"></td><td colspan="4"></td><td>Sector 3</td><td></td></tr>
<tr><td colspan="2">Client 1(Sector)</td><td colspan="4">TAV Tunisia/ Infrastructure</td><td colspan="2" rowspan="3"></td></tr>
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IFC's total committed portfolio in Tunisia is currently US$275 million in 8 companies. The portfolio is predominantly comprised of infrastructure and financial markets projects. IFC's role in ordinary projects has been reduced in Tunisia, given alternative sources of financing at spreads lower than IFC's. We therefore continue to seek business when we can play a clear developmental role and add value beyond price sensitive projects.

In this context, IFC's focus in Tunisia is on new sectors or products. IFC will continue considering investments in the financial sector in addition to large and complex private sector infrastructure investments or in sectors such as oil and gas, IT, health and education, which are not well serviced by Tunisian commercial banks. It also expects to be more active in TA & advisory services through PEP-MENA, particularly on the investment climate and corporate governance. In addition, Tunisia is proving to be a source of South-South investments in the Maghreb and Africa. IFC has financed some Tunisia-South projects (e.g. Maghreb Leasing Algerie) and is considering such investments in manufacturing, banking, health, insurance and leasing.

Recent investments: In April 2008, IFC committed US$193.5 million for its own account and US$364 million for B loan participants in the landmark TAV Tunisia project-- the first large infrastructure PPP in Tunisia and the first airport concession in North Africa. In March 2009 additional $35 million was invested in the equity of the project. In September 2007, IFC invested US$2.6 million in ENDA Inter-Arabe, a Tunisian microfinance institution, in the form of a local currency loan. This marks IFC's first investment in the microfinance sector in the country. In June 2006, IFC invested US$13 million in Maghreb Private Equity Fund II followed by a second investment of 7.5 million in January 2008, a regional private equity fund targeting SMEs in Tunisia, Algeria and Morocco. The fund is managed by Tuninvest Finance Group, an independent Tunisian financial services company. IFC has also committed US$10 million equity investment in a leading Tunisian group to help support the Group's global expansion.

Future IFC investment activities in Tunisia: IFC is currently considering investments in a number of strategic sectors as follows: (1) US$50 million equity to a private bank to support its expansion in the country and in Algeria. This investment will also include TA on corporate governance and SME lending; (2) Disbursement of US$2.6 million investment in South Mediterranean University (SMU), a small private sector university; (3) early-stage financing to support the development of commercially prospective oil discoveries; (4) a greenfield tertiary care operation which will specialize in oncology, cardiology and orthopedics; (5) an insurance group both in Tunisia and Algeria.

Advisory and Technical Assistance program: IFC's PEP MENA, the technical assistance program for the MENA region, is interested in developing a Corporate Governance program to improve practices for private companies and banks. It also undertook an advisory assignment in 2005 with BIAT bank to improve lending procedures to retail customers and SMEs. This could be also offered to other banks.

Multilateral Investment Guarantee Agency (MIGA): MIGA does not have any exposure in Tunisia and has not received any requests to provide guarantee coverage of any inbound investments during FY09. Tunisia as Investor Country. The Agency has provided coverage (against the risks of transfer restriction, expropriation, and war and civil disturbance) of an equity investment and loan guarantees from Tunisie Telecom to MATTEL in Mauritania. The current outstanding exposure from this investment is $5.4 million. The project, which involves the installation, operation and maintenance of a new GSM telephone network, aims to: (i) increase teledensity in Mauritania (among the lowest in the world); (ii) expand the scope of service; and (iii) improve the quality of service, all important positive developments for the local business community.

All dollar figures are in US dollar equivalents. **Updated April 2010**

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