Deauville Partnership

Compact for Economic Governance

Stocktaking Report: Tunisia

March 2017

With the support of the Federal Republic of Germany Foreign Office

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Executive Summary

Five years since the 2011 Revolution, Tunisia has a window of opportunity to focus on long-term structural and economic governance reforms. The country's political transition has been very successful. The country has coped with dramatic social, economic and political turmoil to build a democratic model and conform to the aspirations of its citizens. The transition governments have primarily focused on short and medium term objectives: maintaining macro-economic stability, reinforcing security and building the framework and institutions of the democratic Tunisia, including the 2014 Constitution. To some extent, this challenging and ambitious agenda has dominated the priorities of legislators and policy makers. On the other hand, structural reforms aimed at addressing the imbalances created by old economic model have proceeded more slowly. The government elected in December 2015, and more so the National Unity government have a clear and legitimate mandate to accelerate the pace of reform to develop a new social contract and a new economic model based on strong economic governance institutions.

Together with exogenous factors, the imbalances of the pre-revolution economic model have affected growth and macroeconomic stability since 2011. Tunisia's traditional development model was relatively successful at promoting economic growth and reducing poverty levels. Yet it created a series of imbalances and, crucially, a divide between rich and poor regions, on-shore and off-shore firms, and workers with jobs and those unemployed, which hinder the level and inclusiveness of economic growth. Since the global economic crisis and the revolution, the country has experienced a challenging economic situation, characterised by (a) levels of growth below pre-2011 figures (with an important recession in 2011 and modest growth since then); (b) declining levels of public and private investment; (b) high unemployment levels, notably amongst youth, women, university graduates and people living in interior regions; and (c) increasing pressures on public finances (with a growing public debt stock and an increase in recurrent expenditure compared with investment and social spending) as well as the current account. This performance can be, at least partly, explained by the complexity of economic and political transition.

The government has put together a clear vision for economic reform and significant progress has been achieved but implementation of certain key reforms is proceeding at a slow pace. The authorities have started to pivot from a significant focus on the political aspects of the transition to the economic agenda, in particular since 2014. A new strategic orientation note informing a new National Development Plan for 2016-2020 has been prepared and the government has developed a national programme for major reforms. Key achievements since 2011 include the adoption of new legislation on investment (aimed at blurring the divide between the onshore and offshore sectors), a new framework for PPPs, an ongoing financial sector reform programme (including the restructuring of state-owned banks), multiple reforms to improve governance, transparency and the fight against corruption. Yet, certain difficult reforms are proceeding at a slow pace, including the implementation of the new investment code and the reform of the Tunisian civil service.

Tunisia needs to reformulate its development model under a new social contract creating the conditions for inclusive growth. The country's main challenge is to transform the structure of its economy to boost competitiveness, value addition and productivity as a requirement for higher and more inclusive growth. The government's reform agenda is based on a solid identification of the country's problems and the potential solutions, which require concerted action to improve economic governance institutions across the four pillars of the Deauville Partnership Compact for Economic Governance.

The Deauville Partnership Compact for Economic Governance and Tunisia's Stocktaking Exercise

The **Compact on Economic Governance** is a roadmap for policy reform in the area of economic governance for Arab Countries in Transition (ACTs). The Compact was adopted under the German Deauville Partnership Presidency in May 2015 building on past action plans on topics such as open government, anti-corruption, asset recovery and SME development. The Compact provides a framework for reform efforts across ACTs aimed at promoting good governance and a sound business climate as preconditions to boost inclusive growth through four key pillars focusing on (I) economic policies for inclusive and sustainable growth, (II) public sector transparency and efficiency; (III) investment climate and private sector development; and (IV) inclusive decision-making.

The Compact is designed as an operational document to inform policy dialogue within the Deauville Partnership through a steady dialogue and consultation process. This takes the form of a peer review and peer learning mechanism supported by the OECD, the Deauville Partnership's international financial institutions (IFIs) as well as relevant coordination platforms. The Compact's priorities are to be operationalised through country-tailored implementation plans under which ACTs identify specific policy measures which could then be supported by G7 and partner countries through technical assistance other supporting measures and which can be subject to a process of progress reporting to measure and monitor policy effectiveness. A methodology for the country-level implementation of the Compact was developed by the OECD and endorsed by Deauville Partnership Senior Officials in November 2016 (see Annex II for more details).

The present report constitutes the first step of the process, aimed at taking stock of economic governance reforms since 2011 in ACTs and developing the skeleton of each ACT's implementation plan. This report has been prepared by the OECD with the support of the German Foreign Office, in consultation with the Tunisian authorities and in cooperation with Deauville Partnership International Financial Institutions.

Against this background, the implementation of the Compact of Economic Governance in Tunisia would require correcting the imbalances of the previous development model to put the country on the path of higher and more inclusive growth. In particular, the authorities could accelerate the pace of reform across four structural priorities:

- **Fostering structural transformation to boost competitiveness and value addition**. Tunisia needs to move its economy into higher-value-added activities and further integrate into global value chains. The ongoing reform of the investment framework is key in this regard. Other complementary reforms cover areas such as customs, logistics, or the labour market.
- **Promoting regional development to reduce inequalities.** Spatial inequality is a major challenge in Tunisia and perhaps the most significant consequence of the pre-2011 development model. A new approach to regional development is required to proceed in parallel with the ongoing decentralization process at the political level. A clear vision for decentralization and regional development is required.
- **Creating jobs through labour market reforms and other complementary policies.** Job creation is Tunisia's most pressing development challenge. While wholesale labour market reform may be impracticable over the short term and complementary policies aimed at boosting private sector activity may be part of the solution, the government should continue to make efforts to conclude the dialogue with social agents and adopt a National Employment Strategy to reform its labour market institutions, including active labour market policies and measures to promote female participation.
- **Strengthening financial stability and banking sector governance.** The government should continue the ongoing restructuring of the banking sector, and in particular the three main state-owned banks, which, in the aftermath of the revolution, represented a major source of vulnerabilities for macroeconomic stability and the functioning of the real economy.

The transformation of the Tunisian development model will also require the effective implementation of reforms to enhance public sector efficiency, create the conditions for private-sector-led growth and enhance the inclusion of youth and women in policy making. Among Tunisia's priorities in these areas the following can be considered as key:

- **Reforming the central government towards a leaner, more efficient public administration**, with particular attention to civil service reform (aimed not only at reducing the wage bill but also to create incentives and strengthen the capacity of public servants) and the introduction of greater transparency and accountability in public enterprises.
- **Promoting good governance** through the implementation of ongoing reforms in anticorruption and open governance (including the establishment of a new authority and the effective implementation of the national anticorruption strategy as well as the adoption of pending legislative reforms) and a comprehensive reform of the justice system.
- **Enhancing domestic resource mobilization** (including to promote a fairer and more efficient tax system through an acceleration of the ongoing tax reform programme) and public financial management (with the continued implementation of budget reforms and the upgrading of existing control mechanisms).
- **Improving the regulatory level playing field for firms and reforming the investment framework**, including the adoption of outstanding regulations under the new investment code and the effective implementation of the recently-upgraded PPP and competition frameworks.
- **Promoting trade facilitation and streamlining trade regulation** (in particular through the reform of the customs system) **while improving market connectivity** (including by addressing existing infrastructure bottlenecks and upgrading the country's logistics system).
- **Upgrading skills and innovation to boost firm competitiveness and productivity**, in particular by addressing skills mismatches in the labour force.
- **Promoting access to finance** (in particular by SMEs) by promoting competition and efficiency in the banking sector and developing alternatives to bank finance.
- **Fostering youth and women economic and political inclusion** (in particular by addressing labour market outcomes for both groups) **while promoting participatory public-private dialogue** building on the progress made since 2011.

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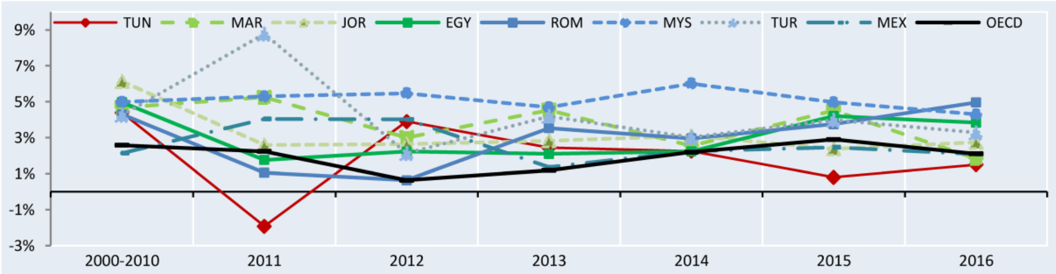
Compact for Economic Governance: Tunisia Indicator Dashboard

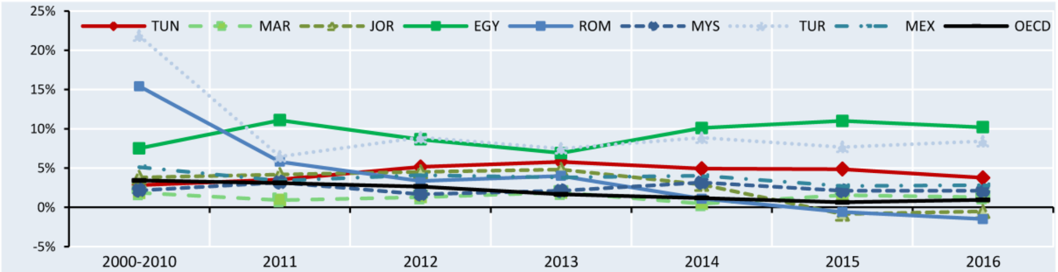
ECONOMIC POLICIES FOR INCLUSIVE AND SUSTAINABLE GROWTH

1- Real GDP growth (% change)



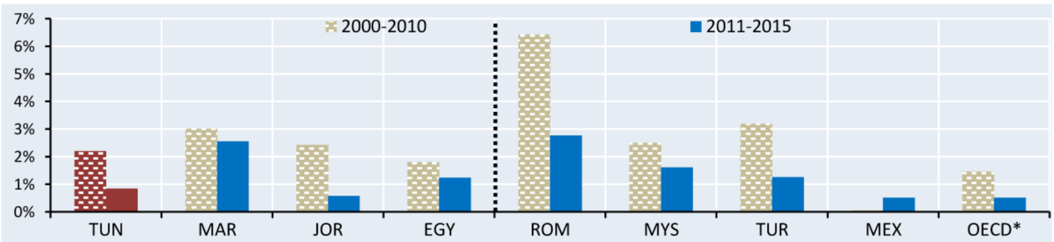
Source: IMF World Economic Outlook databases. Note: 2015 data for Tunisia and 2016 data for all countries are estimates

2- Inflation (average consumer prices)



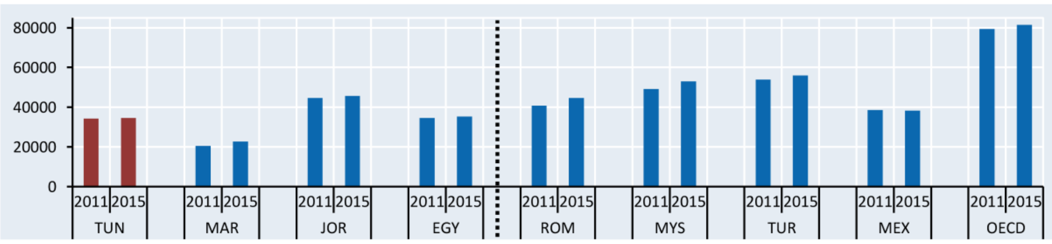
Source: IMF World Economic Outlook Databases. Note: 2016 data for all countries are estimates

3.a- Labour productivity (annual growth rate)



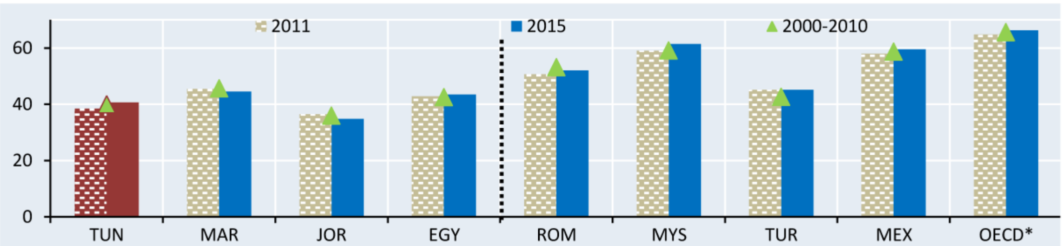
Source: Calculations based on ILO Key Indicators of the Labour Market database, OECD Labour Market Statistics. Note: Labour productivity for OECD countries is measured as GDP per hour worked. For non OECD countries GDP per worker is used instead

3.b- Labour productivity (output per worker)



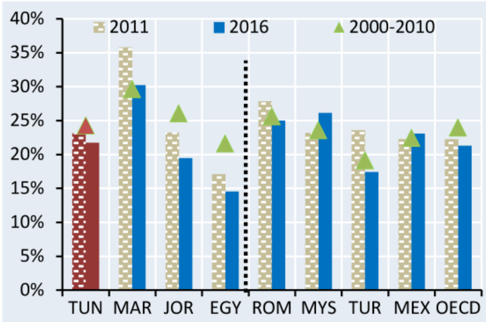
Source: Calculations based on ILO Key Indicators of the Labour Market database, OECD Labour Market Statistics
Note: Labour productivity for OECD countries is measured as GDP per hour worked. For non OECD countries GDP per worker is used instead

4- Employment-to-population ratio



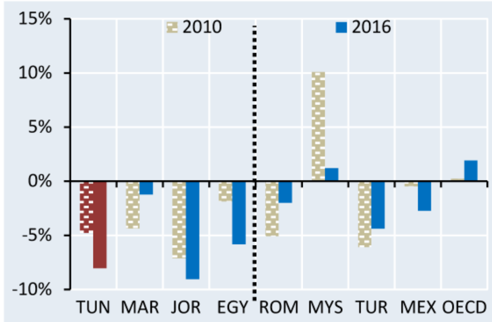
Source: ILO Key Indicators of the Labour Market database, OECD Labour Market Statistics. Note: OECD average is for 2005-2010

5- Total investment (% of GDP)



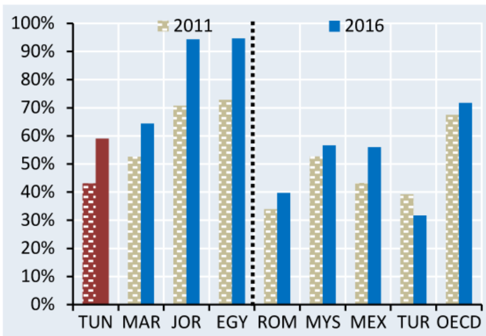
Source: IMF World Economic Outlook Databases
Note: The 2016 data for all countries are estimates

6- Current account balance (% of GDP)



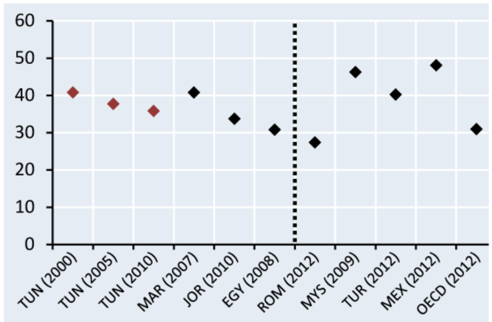
Source: IMF World Economic Outlook Databases
Note: 2016 data for all countries are estimates

7- General government gross debt (% of GDP)



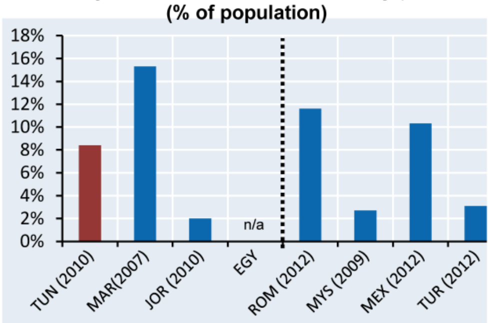
Source: IMF World Economic Outlook Databases

8.a- Gini Coefficient



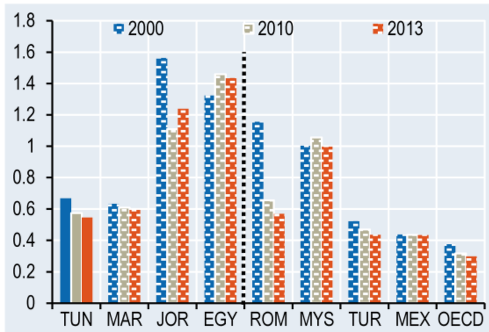
Source: World Bank World Development Indicators, OECD Social and Welfare Statistics

8.b- Poverty headcount ratio at $3.10 a day (2011 PPP) (% of population)



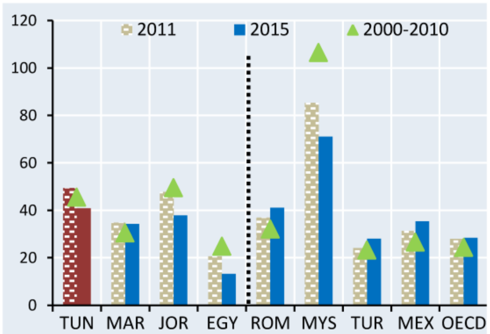
Source: World Bank World Development Indicators, OECD Social and Welfare Statistics; and the World Bank Worldwide Development

9- CO2 emissions (kg per USD 1,000 of GDP)



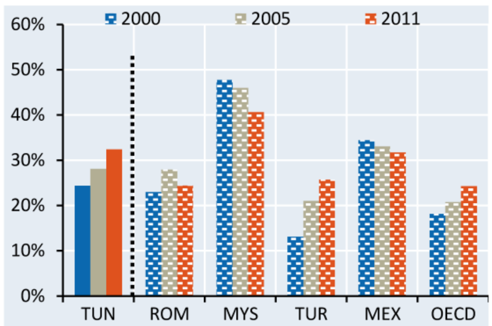
Source: International Energy Agency

10.a- Total exports of goods and services (% of GDP)



Source: World Bank World Development Indicators

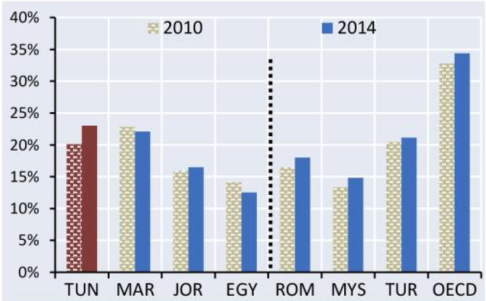
10.b- Trade in Value-Added (TiVA) (foreign value-added share of gross exports)



Source: OECD Trade in Value Added

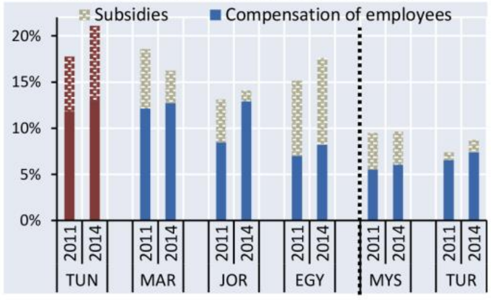
PUBLIC SECTOR TRANSPARENCY AND EFFICIENCY

11- Tax revenue (% of GDP)



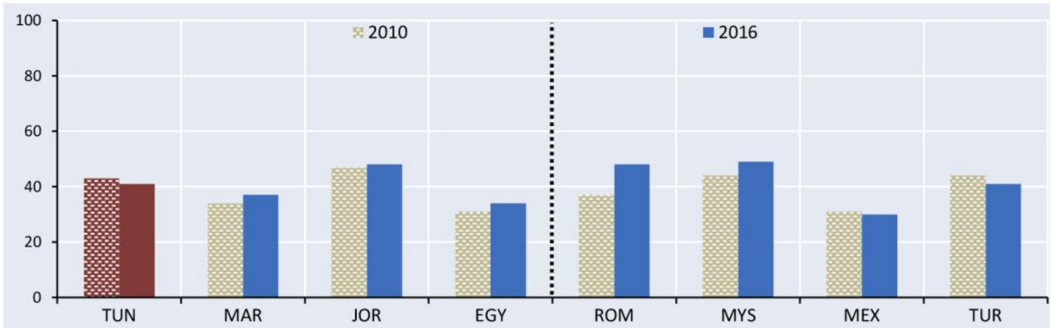
Source: Government Finance Statistics Yearbook, IMF Country Reports for Jordan, Malaysia, Morocco and Tunisia, OECD Revenue Statistics for OECD average. Note: 2014 data for Tunisia is preliminary

12- Government expenditure in (1) compensation of employees and (2) subsidies (% of GDP)



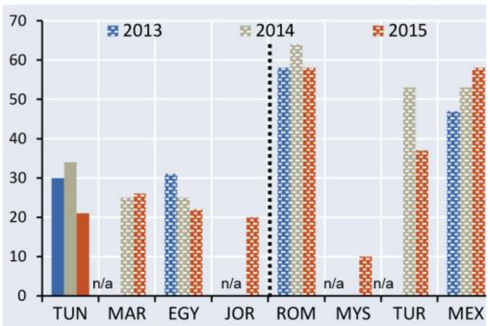
Source: IMF Government Finance Statistics database, Tunisia IMF Country Reports. Note: call figures concern budgetary central government.

13- Corruption Perception Index (0-100)



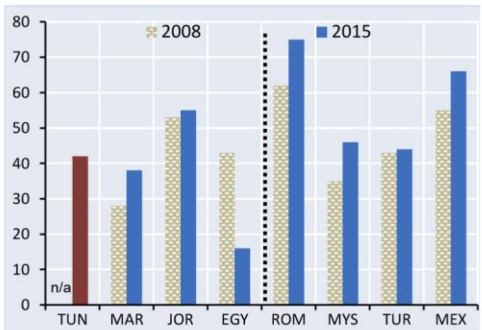
Source: Transparency International, Corruption Perceptions Index 2009-2016. Note: Score 100= very clean; 0= highly corrupt

14- Global Open Data Index score (%)



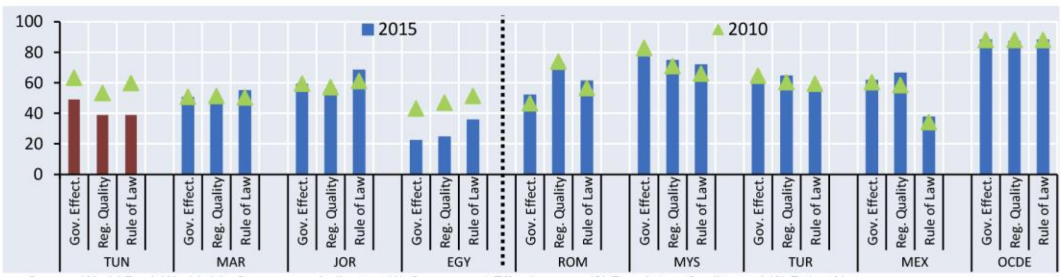
Source: Open Knowledge Global Open Data Index

15- Open Budget Index (0-100)



Source: International Budget Partnership, Open Budget Index

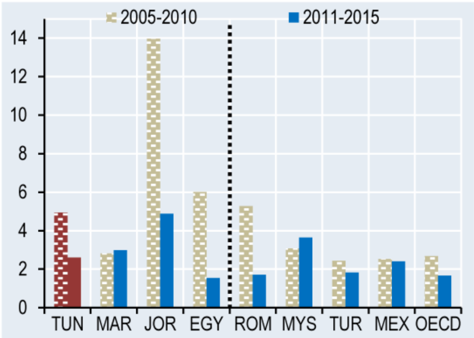
16- Worldwide Governance Indicators (percentile rank, 0-100)



Source: World Bank Worldwide Governance Indicators (1) Government Effectiveness; (2) Regulatory Quality; and (3) Rule of Law

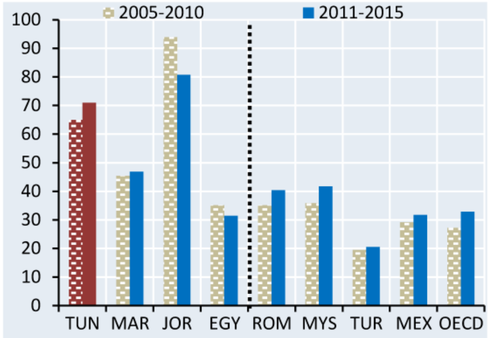
INVESTMENT CLIMATE AND PRIVATE SECTOR DEVELOPMENT

17.a- FDI flows (% of GDP)



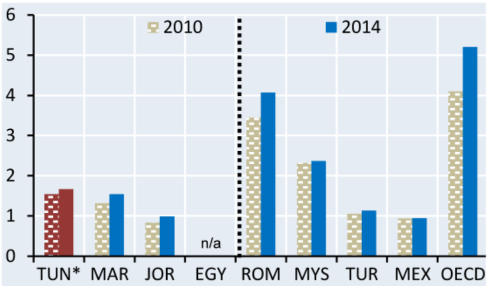
Source: UNCTAD Statistics Database

17.b- FDI stocks (% of GDP)



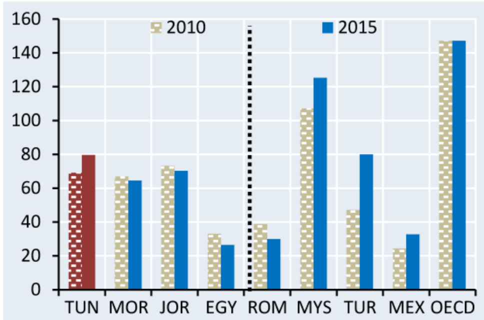
Source: UNCTAD Statistics Database

18- New business density (new limited liability firms per 1,000 working-age people)



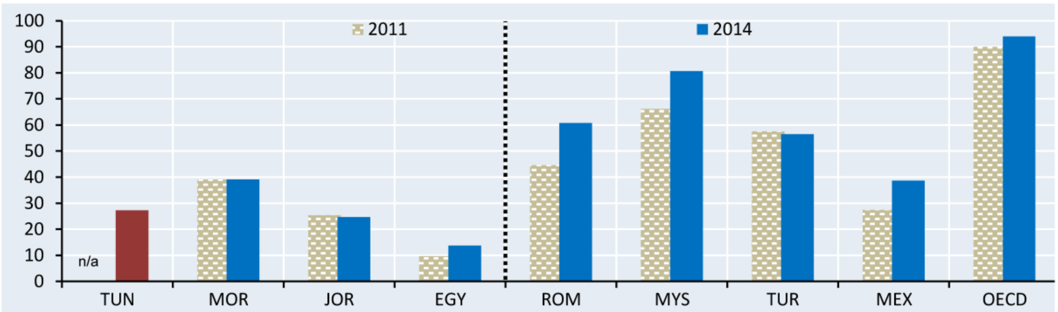
Source: World Bank Entrepreneurship Database.
Note: Data for Tunisia are for 2013 rather than 2014.

19- Domestic credit to private sector (GDP)



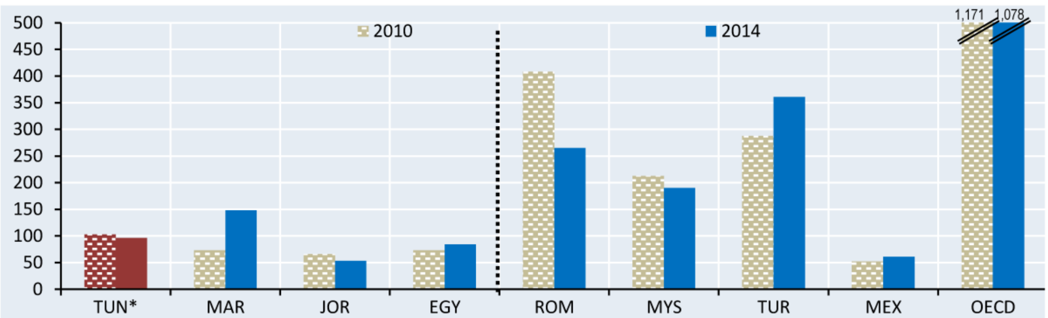
Source: IMF International Financial Statistics

20- Financial inclusion (% of adults with an account at a financial institution)



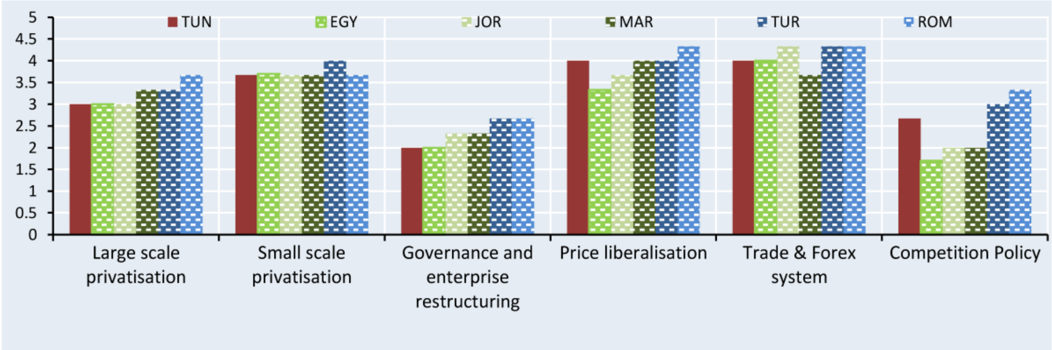
Source: World Bank Global Financial Inclusion Database. Note: Data for 2011 for Tunisia is not available

21- Resident patent applications per 100 billion USD GDP (2011 PPP)



Source: World Intellectual Property Organization Statistics Database. Note: Data for Tunisia are for 2013 rather than 2014

22 - EBRD Transition Indicators (scale from 1 to 4+)

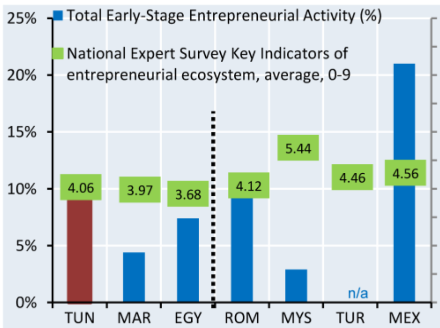


Source: EBRD Transition Indicators, 2014 Database

23- FDI Regulatory Restrictiveness Index (total FDI Index, all types of restrictions, 0-1)

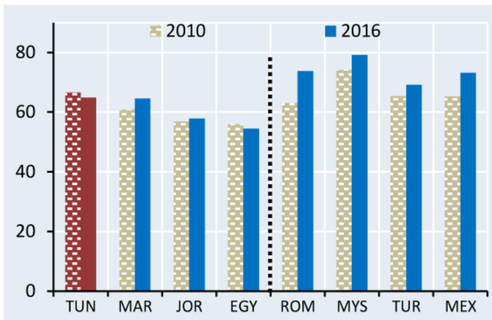
Source: OECD FDI Regulatory Restrictiveness Index. Data for 2010 and 2011 for Jordan is not available. Note: 0 = open; 1 = closed

24- Global Entrepreneurship Monitor (2015)



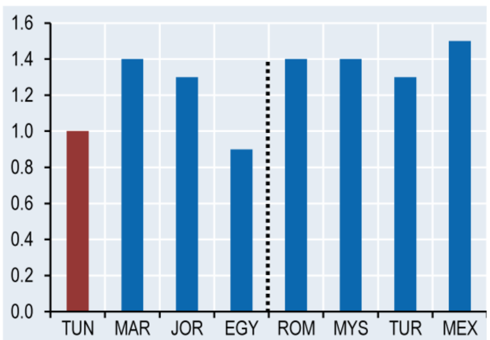
Source: Global Entrepreneurship Monitor. Note: GEM Data for Jordan is not available; TEA data is only available for the other ACTs starting in 2015

25- World Bank Doing Business, Distance to Frontier (0-100)



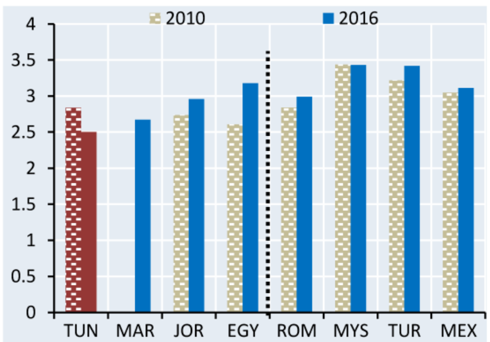
Source: World Bank Doing Business
Note: Distance to frontier covering all Doing Business dimensions; scores for 2015 and 2016 follow new methodology

26- Average trade facilitation performance, 2015 (0-2)



Source: OECD Trade Facilitation Indicators

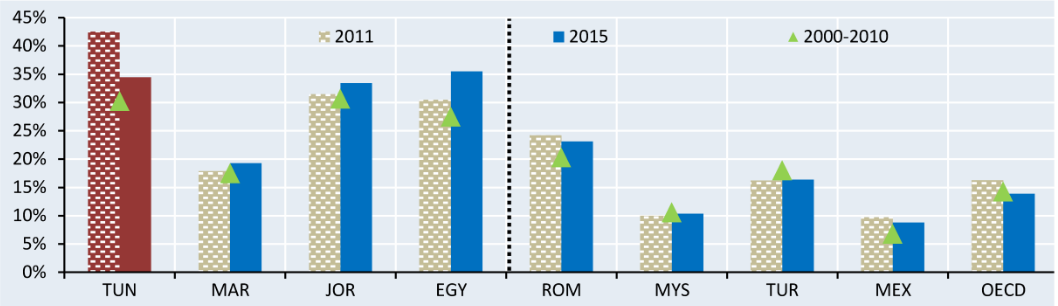
27- Logistics Performance Index (overall score 1-5)



Source: World Bank Logistics Performance Index

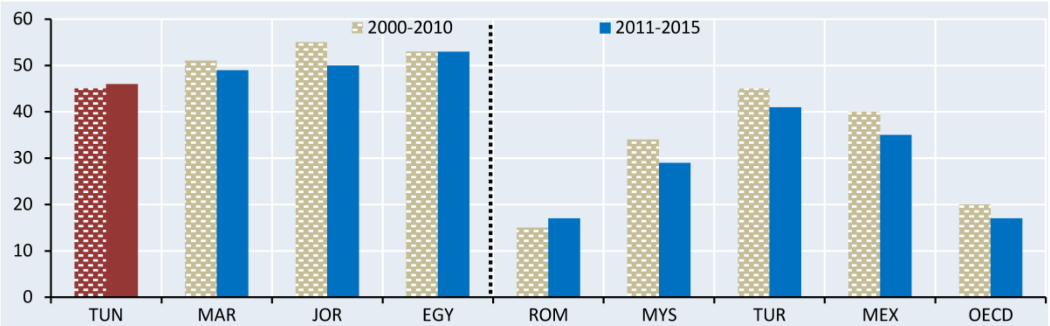
INCLUSIVE DECISION-MAKING

28- Youth unemployment rate (% of total labour force, ages 15-24)



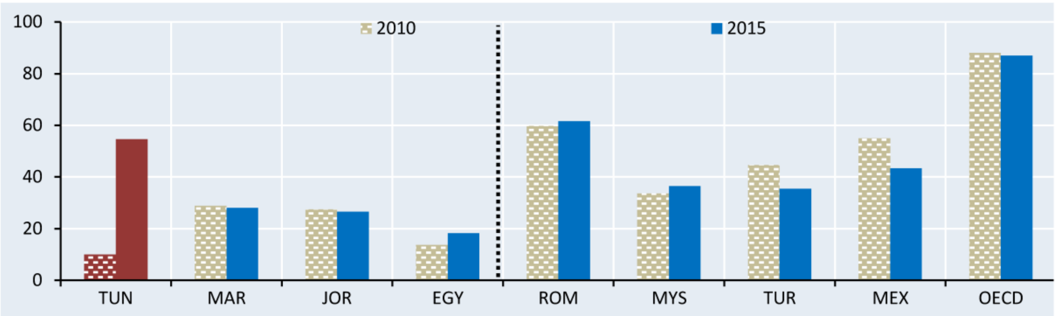
Source: ILO Key Indicators of the Labour Market database; OECD Labour Market Statistics

29- Gender labour participation gap



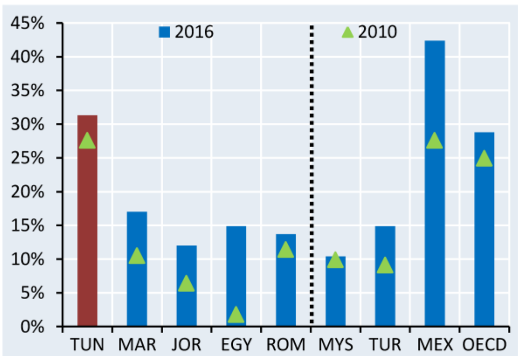
Source: ILO Key Indicators of the Labour Market database; OECD Labour Market Statistics

30- Worldwide Governance Indicator for Voice and Accountability (percentile rank, 0-100)



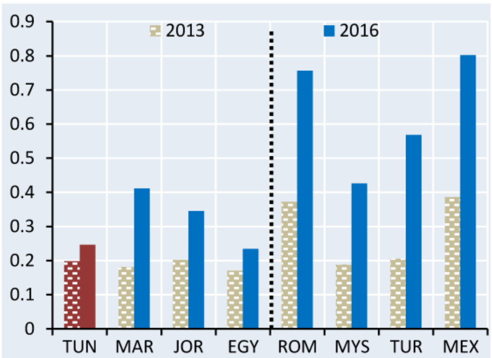
Source: World Bank's Worldwide Governance Indicators

31- Proportion of seats held by women in national parliaments (%)



Source: Inter-Parliamentary Union (figures as of January of each year for lower or single house); OECD Gender Data Portal

32- Political participation score in Commonwealth Youth (0-1)



Source: Commonwealth Youth Development Index

Country Overview

Five years since the 2011 Revolution, Tunisia has a window of opportunity to focus on long-term structural and economic governance reforms. The country's political transition has been very successful. The country has coped with dramatic social, economic and political turmoil to build a democratic model and conform to the aspirations of its citizens. The transition governments have primarily focused on short and medium term objectives: maintaining macro-economic stability, reinforcing security and building the framework and institutions of the democratic Tunisia, including the 2014 Constitution. To some extent, this challenging and ambitious agenda has dominated the priorities of legislators and policy makers. On the other hand, structural reforms aimed at addressing the imbalances created by old economic model have proceeded more slowly. The government elected in December 2015, and more so the National Unity government have a clear and legitimate mandate to accelerate the pace of reform to develop a new social contract and a new economic model based on strong economic governance institutions.

Table 1: The Tunisian Economy at a glance

Key economic indicators			
Population	11.30 million (July) 2016)	**GDP**	42.080 billion USD (2016)
Unemployment rate	15.5% (T4 2016)	**GDP per capita (PPP)**	11,406 USD
Employment to population ratio	41.3%	**Real GDP growth (estimate)**	1.0% (2016)
Human Development Index (2015)	0.721 (96 out of 188 countries)	**Budget Balance (% of GDP) (estimates)**	-5.7%(LFC2016)
Population below poverty line	15.5%	**Current account (% of GDP) (estimates)**	-9.0% (2016)
Life expectancy	74.8	**Inflation rate**	3.7%
Gini Index	40	**Public debt**	61.8% (LFC 2016)

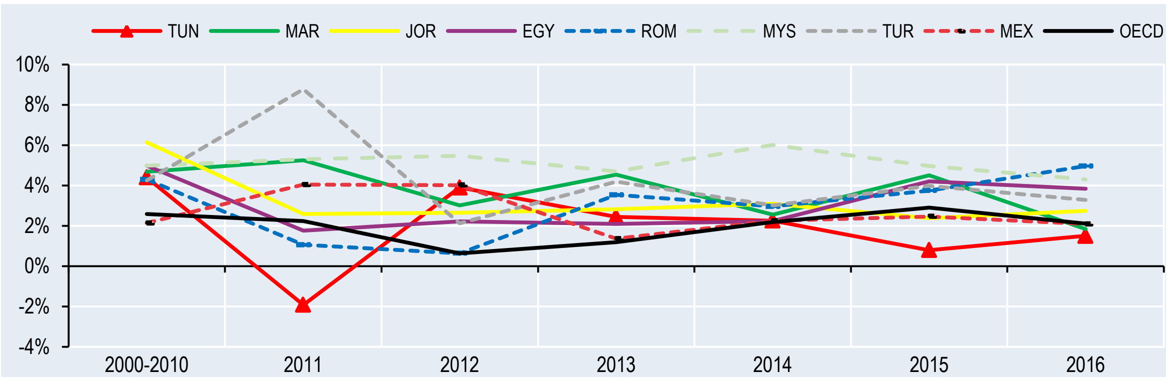
Note: Key economic indicators refer to 2016 unless otherwise specified.
Source: IMF, Tunisian Government, INS, UN.

Over the last two decades preceding the revolution, the country benefitted from a stable political situation and macroeconomic environment. Following more than a decade of quasi-socialist (collectivist), a semi-liberal *Infitâh* policy was launched in the 1970s combining import substitution and private sector export promotion and leaving an important role for the state in the management of monopoles in heavy industries and utilities. The government promoted the development of the private sector through incentives for investors in low capital-intensive and technology unsophisticated manufacturing activities (primarily textile and assembly activities). This policy led to the creation of a dichotomy between a liberalized off-shore sector targeting exports with simple products and an on-shore sector that was protected from competition and subject to a significant level of state intervention. This model started to crumble down in the 1970s and 1980s and a structural adjustment programme was launched in 1987. This program combined measures that foster the liberalization of the economy, the promotion of the private sector and the reduction of the fiscal deficit. These measures and the political stability of the country had a positive impact on the business climate and boosted export-oriented activities. The liberalisation push was intensified in the 1990s, with privatisations and greater trade integration. Overall, the liberalisation of the economy, prudent macro-economic policies and political stability fostered private sector development and the Tunisian economy grew by 5% on average per year during the 90s. Robust growth continued until 2006, driven mainly by private consumption, and export volumes of goods and services growing at average levels in excess of 8% per year. The poverty rate fell from 32.4% in 2000 to 15.5% in 2010. The global crisis put an end to the *Tunisian success story* as sluggish growth and higher levels of unemployment revealed the shortcomings of the Tunisian development model.

Together with exogenous factors, the imbalances of the pre-revolution economic model have affected growth and macroeconomic stability since 2011. Since the global economic crisis and the revolution, the country suffered an abrupt economic slowdown while mounting macroeconomic imbalances (high inflation, as well as a widening of the twin fiscal and current account deficits) prompted the Tunisian Authorities to seek the support of the IMF in 2013.

Growth below pre-2011 levels. The global economic crisis and the revolution hit the Tunisian economy hard and the country is struggling to renew with its pre-revolution growth levels. GDP contracted by 1.9% while Egypt's economy grew by 1.8% in 2011 (see Figure 1). While a slow recovery started in 2012, Tunisia is yet to catch-up with the pre-revolution growth levels. This performance is the result of a series of exogenous and endogenous factors (Central Bank, 2015). The former include (i) the resurgence of terrorism and its impact on the tourism industry; (ii) the weakness of external demand notably from Europe; and (iii) the deepening of the Libyan crisis. The tourism and phosphate sectors were hardly hit following the revolution. The tourism sector which accounted for 7-8% of the GDP with 7 million tourists per year and employed circa 13% of the active population before the Revolution, was impacted already by the revolution declining to 4.3% of GDP in 2013 and the number of tourist falling to 6 million. After a short respite in 2014, the sector was hardly hit by the 2015 terrorist attacks: the total number of visitors declined by 25% and receipts by 35% between 2014 and 2015. The phosphates sector is also struggling to recover with pre-revolution levels due to local social unrest in the mining region of Gafsa and production has fallen to 40% of pre-revolution level. These developments were partly offset by a good performance of the agricultural sector and an increase in the exports of olive oil and dates in 2015.

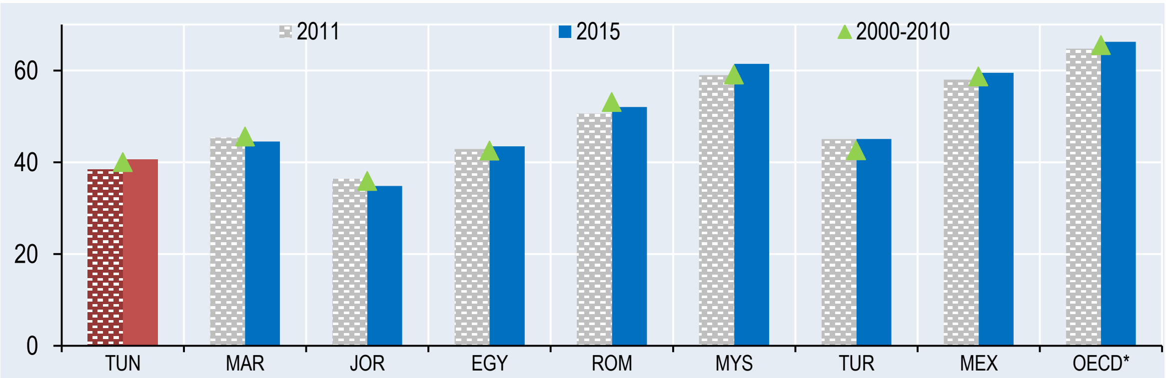
Figure 1: Real GDP (percent change) 2000-2016



Note: 2016 data are estimates for Jordan, Malaysia, Morocco and Tunisia.
Source: IMF World Economic Outlook Databases.

High unemployment notably among youth, women, university graduates and interior regions. Since the revolution, the unemployment rate increased sharply from 13% in 2010 to 19% in 2011 before stabilizing around 15% in the recent years. Unemployment levels are particularly alarming among the youth, women, and university graduates (see Pillar IV) and, from a geographic perspective, in the interior regions (see Pillar I). More generally, Tunisia, along with other countries in the MENA region, exhibits a low level of employment-to-population ratio (between 35-45%, with Tunisia at 40.6 in 2015) in comparison with other emerging economies such as Malaysia (61.4%) or Mexico (59.5%). This indicates a persistently poor ability of the Tunisian economy to create quality jobs, a high level of skills mismatches, and a very low female labour market participation, which has been plateauing at 25% for several years. It also echoes the growing importance of the informal economy. According to a study conducted by the *Centre de Recherches et d'Etudes Sociales* (CRES) and the African Development Bank (AfDB) (CRES and AFDB, 2016), 1.1 million Tunisians work in the informal sector representing almost one-third of the active population.

Figure 2: Employment-to-population ratio (%)

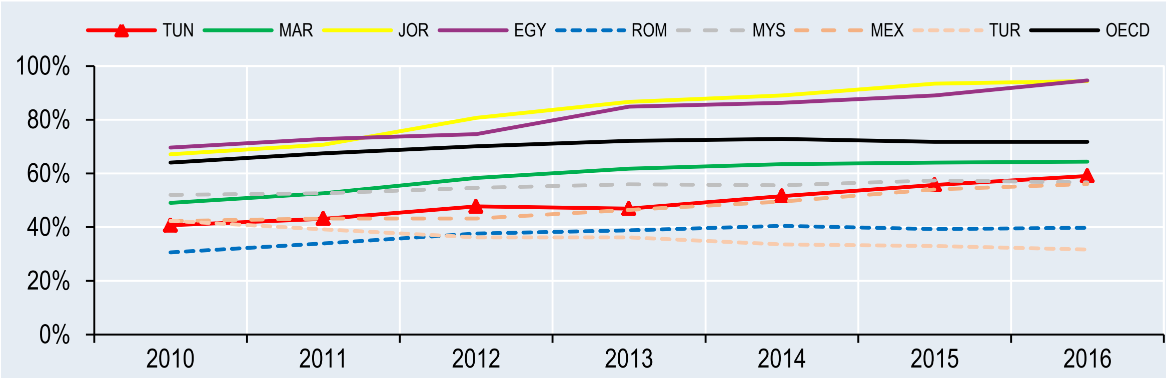


Note: OECD average is for 2005-2010.
Source: ILO Key Indicators of the Labour Market database, OECD Labour Market Statistics.

Moderate increase in inflation. Inflation was maintained below 3% per year in most years prior to 2010. Following the Revolution, the country suffered from important inflationary pressures due to local and regional instability as well as important increases in government wage bill and the reduction of energy subsidies. The Central Bank of Tunisia conducted a prudent monetary policy – with the help of lower international energy and food prices - and managed to keep inflation per annum fluctuating between 3% and 6% with inflation decreasing to 3.7% in 2016.

Public finances under mounting pressures. Public spending increased notably to cope with social tensions and due to important recruitments in the public sector with the wage bill increasing by 71% between 2011 and 2016 to reach 45% of the total government spending. Fiscal deficit is also impacted by the high level of losses by large Tunisian SOEs notably in the banking sector (OECD, 2015a). Thus, public deficit peaked from 3.3% in 2011 to 5.5% in 2012. In recent years, fiscal consolidation efforts have managed to reduce the deficit below 4.8% in 2015 but this has come at the expense of public investment, not recurrent expenditure. Government debt level increased sharply from 40.2% in 2010 to 52.4% in 2015, a level that the IMF considers sustainable (IMF, 2016a) and below that of regional peers (see Figure 3). Much of the Tunisian debts have long maturities and interest costs remain moderate given that almost 65% of the external government debt is held by bi- or multi-lateral lenders (OECD, 2015a).

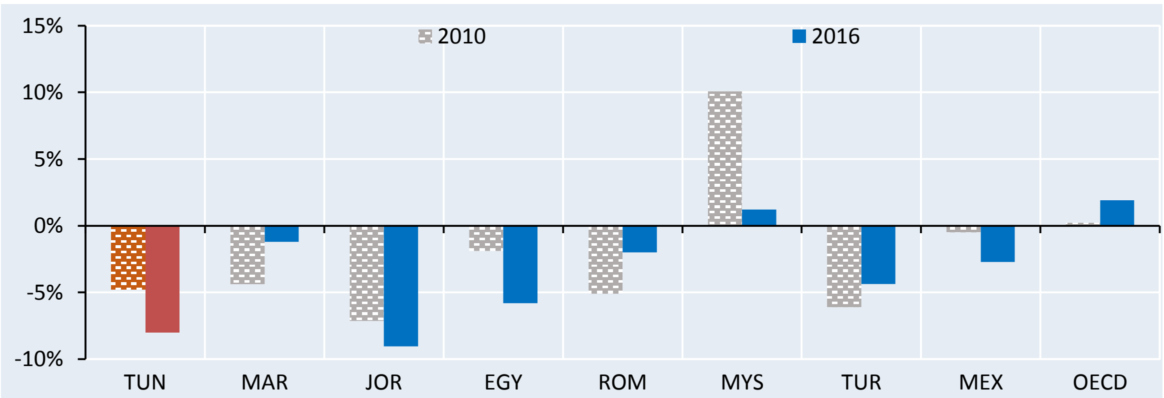
Figure 3: General government gross debt (percent of GDP)



Source: IMF World Economic Outlook Databases.

Widening current account deficits despite a slight recent improvement. Following the revolution, the current account deficit standing at 4.8% of GDP in 2010, has swollen to a 9.1% in 2014 before slightly improving to 8.8% in 2015. The deterioration of Tunisia's external position was mainly driven by the poor performance of the tourism and phosphates sector, falling revenues in manufacturing and sluggish growth in Europe, Tunisia's main trading partner. This decline was partly compensated by falling energy prices and higher agricultural exports driven notably by higher quotas in the EU. Since the revolution, The Central Bank introduced several depreciations (2013, 2014) of the Tunisian Dinar (TND) to boost export competitiveness[1]. In 2014, the Government also introduced more flexibility to the foreign exchange market. However, the Tunisian Dinar remains overvalued by 6-13% according to IMF estimates (OECD, 2015a). In this context, the ability of the central bank to maintain the dinar's peg against a basket of currencies is increasingly under scrutiny. Finally, Foreign exchange reserves, at 6 months of imports in 2010, declined hazardously following the revolution to a record low of 2.8 months in 2012 before stabilizing around 4 months in 2015 and 2016 – an improvement that does not however constitute a comfortable protection against external shocks.

Figure 4: Current account balance 2010-2016 (percent of GDP)



Note: 2015 data are estimates except for Mexico and Romania.
Source: IMF World Economic Outlook Databases.

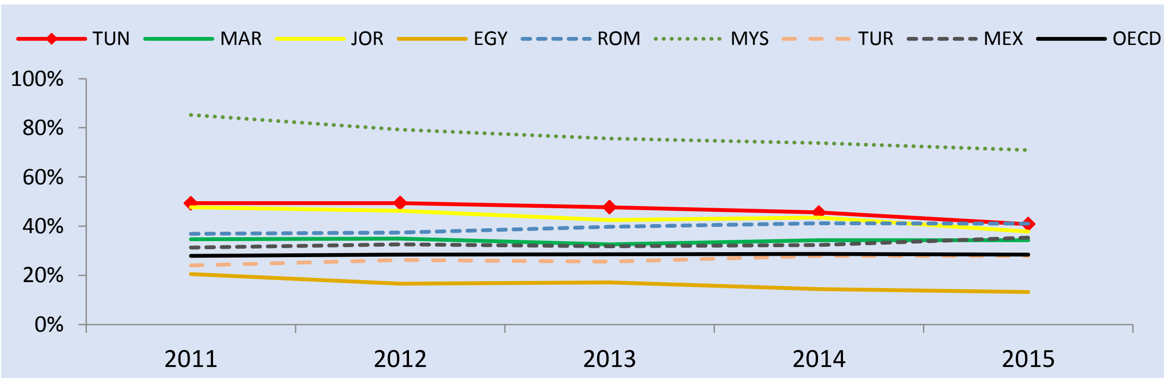
Declining public and private investment. Total investment represented almost 25% of GDP during the decade preceding the revolution. Following the global crisis and the Revolution, investment

[1] The Tunisian dinar is pegged to a basket of currencies. The exchange rate is only partly managed by the central bank through foreign-exchange (FX) transactions and capital controls

decreased to 19.9% of GDP in 2015. The share of public investment in GDP which was already on a structural downward path before the revolution declining from 10% in 1990 to 6.5% in 2008, further decreased after the revolution to a record-low of 4.2% of GDP in 2014. In the meantime, the gap between the level of investment in Morocco and Tunisia increased from 5% on average during the 2000-2010 period to 12% in 2015. Foreign direct investment (FDI) also sunk since the revolution to circa 2.6% of GDP from an average of 4.1% during the preceding decade (ITCEQ, 2016). Noteworthy that FDIs in Morocco are three times higher than in Tunisia where on average 50% of FDI are directed to the energy sector which creates few employment opportunities. Moreover, the level of gross national savings is also declining: Gross national Savings/GDP decreased from 16.4% in 2012 to 14.2% in 2014.

Trade sector affected by structural weaknesses, low levels of sophistication and concentration. Despite a high number of trade agreements, Tunisia’s trade is highly concentrated both in terms of destination and composition. The EU is Tunisia's largest trading partner: concentrating 71% of the country's exports (France accounting for 32.0%, Italy 17%, Germany 10%) and 53% of imports respectively (INS, 2016). Tunisia’s exports to the EU have little diversification and are mostly made up of machinery and transport equipment (40.6%), textiles and clothing (23.9%) and agricultural products (8.5%). In April 2016, Tunisia and the EU initiated the first round of negotiations for a Deep and Comprehensive Free Trade Area (DCFTA), to expand free trade in services, parts of agriculture, and investment, and to reduce non-tariff barriers. The country has trade agreements with neighbouring countries Algeria and Libya however, trade with these countries remain low at 5% and 3.3% of total exports respectively. After the revolution, Tunisia’s trade suffered from sluggish growth in the EU its main trading partner and weak trade with fast growing emerging markets. Finally, the competitiveness of Tunisian export suffers from an overvaluation of the Tunisian Dinar estimated at 6-13% according to the IMF (OECD, 2015a)

Figure 5: Total exports of goods and services (value, percent of GDP)



Source: World Bank World Development Indicators.

Pillar I: Designing sound economic policies for an inclusive and sustainable market economy

A deep transformation of the Tunisian development model is needed to put the country on the path of higher and more inclusive growth. Under this Pilar of the Compact of Economic Governance, three key structural challenges are analysed, in particular trying to address the main imbalances and asymmetries created by the old model between firms, regions, and individual citizens. These priorities can be seen as mutually reinforcing and cross-cutting across the three other Pillars:

- **A. Fostering structural transformation to boost competitiveness and value addition**;
- **B. Promoting regional development to reduce inequalities**;
- **C. Creating jobs through labour market reforms and other complementary policies; and**
- **D. Strengthening financial stability and banking sector governance.**

A. Fostering structural transformation to boost competitiveness and value addition

Current situation

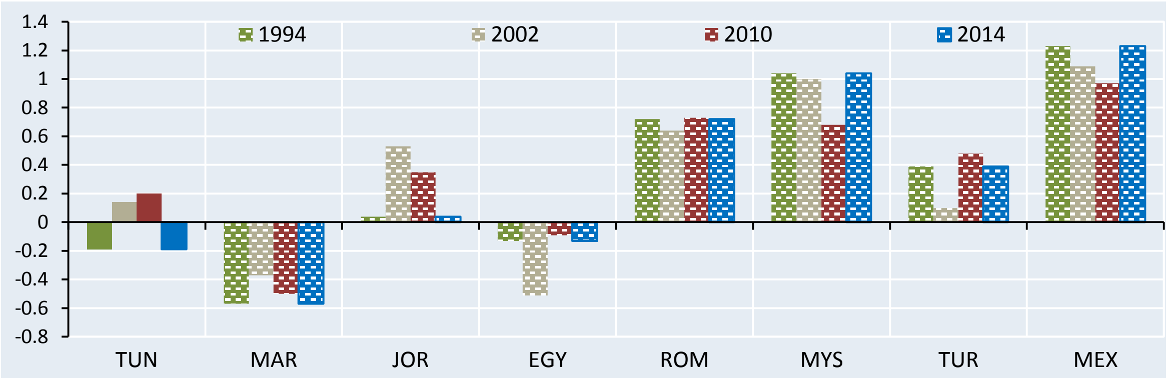
The Tunisian development model created a divide between the off-shore and on-shore sectors. The development of the Tunisian industrial sector was based on a policy using financial and tax incentives to attract FDI and promote export-oriented firms. Those firms benefitted from preferential treatment from the administration, customs and banks. On the other hand, firms in the on-shore sector were shelled from competition and deprived from the preferential treatment allocated to the off-shore regime which impeded them from improving their productivity and growing.

The off-shore regime allowed the emergence of an industry that is characterised by limited diversification and sophistication. This regime allowed primarily the development of the textile industry, which accounted for 36% of the Tunisian exports in 2006. This sector grew initially fast but is currently stagnant and facing important cost pressures. The local manufacturing industry was labour intensive and required low-skills, which inevitable branded Tunisia as a low-cost destination for investment. Since the 2000s, the country started moving towards higher value-added activities and witnessed the emergence of new export sectors such as mechanical and electrical industries, and automotive components. As of 2016, the mechanical and electrical industries accounted for 50% of the Tunisian exports while textiles have been progressively losing export share (20%).

The Tunisian development model based on incentives failed to adapt rapidly and move to higher-value added industries. Its industrial policy tended to attract entrepreneurs looking for subsidies and public assistance, and they have subsequently had trouble coping with competition from low-cost countries (OECD, 2015a). Low value added industries therefore concentrated a high number of employees (e.g. the textile sector accounted for 34% of manufacturing jobs in 2014) but also absorbed an important part of fiscal incentives to the detriment of higher-value industries. This partly explains Tunisia’s inability to capitalize its sizeable investments in the educational sector and, ultimately, the high level of unemployment and underemployment among young college graduates. Overall, 77% of the workforce is employed in low-value added jobs. This has also impacted overall economic complexity: while Tunisian economic complexity increased significantly based on the

Economic Complexity Index of the MIT (see Figure 6) during the 1994-2010 period, it declined subsequently and remains below other benchmarking economies.

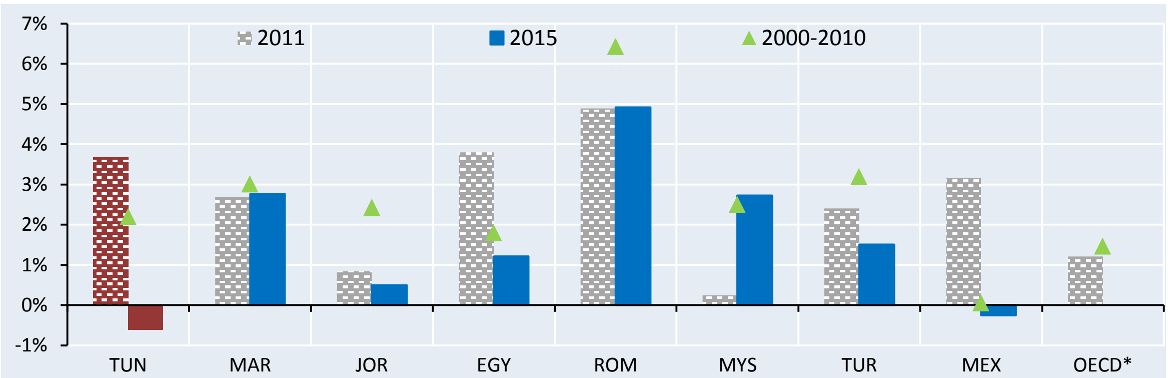
Figure 6: Economic complexity index (1994-2014)



Note: Economic complexity is expressed in the composition of a country's productive output and reflects the structures that emerge to hold and combine knowledge. Best performer is Japan with a score of 2.25 in 2014.
Source: The Observatory of Economic Complexity – MIT.

Failure to move to higher value-added industries led to lower productivity and weakened growth. Labour productivity in Tunisia increased only by 2.2% on average per year between 2000-2010, in line with Morocco but below other emerging markets (see Figure 7) due to inadequate allocation of human resources and capital. This increase was mainly driven by the non-manufacturing industry sector and the reallocation of resources towards more productive industrial sectors such as the mechanical and electrical industries. In addition, the total factor productivity (which can be linked to technological progress) has been growing more slowly in Tunisia than in other Emerging Economies, in the 2000s (IMF, 2015a). Following, the global crisis and the Tunisian revolution, labour productivity plummeted and is struggling to recover pre-revolution levels.

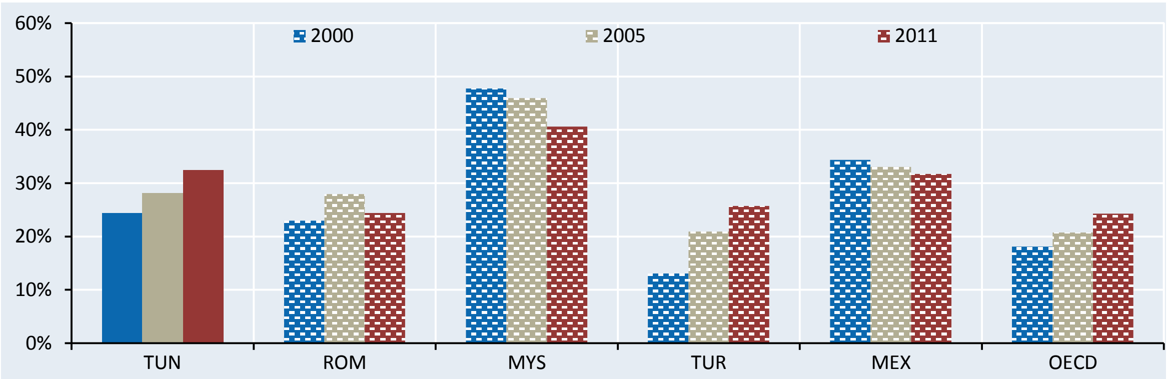
Figure 7: Labour productivity (GDP at PPP exchange rates per employed person; annual growth rate)



Note: Labour productivity for OECD countries is measured as GDP per hour worked. For non-OECD countries GDP per worker is used instead.
Source: Calculations based on ILO Key Indicators of the Labour Market database, OECD Labour Market Statistics.

Tunisia is overall well integrated in the Global Value Chains (GVCs) but it still limited to a few sectors and faces difficulties to move up due to the quality and productivity of its services. Tunisia is overall well integrated into the GVCs as illustrated by a high level of exports, which account for 50% of its GDP (see Figure 8). However, integration is limited to a few industrial sectors (primarily mechanical, electrical and textiles representing 70% of the Tunisian manufacturing exports) that rely on imported inputs given that its exports mainly consist of intermediary products. As for services, trade remains largely driven by tourism and more recently by the development of information and communication technologies and the emergence of outsourcing services (OECD, 2015a). However, the competitiveness and the ability of Tunisian exports to upgrade in value chains suffer from multiple obstacles to services trade and investment in Tunisia (see Pillar III).

Figure 8: Trade in Value-Added (TiVA) (foreign value-added share of gross exports)



Source: OECD Trade in Value Added (TiVA) Database.

FDI has generated limited positive spillovers to the rest of the economy. FDI in Tunisia typically had a low technological content and, as a result, did not generated noticeable transfers of technology and know-how. In addition, the barriers between the off-shore and domestic sectors limited the transmission of good practices and competition despite some recent efforts to open-up the domestic market to off-shore companies mainly due to administrative hurdles. During the 2000s, the government established technological and industrial parks in order to foster innovation, however these experiences had mixed effects (see Pillar III).

The Tunisian development model contributed to poverty reduction and greater income/consumption but exacerbated geographical inequalities and failed to cater to the most vulnerable groups. Economic growth in Tunisia allowed for a fast reduction of poverty rates from 27.4% in 1990 to 8.4% in 2010.[2] Inequality (at least as measured by the Gini index) also decreased over the same period (from 40.2 to 35.8) (see Figure 9). However, these trends conceal the widening geographical inequality caused primarily by a development model that favoured the coastal regions and was unable to help some of the most vulnerable groups in inland areas to close the living standards gap with the rest of the population (Leiva, C., and J. Antonio, 2016).

[2] World Bank Development indicators, poverty headcount ratio at $3.10 a day (2011 PPP) (% of population).

Figure 9: Gini coefficient (latest available year)

Source: World Bank World Development Indicators, OECD Social and Welfare Statistics.

The Tunisian development model is also confronted with a growing informality in the on-shore sector. The informal sector accounts for an estimated 35% of Tunisian GDP, compared to an EU average of 18.4% (Schneider, 2013). Informality remains very high among MSMEs which lead to the creation of subsistence jobs and low levels of productivity[3]. According the INS, in 2012, micro-enterprises and small businesses in the informal sector accounted for 76.8% of the existing jobs but just 41.3% of value added. Confronted notably with a lack of access to finance, support from public institutions, corruption and a lack of human resources and capacity to deal with administrative requirements, an increasing number of small businesses slip into informality and are unable to grow. In addition, the Utica business association, raises the issue of increased informality as a source of unfair competition for businesses and a drag for the competitiveness of the overall economy[4].

Reform efforts

Since the revolution, Tunisia is striving to adopt a new development model that better responds to the aspiration of its citizens. Government efforts are notably demonstrated through adoption of the new constitution, legislative reforms aiming at reinforcing the investment climate, especially the investment code, and measures included in the National Development Plan (2016-2020).

A new constitution that enshrines sustainable development. Sustainable development is enshrined in the new Tunisian constitution adopted in 2014 (article 12). The constitution provides for the establishment of a commission for sustainable development and the rights of the future generation (article 129) that should be consulted on draft laws regarding economic, social and environmental issues.

Legislative reforms aiming at reinforcing the investment climate and eliminating distortions. Tunisia adopted a new investment code in September 2016. The new code is aimed at eliminating the distorting effects of fiscal and financial incentives and thus mitigates the on-shore/off-shore dichotomy. The new investment code also removes restrictions in several sectors including in services (see Pillar III). Other reforms that should reinforce the overall competitiveness of the economy include (i) the on-going reform of the banking sector (see below); (ii)) the reinforcement of the competition framework through the (see Pillar III); (iii) multiple reforms to improve governance,

[3] According to Tunisian think tank Joussour, MSMEs in the informal sector record productivity levels 6 times lower that ones in the formal sector.
[4] June 2016 conference in Tunis

transparency and fighting against corruption (see Pillar II); and (iv) the establishment of a Public Private Partnership (PPP) framework that should notably contribute to reinforcing infrastructure and reducing regional inequalities.

A new National Development Plan promoting the transition from a low-cost country to an economic hub. The 2016-2020 National Development Plan is the first such plan adopted since the 2011 Revolution. It includes important public investment in infrastructure and logistics in the regions, including through PPP projects which should allow for the sophistication of the economy. More importantly, it lays down a clear vision, targets and reform priorities to change the country's economic model.

Box 1: Objectives and key reforms of the 2016-2020 National Development Plan

Tunisia's development objectives and policies were since the independence formulated through five-year plans for social and economic development. Following the revolution, the development plans were abandoned to cope with urgent priorities and government focused on more short-term objectives. The 2015 elections allowed for the elaboration of a development plan for 2016-2020.

The first development plan following the revolution adopted multiple innovations including: a participatory approach that involved 26,000 participants, a positive discrimination approach aiming at rebalancing the regional development and the promotion of green energies.

An ambitious plan to drive development:

Main objectives 2020

- *A growth rate of 4% per year against 1.5% growth during the 2011-2015 period*
- *Poverty reduction to 2% from 4.6% in 2010*
- *An increase of total investment to 25% of GDP from 18.5% in 2015*
- *Creation of 400, 000 jobs and reduction of unemployment from 15.2% to 12%*
- *An increase of national savings rate from 12.5% in 2015 to 18%*
- *Reducing informality to 20% of the economy*

A sustainable and inclusive vision for development
The plan defines a new vision of social and economic development that is based on the development of Human capital and the reinforcement of the Tunisian infrastructure notably to connect the interior regions.
The plan is structured around 5 key pillars:

- Pillar 1: Good governance, public administration reforms and anticorruption measures
- Pillar 2: Transition from a low-cost country to an economic hub
- Pillar 3: Human development and social inclusion
- Pillar 4: Fulfilment of regional ambitions
- Pillar 5: The green economy, a pillar of sustainable development

To achieve the objectives of the Plan, the Government of Tunisia is implementing numerous structural reforms that aim at supporting efficiency and promoting private investment.

Source: *Note d'orientation stratégique*, Tunisian government.

Key priorities

All reforms and policy recommendations identified in this report and in particular those listed in the Tunisia Compact Implementation Plan (see Annex I) are aimed at transforming the structure of the Tunisian economy, in particular by addressing key constraints to a more balanced and inclusive growth, including: (i) financial sector vulnerabilities and limited financial inclusion (see Pillars I and III); (iii) striking regional inequalities notably in terms of infrastructure (Pillar I); (iv) weak competition and market access notably in the service sector (Pillar III); (v) rigid labour laws (Pillar I); (vi) ineffective public spending and governance concerns (Pillar II); (vii) limited innovation and human capital development (Pillar III). Across these areas, the government should take into account two main considerations:

- ***Some key reforms need to be fast-tracked and be more participatory.*** The government should notably accelerate the reform of the financial sector and the reform of the labour market. In addition, trade facilitation reforms including customs that can facilitate the penetration of global markets seem to be falling behind schedule despite some improvement regarding ports. Moreover, the establishment of formal mechanisms allowing a participatory approach to strategic economic decisions are yet to be rolled out.
- ***Other reforms should be better defined.*** Some aspects of the ambitious reforms announced in the National Development Plan still need to be elucidated and transformed into concrete sets of coordinated actions including: (i) the redefinition of the role of the State in the economy; (ii) the reinforcement of the competitiveness of the business environment by encouraging long term productivity through FDI promoting technology transfer, educational quality, diaspora support and service quality; and (iii) the development of a coherent industrial policy.

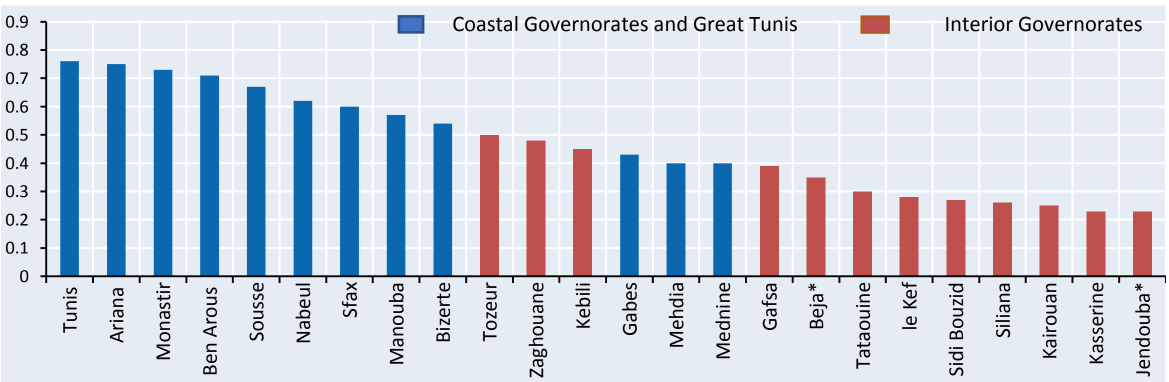
- ***Also, the Government should develop a fully-fledged strategy that increase the integration of the informal sector in the economy***.

B. Promoting regional development to reduce inequalities

Current situation

Tunisia suffers from high levels of regional development disparities between the coastal areas and the hinterland. The vast majority of the country's industries and services notably textile and tourism are based in the coastal areas. A recent study by the European Council on Foreign Relations found that 92% of industrial companies are located within an hour's drive of the country's three largest cities (Tunis, Sfax and Sousse), which account only for 56% of the population (ECFR, 2017). Poverty is also higher in the interior regions. In 2015, the North-West, the Centre-West and the South-West regions which hosted 30% of the population accounted for 70% of the Tunisian citizens in extreme poverty. The multi-dimensional Regional Development Index developed by the Tunisian government reflects this divide (see Figure 10).

Figure 10: Regional Development Index 2015



Note: the regional development index reflects the level of development of regions based on 4 components: life conditions, social and geographic indicators, human capital and economic indicators for the labour market.* Beja and Jendouba are regarded as interior governorates despite their costal access notably for geographic/demographic reasons. *Source*: MDCI.

Regional disparities are largely explained by economic governance policies. The striking disparities in terms of development between the regions stem from two main interlinked reasons: (i) a development model that favours the coastal regions and (ii) an institutional framework limiting citizens and regions' involvement in development policies.

The Tunisian development model fuelled the regional divide. The coastal regions benefitted from important public and private investments: INS statistics show that 80% of public and private investments were concentrated in these regions over the 1992-2011 period. Export-oriented policies directed higher levels of investment toward the coastal regions. As a result, coastal regions became better endowed with better infrastructure, services and attracted the lion's share of FDI (World Bank, 2014d). In addition, agricultural policies focusing on food security through agricultural price controls may also have contributed to the distortion of agricultural production, the impoverishment of farmers in the North West and Centre regions and the exacerbation of regional disparities (OECD, 2015a).

Infrastructure, health services and schooling varies dramatically between the coastal and interior regions. Quality of infrastructure is significantly lower in the interior regions. For instance, the Tunisia highway network is mainly linking the coast areas. The divide is even more striking regarding the access to public services: levels of access to drinking water vary widely between 99.7% in the Tunis Governorate and 54.6% in Sidi Bouzid. As a result, coastal areas are able to attract better human resources. For instance, 81% of engineers, 57% of university professors and 73% of lawyers, judges and accountants are concentrated in the great Tunis and Centre West regions of the country. According to an IACE study, 50% of the country's governorates do not have the sufficient infrastructure and quality of life to attract private investors (IACE, 2016a).

Increased public sector investments and transfers were insufficient to reverse the situation, in particular due to the failure to attract private sector investments in the interior regions. Over the 1992-2010 period, the 14 interior governorates were allocated 47% of public investments (TND 3,705 TND per inhabitant, compared to TND 2,857 TND for the 10 coastal governorates). Yet, the costal governorates continued to attract 71% of private sector investment over the same period. As a result, total investment per inhabitant in the coastal governorates remains 25% higher than in the interior governorates (see Table 2). In addition, public investment programs in the interior regions faced multiple difficulties and delays notably linked to insufficient capacities at the local levels. While incentives for private sector development in interior regions were introduced, those failed to deliver tangible results. For instance, the regional development zones (*zones de développement regional*) mainly located in the interior regions were only able to attract 13% of foreign firms despite significant financial and fiscal incentives.

Table 2: Public and private investments in Tunisia (1992-2010)

	Public investments		Private investments		Total investments	
	Total (in TND)	Per capita (TND/inhabitant)	Total (in TND)	Per capita (TND/inhabitant)	Total (in TND)	Per capita (TND/inhabitant)
Coastal Governorates	17,810 (52.4%)	2,857	42,830 (70.7%)	6,872	60,640 (64.1%)	9,727
Interior governorates	16,181 (47.6%)	3,705	17,739 (29.3%)	4,062	33,920 (35.9%)	7,766
Tunisia	33,991 (100%)	3,222	60,570 (100%)	5,742	94,560 (100%)	8,960

Source: Direction générale du Ministère du développement régional, 2011, GIZ 2014, OECD.

A major consequence of the unbalanced development model is lower economic opportunities and higher levels of unemployment in the interior regions (see Table 3). 85% of Tunisia's GDP is generated within a one-hour drive from the three main cities (ECFR, 2017). 17.9% of national manufacturing sector employment and 22.5% of industrial companies are found in the interior governorates (AfDB, 2014b). This situation explains significant levels of internal migration to the capital and the east of the country (see Table 3), increased social tensions and unrest, notably in the Gafsa, Sid Bouzid and Kasserine governorates, as well as the increased importance of the informal economy and smuggling in border regions.

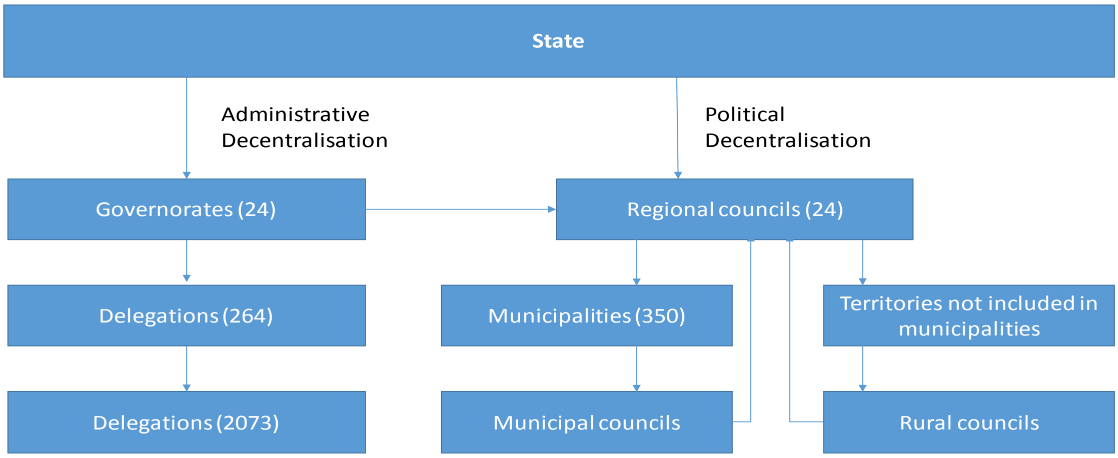
Table 3: Unemployment rate and internal migratory balance by region in Tunisia

Region	Unemployment rate (2015)	Internal migratory balance (2009-2014)
Grand Tunis	16.9 %	+ 46,300
North East	8.8 %	+ 4,700
Centre East	9.9 %	+ 28,900
South East	26.6 %	-0,200
North West	17.8 %	- 34,800
Centre West	18.7 %	- 39,500
South West	22.3 %	- 5,800
National	**15.4 %**	**0**

Source: INS.

A highly-centralised governance system hampered regional development. At independence in 1956, Tunisia inherited a highly centralised governance system. The Tunisian territory is organised following two logics: (a) administrative decentralisation (24 governorates (*wilayat*) subdivided into 264 delegations (*mutamadiyat*), and sectors (*imadats*) – all directly appointed by the central government); and (b) political decentralisation (350 municipalities (*baladyiat*) directly elected by citizens and 24 regional councils – although almost one third of the population are not covered by the communal coverage) (see Figure 11). The logic of administrative decentralisation largely dominates the territorial organisation of Tunisia while citizens have historically had very limited participation in the design and implementation of development policies.

Figure 11: Tunisia's territorial organisation



Source: Turki and Verdeil (2015).

Municipalities continue to play a limited role. Despite legislative efforts to provide more prerogatives to the local level over the past decades, the role of the municipalities is primarily focused on the implementation of the communal investment programmes that are designed at the central level. Recently, these prerogatives were complemented with new responsibilities related to the management of small scale infrastructure projects and the handling of water, sewage and garbage collection but their role in urban planning remains residual. Municipalities have severe capacity constraints. The total number of local public servants represents approximately 10% of the total number of public employees, compared with 35% in France. In 2013, the *Centre international de développement pour la gouvernance locale innovante* conducted a study to evaluate local administration and found that 75% of the considered municipalities did not have qualified human resources to undertake development planning (CIGL, 2013). Financial resources are also insufficient as resources originate from local taxes on land, real estate, the management of local markets, contributions from the state and access to financial aid and loans from the *Caisse des prêts et de soutien des collectivités locales* (CPSCL). Municipal budgets represent only 4% of the total public spending in Tunisia and there are important disparities between the budgets of urban and rural municipalities (e.g. in 2013, the 7% richest municipalities controlled 51% the municipal budgets).

Reform efforts

Regional and local development has been paid increased attention since 2011. Following the Tunisian revolution, which originates in the interior regions of the country, notably Sidi Bouzid and Kasserine), the Tunisian government introduced several legislative reforms and measures to reduce regional inequalities.

A new constitution empowering local authorities and reinforcing the participation of citizens in decision-making. The 2014 Constitution enshrines the principle of equality between the regions in its preamble. In addition, Article 12 highlights the importance of regional balance, social justice and sustainable development and stipulates that positive discrimination can be used in order to achieve these goals. In addition, the Constitution affirms the principle of decentralisation and introduces the basis of a new model of cooperation between the central government and the local authorities. The Constitution states that decentralisation should reach the entire territory and outlines the basic principles for a new distribution of powers between the central and local authorities protecting the financial and administrative independence of the latter and providing them with increased responsibilities to manage local matters. The Constitution also provides the organisation of elections at the regional and municipal levels. Fulfilling the constitutional mandate, the government has extended the territorial coverage of municipalities, with the creation of 61 municipalities in 2016.

A new investment regime aimed at reducing regional inequalities. The new Investment Law of 2016 (see Pillar III) expressly mentions an integrated and equal regional development as one of its objectives. In this regard, the new law considerably reduces the incentive system that created the on-shore/off-shore dichotomy of the economy. It restricts the provision of incentives to direct investment to (a) sectors that improve the value added and competitiveness of the economy such as new technologies, (b) investments promoting regional development based on the regional development index developed by the Tunisian government, and (c) investments that promote environment protection and fighting pollution. The new law also encourages the development of infrastructure notably in the regions.

A new PPP framework to bolster infrastructure projects in the interior regions. The 2015 PPP law and 2016 implementing regulations integrate regional development as a key objective. The law also provides local governments with the authority to resort to PPPs to stimulate the local economy and develop social infrastructure projects. PPPs offer great potential for the regions. For instance, during the Tunisia 2020 conference organised by the government in 2016 to showcase priority development projects, 34 out of a total of 142 projects were presented as PPP projects, several focusing on the interior regions including infrastructure and logistics projects and agricultural food exporting projects.

New draft legislation on local governments and the organisation of local elections. A new law governing local authorities was drafted in June 2016 and submitted to Parliament. This draft law operationalises the general principles laid down in the 2014 Constitution based on the principals of local democracy and good governance. The Tunisian government also drafted a law that will regulate and organise the first and free elections at the local level in Tunisia. The draft project law was submitted to the national assembly in January 2016. His adoption is proving difficult notably regarding the voting rights of the security forces and the military. The organisation of municipal and regional elections has been postponed several times and should take place in 2017 according to the government.

Greater participation by local authorities in the budgetary processes and the national development plan. Since the 2012, regions are more involved in the budget exercise to reflect regions' priorities and needs and overall, the budget allocated to regional development was quadrupled since the Revolution. However, this is being done in the absence of any formal participatory mechanisms. Also, local authorities and populations participated in the preparation of the National Development Plan 2016-2020. The plan sets up ambitious objectives to reduce regional disparities by 30%. It notably promotes infrastructure projects to further the inclusion of interior regions into the GVCs. For instance, Kasserine will notably benefit from a new highway to Tunis, a national road to Sfax, and the rehabilitation of two railway lines to Sousse and Tunis.

Key priorities

The regional development agenda is a complex reform process touching on very sensitive issues and which is likely to take several years. Building on the substantial progress achieved since the adoption of the 2014 Constitution, the government may want to prioritise the following actions:

- Progressing with the **local and regional electoral process**, which is constraining the full roll-out of decentralisation reforms. In addition, the communal coverage of the country should be further expanded to the 30% of the population not yet covered.
- **Clarifying the country's vision and roadmap for decentralisation**. Almost 3 years after the adoption of the Constitution, key elements of the decentralisation reform are still to be clarified. Those include: (i) the division of prerogatives between the central state and the local authorities; (ii) the measures that need to be adopted to ensure the financial independence of local authorities; (iii) the type of regulation that local authorities can adopt and (iv) the mechanisms to enable local authorities to manage local matters.
- **Reinforcing capacity at the local level.** There is also a need to reinforce transparency and accountability of the local authorities towards citizens to build a trust relationship in particular with the youth. Capacity development should also include civil society at the regional/local level.
- **Improving the assessment of regional inequality and monitoring performance, including through the development of regional statistics.**

C. Creating jobs through labour market reforms and other complementary policies

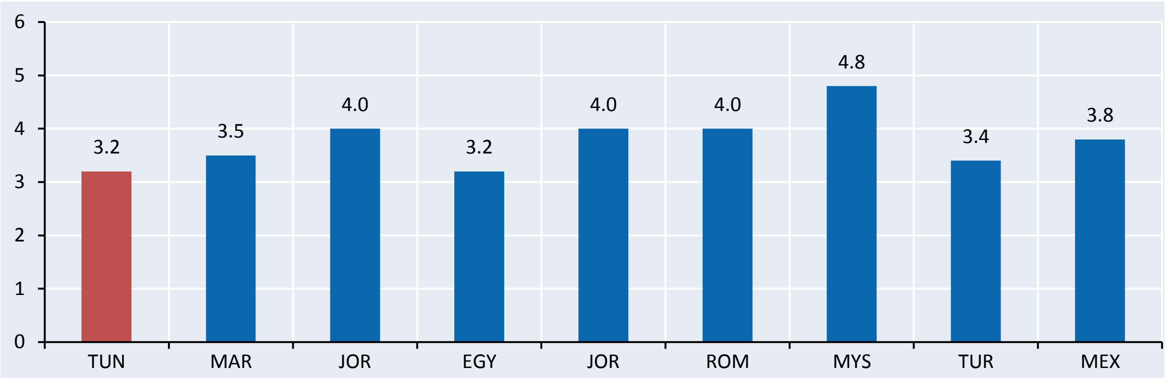
Current situation

Job creation is Tunisia's most pressing development challenge. The Tunisian labour market is characterized by a high level of unemployment (15.5% during the 4rd trimester 2016). Unemployment is particularly high for certain demographic groups namely (a) youth (35% for persons aged 15-24 in 2015), (b) university graduates (31.9%), and (c) women (23.2%). Labour participation is also very low (50% in 2015, 28.5% for women) compared to other emerging economies such as Malaysia (62%) and to upper middle income countries (74%). The economy is also characterized by growing informality and according to recent studies, one-third of the workers are employed in the informal sector (CRES and AfDB, 2016).

The labour market has been unable to cater to the needs of firms thus harming the competitiveness of the Tunisian economy. During the decade preceding the revolution, job creation grew at an average of 2.5%, almost the growth rate of the labour force, but declined following the Revolution. Most of the new jobs were created in low-productivity sectors as the Tunisian economy suffers from a structural mismatch in the labour market between the increasingly educated labour force and the demand for low skilled labour. According to the World Bank, 50% of the new jobs were concentrated in low-end manufacturing and the construction sector (World Bank, 2014d).

The Tunisian labour market is characterized by several structural dysfunctions. While a number of structural factors have contributed to a stunted private sector, low job creation (particularly for certain segments of the population), and job insecurity, this section focuses on the role of labour market institutions. More specifically, labour regulation is among the most rigid in the MENA region. The country ranks in the bottom of the 2016-17 Global Competitiveness Index dimension regarding labour market efficiency, where it stands 133rd out of 138 countries. This poor performance is driven by; (i) weak links between pay and productivity (132nd); (ii) limited flexibility with regards to wage determination (129th); (iii) lack of labour-employer cooperation (128th); (iv) low women participation in the labour force (127th); (v) inflexible firing and hiring practices (126th); and (vi) limited country capacity to attract talent (123rd) (see Figure 12).

Figure 12: Labour Market Efficiency scores 2016-2017 (1-7 scale)



Source: World Economic Forum, Global Competitiveness Report 2016-2017.

Tunisia is characterized by rigid regulation regarding the termination of work which has negative effects on job quality. Firing workers is highly regulated and requires government approval. As a result, many firms resort to fixed term contracts that have a maximum cumulative duration of 4 years according to Tunisian labour law and are subject to very light regulation. This allows firms to avoid cumbersome termination procedures and expensive processes but leads to high levels of turnover given the limited incentives to retain workers notably in low-end sectors. This trend, which intensified during the Ben Ali era, leads to job insecurity and limited investments in skills and trainings and thus the productivity of Tunisian workers. It also deprives fixed-term employees from social protection (Urdinola et al. 2014).

Labour regulation also contains significant disincentives for hiring. Overall, minimum wages and employer social security contributions in Tunisia are not particularly high compared to OECD standards. Wages are determined through periodical labour negotiations and are not differentiated by size, regions or productivity. However, Tunisia has a high tax wedge that is superior to 35 % and the main reason is the high level of social contributions by middle-income-country standards, which make regular hiring costs expensive for the average firm (AfDB, 2013). Hence, many firms are unable to afford regular employment and some slip into informality (Urdinola et al. 2014) or limit formal recruitments. In addition, workers are attracted by jobs in the public sector, which provide higher salaries and protection notably for the low-skilled workers.

Reform efforts

In 2013, the Tunisian government initiated a tri-partite social dialogue with business organisations and trade unions with the objective of agreeing on comprehensive National Employment Strategy (NES). The NES aimed at identifying specific measures including the reform the labour market through reviewing the rigid hiring-firing policies, worker protection system, and public/private sector compensation. The NES is still work in progress and at the moment it is expected to be released by the first quarter of 2017. Based on the dialogue initiated in 2013 and within the framework of the social contract, the government also started preparing an action plan for the implementation of a five-year vision for the labour market that targets: (i) an improvement in the employability of job seekers; (ii) the development of an entrepreneurial culture; (iii) the stimulation of labour demand; (iv) public service intermediation; and (v) the reform of vocational training to serve business.

In addition to the above policy initiatives, post-revolution governments have also implemented several programmes targeting the youth and underprivileged regions (including VET- vocational education and training, support schemes for SMEs, and micro-projects - including microfinance - as well as social enterprise), support schemes for SMEs and micro-projects (including microfinance) as well as social enterprises.

Key priorities

Despite the government efforts, the social dialogue is stalling and efforts to reconcile the views of trade unions and business associations with regard to worker protection and flexibility for firms are proving difficult. As a result, the development of a fully-fledged NES has been delayed. In this context, the government should **continue to make efforts to conclude the dialogue with social agents and adopt the NES**. In this context, the new strategy should notably focus on the following priorities:

- **Reducing the gap between permanent and temporary contracts** in terms of hiring and firing regulation, protection; and regulating better the work of temporary work agencies;
- **Revising wage-setting mechanisms** (minimum wages and collective wage agreements) to reduce discretion and provide incentives to employers to hire youth;
- **Improving the design of social insurance programmes to expand coverage and reduce the tax wedge**;
- **Reviewing compensation policies in the public sector in order to make private sector jobs more competitive** (see Pillar II);
- Promoting **female labour force participation** (see Pillar IV);
- **Reviewing and rationalising the existing programmes managed by ANETI, the National Employment Agency,** including training, counselling and job search services in order to better respond to the needs of the unemployed and firms (see Pillar III). This would notably require a better cooperation between ANETI and the private sector.

D. Strengthening financial stability and banking sector governance

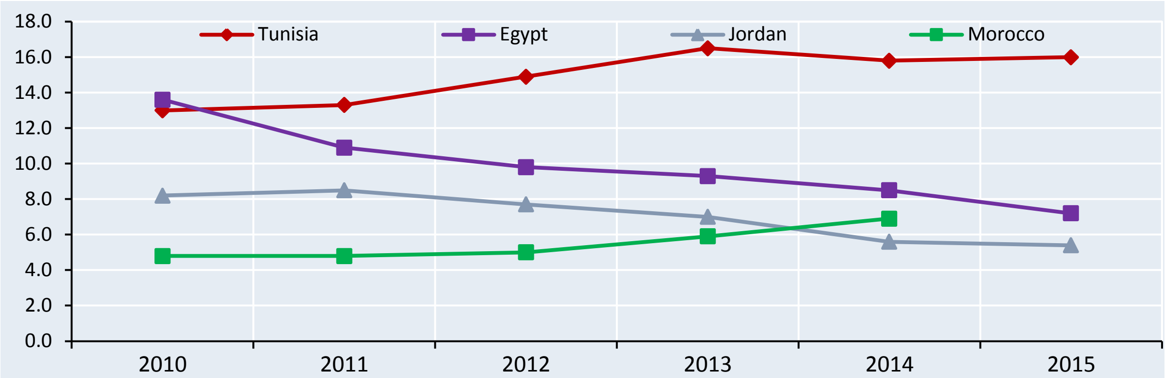
Current situation

The Tunisian banking sector, and in particular its large state-owned banks, has become a source of macroeconomic fragility. Reflecting wider imbalances in the development model, inadequate supervision, governance shortcomings, lack of competition, poor management and political interference in the operation of public banks before the Revolution, have distorted the supply of credit and threatened financial stability. Governance issues have particularly affected three state-owned institutions representing an important share of the overall banking sector. (38.7% of assets in 2014)[5]

Non-performing loans account for 16% of total bank portfolio in 2016, with a slight reduction since 2013 (see Figure 13). The problem seems particularly concentrated in the tourism and agricultural sectors, where 57.5% and 36.1% of loans were non-performing as of 2014, according to Central Bank figures (see Figure 14).

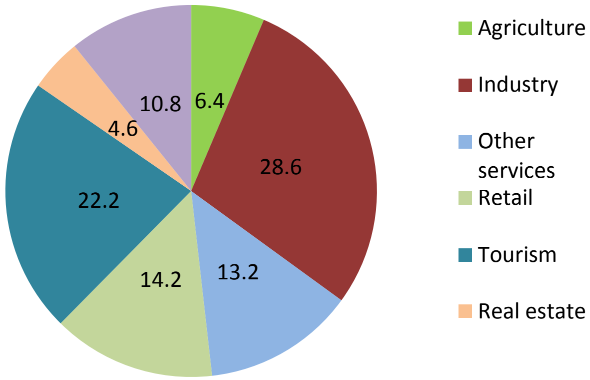
5. Banque de l'Habitat (BH), Société Tunisienne de Banque (STB) et Banque Nationale Agricole (BNA).

Figure 13: Non-performing loans (NPLs) in Tunisia (% of total portfolio)



Source: CBT Banking Supervision Reports (2012-2014), IMF Global Financial Stability Report.

Figure 14: Non-performing loans (NPL) composition by sector (2014)



Source: CBT Banking Supervision Report 2014.

In addition to hindering financial intermediation (with a negative impact on access to finance – see Pillar III), the vulnerable position of state-owned banks represents a major source of concern for the soundness of the Tunisian financial sector as a whole as well as for macroeconomic stability.

Reform efforts

Since 2012, the Tunisian authorities have taken various steps to address these risks at three levels. First, ***prudential regulation*** for credit institutions has been strengthened considerably since 2011. For instance, minimum core capital and equity ratios were increased to 7% and 10%, starting in 2014, and a new liquidity coverage ratio was introduced in January 2015. The Central Bank of Tunisia (CBT) has also stepped up inspections and introduced a bank rating system in September 2014 as well as an automated reporting tool in June 2015. These efforts have resulted in a modest improvement in bank resilience metrics (e.g. overall capital adequacy improved to an estimated 12.2% as of December 2015, compared to 8.2% in 2013) and an improvement in the percentage of NPLs covered by provisions (from 56% in 2013 to 65% in 2016) (IMF, 2016a). Building on this progress, the CBT has adopted a 5-year supervision plan (2016-2020) aimed at progressively transitioning towards a risk-based approach, generalise automatic reporting by banks and adopting key Basel 2 and 3 standards.

Second, the ***legal and regulatory framework*** has been strengthened in 2016, with the adoption of three important pieces of legislation after several months of preparatory work and parliamentary debates:

- A *new CBT Statute* was enacted by Parliament in April 2016. The Statute reinforces central bank autonomy, identifies price stability as the primary objective of monetary policy and introduces a full-fledged lender-of-last-resort mechanism.
- A *new Banking Law* was adopted in May 2016. The law improves bank governance and regulation by introducing new licensing requirements, regulating certain activities (e.g. Islamic finance), clarifying the scope and modalities of banking supervision and strengthening enforcement powers. The law also introduces two major instruments to protect financial stability: a new banking resolution framework and a deposit guarantee scheme.
- Finally, the adoption, in April 2016, of a *new bankruptcy law* broadly in line with international standards is expected to help financial institutions deal with the stock of NPLs.

Finally, the government has undertaken an important **recapitalisation and restructuring of the three state-owned banks**. This process has progressed slowly, often in a delayed manner, but significant progress has been made. STB and BH were recapitalised in 2015 with an estimated total fiscal cost of 0.7% of GDP. A full audit of all three banks was undertaken in 2013-2014 and comprehensive restructuring programmes are being implemented between 2015 and 2019. As part of these programmes, governance improvements have been introduced (including the separation of the functions of chairman of the board and CEO and the convergence in the regulatory framework for public and private banks), the business plans of the three banks were approved in 2016 and the new management teams (appointed in April 2016) are expected to sign performance contracts with clear and monitorable indicators.

Key priorities

Going forward, Tunisian authorities should **continue addressing vulnerabilities in the banking sector**. NPL levels remain high and insufficiently covered by provisions, and banks continue to depend on central bank refinancing. Continued improvements in bank supervision, the progressive adoption of international norms, including Basel 2/3 prudential standards (e.g. a net stable funding ratio), and the strengthening of regulation in key areas (e.g. related-party transactions) remain priorities for the short to medium term. The **bank restructuring programme**, which is still ongoing, should continue as planned, with specific measures to reduce the volume of NPLs. Further, the planned entry of strategic partners in the shareholding of the three state-owned banks under restructuring will have a positive impact in their financial situation and operational performance. A comprehensive privatisation plan should therefore be prepared ensuring transparency in the process.

Pillar II. Enhancing the transparency and efficiency of public institutions and processes

Overall, Tunisia has strong and solid institutions as illustrated by its ability to overcome the crisis during the revolution and ensure the continuity of public services. However, the public sector still operates according to a model inherited from the 70s and 80s and its performance is below comparable peers in various areas, including fighting against corruption, transparency and judicial independence. Tunisia's public administration is overstaffed (it employs almost one quarter of the total workforce), plagued with inefficient structures, inadequate access to information, accountability gaps and lack of co-ordination. Ample room for improvement also exists in basic functions of the state, such as tax collection and budgeting.

In a context of increasing fiscal pressures, public sector reform aimed at increasing expenditure efficiency and rationalising overall spending in Tunisia has become a key component of a broader fiscal consolidation effort. Moreover, reforms in this area should promote the emergence of an efficient, effective, accountable and transparent public administration that can improve the quality of policy design and implementation. Public sector reform thus emerges as a key priority for economic modernisation and the development of a new relationship based on trust with citizens and private sector.

Under this pillar of the Compact, particular attention is paid to the need to modernise the public administration and the broader public sector (including SOEs) as well as to a series of priority reforms regarding governance and anti-corruption strategies, regulatory frameworks, public financial management and tax collection.

A. Reforming public institutions: Reforming the reformer

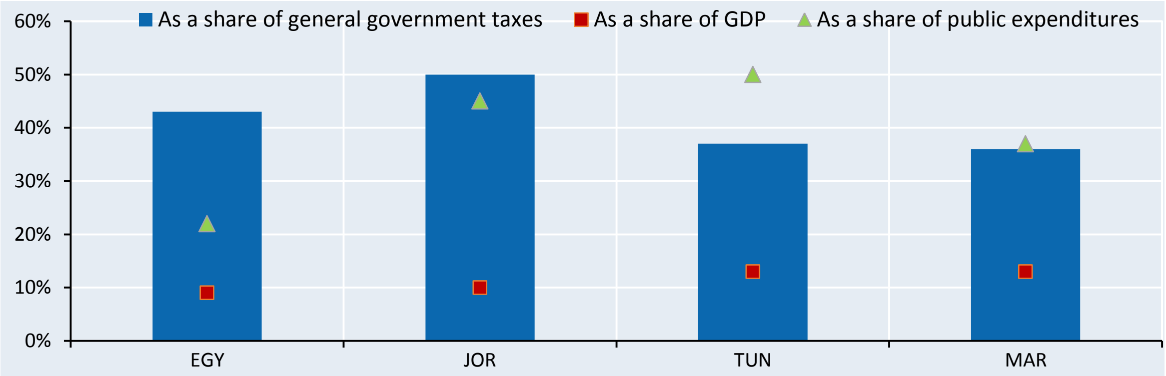
a. *Reform of the central government: A leaner, more efficient public administration*

Current situation

Tunisia's public sector is largely overstaffed and the situation has deteriorated since 2011. It accounted in 2014 for circa 800,000 employees representing almost 24% of the workforce, a level three times higher than in Morocco or other emerging countries such as Chile or Mexico (IMF, 2016b). According to the General Committee of the Civil Service, as of 2014, 583,000 officials were employed in the central and regional administration, 33,000 in local authorities, and 180,000 in state owned enterprises and agencies. The situation deteriorated during the Tunisian revolution as public sector employment was used as an instrument to alleviate social pressure and reinforce security. Public-sector workforce increased by more than 20% over the 2011-2015 period following 117,000 net recruitments. Staff numbers have grown mainly through new hires and the regularization of temporary workers. The security and defence personnel represented 40 % of this increase. Moreover, during the first two years of the transition, the recruitment was primarily based on the age and year of graduation of applicants rather than competency or assessment needs to alleviate social pressures.

This situation is weighing heavily on public finances and represents a major cause of the macro-economic imbalance that the country faces. In 2015, the wage bill represented 14 % of the country's GDP and 63 % of tax revenues, according to the (IMF, 2015b). Overall, the country recorded a 44% increase in the wage bill between 2010 and 2014[6]. These ratios are well above benchmarking countries (see Figure 15).

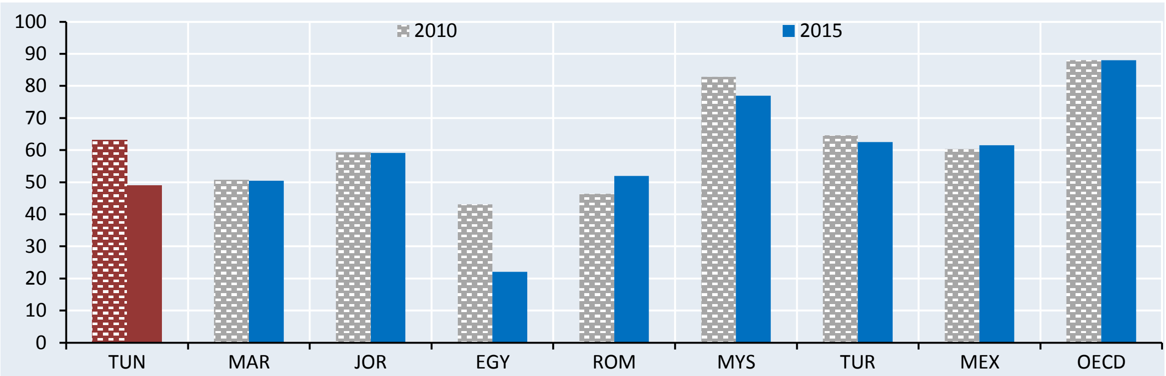
Figure 15: Salaries of public sector employees. Compensation of Employees, 2014



Source: IMF.

A heavier wage bill and increased staffing has been accompanied by deterioration in overall effectiveness. While the Tunisian administration has strong institutions that weathered the challenges of the revolution without major disruptions to public service delivery, government effectiveness has declined in recent years in the absence of a transparent, flexible, user-oriented and performance-based public management (see Figure 16).

Figure 15: Worldwide Governance Indicator for Government Effectiveness (2010-2015)



Notes: (1) Government effectiveness reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies; (2) It measures percentile rank among all countries (from 0 to 100).
Source: Worldwide Governance Indicators.

The administration is plagued with frequent overlaps, duplications and lack of coordination among and between institutions leading to resource wastes and efficiency losses. The expansion of government over the last decades resulted in the dilution of responsibilities due to a multiplication of institutions, agencies and bodies with overlapping competencies and often competing without

[6] It is worth noting that the wage bill had already increased by 28 % between 2006 and 2009.

cooperating. This situation is for instance visible with regards to investment policy implementation which is managed by several institutions[7] that report to different ministries and often work in silos with limited cooperation. Moreover, the planned decentralisation reforms adds risks of additional administrative layers and overlaps a poorly if it is badly designed or implemented.

The Tunisian public sector suffers also from the absence of efficiency and performance based management methods. The country attempted over the past decades to introduce reforms aiming at modernizing the public sector and adopted a legal framework for public performance management that establishes incentives through competitive recruitment and promotion. However, the design and the implementation of the reform failed to provide for adequate performance evaluation and financial incentives leading to the establishment of a system that fails to reward and even inhibits personal initiative (Brockmeyer, A., M. Khatrouch, and G. Raballand, 2015). Evaluations are too often overlooked or based on subjective criteria, the link between employees' performance and compensation is weak, and the variable part of the compensation remains very small. Government employees often regard it as a right as it is almost systematically awarded and was even partly integrated in the salary since the revolution. Thus, up-ward mobility of civil servants is limited and more closely linked to seniority rather than performance. The recruitment model is far from being merit-based. The selection system is often regarded as opaque and candidates often complain that it favours other reasons including personal or family ties rather than objective criteria. Moreover, merit-based selection processes are often bypassed in favour of direct recruitments.

The compensation system in the public sector is also regarded as complex, opaque and distorting. According to the IMF, there are 37 types of specific allowances and more than 140 special allowances in the civil service in Tunisia—these have doubled since 2011 and differ by function and ministry (IMF, 2016b). They represent about 60 percent of the average salary. The salary grid is also distorted pay is high for the lower echelons relative to the private sector, which leads to queuing for low-skill public sector jobs. Meanwhile, salaries are increasingly non-competitive for skilled and higher-level public servants, leading to difficulties in attracting and keeping talent.

Reform efforts

During the post-revolution period, government focused on controlling the wage bill in a context of high security and social pressures. Despite a high level of recruitments, the government made efforts to limit salary increases and promotions. Efforts aiming at improving service delivery were also initiated notably through the increased use of new technologies as well as the implementation of the performance-based budgeting reform (Gestion du Budget par Objectifs). Launched in 2009, this complex reform is currently gaining speed and being extended to all government departments.

More generally, the government is currently working on a comprehensive reform of the public service, which is being discussed in a social dialogue comprising the state, trade unions and employer associations. The goal of the reform is to increase the efficiency of public services, improve the composition of the budget to increase pro-growth expenditures while safeguarding fiscal

[7] FIPA, CEPEX, OTT, APII, APIA, etc.

sustainability. The Public Service Reform Strategy should be finalised in 2017 and implemented by a newly created ministry[8]. The strategy includes notably the following objectives:

- A decrease of the wage bill to about 12% of GDP in 2020 through a reduction in the number of staff (mainly through retirement)
- The restructuring of the public sector toward a rejuvenated, competent, motivated, effective, transparent and honest staff through (a) a revision of the recruitment process, salary structure and allowances; (b) the creation of a specific regime for high-level public servants (*haute function publique*) to attract and retain talent; (c) the redeployment of staff between departments and to the regions; and (d) the review of the carrier development framework

Key priorities

Against this background, the government should focus on the **finalisation and implementation of the Public Sector Reform Strategy**, which can be seen as a bottleneck for the effective implementation of a number of other reforms discussed in this report. This strategy should build on the lessons learned from previous failed reform attempts and consider a number of priority areas:

- Extending the INSAF system (human resources management system introduced in 2002) and accelerating the inclusion of all contract, temporary, regional, and SOE employees in the database as a mechanism to obtain reliable data and improve controls.
- Tightening the link between pay and performance. This could also involve equalising pay between different budget units and aligning wages with private sector comparators as well as increasing salary differentiation among categories to promote productivity.
- Simplifying the complex pay system (base salary, bonuses and allowances), revising recruitment and promotion policies, and upgrading the skills base at all levels of the administration.
- Involving the public service users and citizens in the reform process in addition to unions, the private sector and academia.
- Linking civil service reform of public enterprises, which have been used in the past as a source of public employment creation with limited transparency and efficiency (see below)

b. Reforming State Owned Enterprises: The need for greater transparency and accountability to monitor and reduce risks

Current situation

State Owned Enterprises (SOEs) play an important economic and social role in Tunisia. SOEs are particularly active in key sectors of the country’s economy, including banking, transport, mining, energy, water, agriculture and industry. According to the IMF, the Tunisian government controls 93 non-financial and 6 financial SOEs operating in 19 sectors (against an OECD average of 12 sectors) with some public firms holding monopolistic positions. SOE employees represent 23% of the public-

[8] The Ministry for Public Service and Governance (Ministère de la Fonction Publique et de la Gouvernance) was created in January 2016. Prior to 2016, public sector reform was managed by a directorate in the Prime Minister’s office.

sector workforce and circa 5% of the active population (IMF, 2016b) against an average of 2.5% in developed economies (OECD, 2015a). SOEs' workforce increased by 50% since 2011 notably due to the confiscation of equity and assets in hundreds of enterprises linked to Ben Ali's clan and recruitments based on political and social considerations rather than companies' assessment needs.

Tunisian SOEs' performance is damaged by weak corporate governance and a lack of transparency and accountability. The government often fails to separate between its responsibility as owner and its policy and regulatory roles. SOEs lack of managerial independence in the conduct of their affairs given that board members and senior managers are usually appointed by the executive branch (World Bank, 2014c). During, the Ben Ali regime, these appointments were often based on political and personal relationship rather than competency[9]. Moreover, SOEs were used by the government for broader policy objectives that often conflicted with the company's economic profitability. Paradoxically, government involvement in SOEs is combined with low levels of oversight and control (World Bank, 2014c). The supervision of the operations, management and finances of SOEs is diluted between the relevant sector ministry, the Ministry of Finance and the Prime Minister's office in addition to control agencies. Transparency (particularly regarding financial information) and accountability is also limited. Available data is fragmented and outdated (most of the publicly available information dates back to 2007). The production of balance sheets (when they are done), suffer from long delays and lack of consolidated accounts hinders monitoring and auditing.

As a result, most of the Tunisian SOEs are in dire financial situations and represent a budgetary risk for the fragile Tunisian economy. SOE liabilities are high but hard to quantify according to the IMF (IMF, 2016b). Half of the non-financial SOEs recorded losses in 2013, representing on a consolidated basis a 4.4 percent of GDP deficit. SOEs are strongly subsidy-dependent and highly indebted. The situation further deteriorated since the Tunisian revolution and public transfers to SOEs increased from about 2 percent of GDP in 2010 to about 7 percent of GDP in 2013 (IMF, 2016b).

Reform efforts

Due to political and social pressures, limited progress was made in SOE reform before the 2015 elections. Since then, the Government has improved controls and auditing over SOEs aiming at evaluating their financial performances and governance. Based on this evaluation, the Council of Minister adopted a strategy and general principles to restructure SOEs in November 2015, which were also reflected in the "Note d'Orientation Strategique" 2016-2020.

The strategy includes the establishment of the new body that will be piloting the reform under the tutelage of the Finance Ministry: the "Agence de Supervision et de Coordination pour la gestion des entreprises publiques". This agency will notably oversee the supervision and management of the financial restructuring, social dialogue, and governance of SOEs. The strategy also aims at improving the performance and competitiveness of SOEs including their managerial and financial performances through the introduction of performance contracts[10]. It also introduces new monitoring framework to improve state supervision, and aims at reinforcing the role of executive boards, improving management selection and control and audit systems, and enforcing reporting requirements.

[9] For instance, several army generals were appointed as CEOs of major Tunisian SOEs notably the airline company Tunisair

[10] In 2015, the 5 largest SOEs introduced performance contracts - STEG (Société Tunisienne de l'Électricité et du Gaz), STIR, the Office des Céréales (National Grain Board), Tunisair, and the Régie Nationale des Tabacs (National Tobacco Company) (IMF, 2015b).

Key priorities

The government should prioritise the **implementation of its SOE strategic plan**. Government should complete its thorough assessment of all SOEs and clearly identify the fiscal risks linked to their operations and cross-arrears between SOEs and the Government. The existing strategy should be complemented with an **action plan aiming at reducing the fiscal risks created by SOEs**. It should also ensure an efficient implementation of governance reforms for SOEs, which involves regular publication of financial information, a more transparent framework for managerial appointments, and better performance management. A clear division of labour between agencies and ministries involved in the restructuring efforts should be established. The role of the new institution in charge of restructuring SOEs should be clarified to avoid overlap with some departments in the Ministry of Public Service (e.g. the *Unité de suivi de l'organisation des établissements et des entreprises publics*). Finally, the government should step up communications efforts with stakeholders and the wider public and consider different financing options for the restructuring process (including a PPP-based fund).

B. Promoting Good Governance: Anti-Corruption, Open Governance and Judicial Reform

Current situation

The general perception among the population is that corruption is still high in Tunisia. This is reflected in the country's score in the Transparency International's Corruption Perceptions Index, where Tunisia´s rank moved down 59th in 2010 to 76th in 2015 – still higher than other regional peers like Morocco and Egypt. While the successive governments since the revolution have placed corruption as an important priority, 70% of Tunisians consider that government's efforts to fight corruption are inefficient per a survey conducted by the INS in 2014 (INS, 2016). This perception is also prevalent in the private sector, as close to a third of firms surveyed in the World Bank 2012 Enterprise Survey in Tunisia rate corruption as a severe or very important constraint (placing it as the sixth leading constraint identified from a list of twenty).

Figure 17: Corruption Perceptions Index (CPI) (100: very clean; 0: highly corrupt)

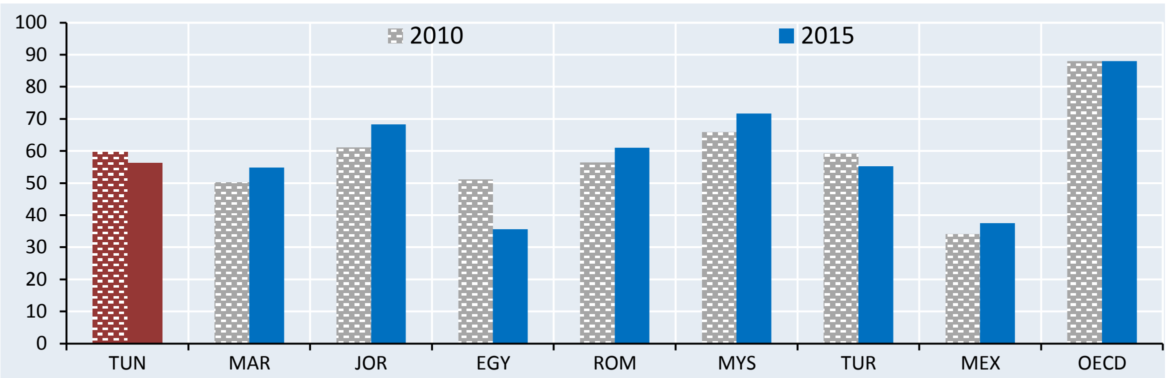
Country	2013 Score	2014 Score	2015 Score	2016 Score
Malaysia	50	52	50	**49**
Romania	43	43	46	**48**
Jordan	45	49	53	**48**
Tunisia	41	40	38	**41**
Turkey	50	45	42	**41**
Morocco	37	39	36	**37**
Egypt	32	37	36	**34**
Mexico	34	35	35	**30**

Source: Transparency International, Corruption Perceptions Index 2012-2016.

Further open government efforts are still required. Since 2011, Tunisia has taken important steps to promote the openness of its public sector, as demonstrated by its membership to the Open Government Partnership and the submission of an Open Government Action Plan. This commitment is further reflected in article 139 of Tunisia's 2014 Constitution which promotes participative democracy, and open government principles to guarantee citizens and civil society participation in policy making process at local level and to follow up its execution according to the law. However, there is still room for improvement. Tunisia's performance remains poor in terms of data openness, ranking 86th out of 122 countries in the 2015 Global Open Data Index (compared to 52nd in 2013 and below Egypt and Morocco but above Jordan). Tunisia is particularly opaque in areas related to government spending, land ownership, company registry, and procurement. In another ranking conducted by the World Justice Project measuring government openness, Tunisia ranks first in the MENA region (59th out of 102 countries). The country's performance is in line with upper-middle income countries in 3 dimensions (publication of laws and government data, right to information and civic participation) whereas performance is weaker in the fourth dimension (complaint mechanism).

Strengthening the justice sector is key for good governance, accountability and private sector development. Prior to 2010, the Ben Ali former regime used the judiciary to legitimise corruption and graft. The judiciary was not independent from the executive, judges' appointments and promotions depended on their political affiliation and multiple cases of intimidation and interference in the judiciary work were recorded. Corruption perceptions persist after the Revolution: according to a 2014 INS survey (INS, 2016), 62% of the population considers that corruption is widespread spread among court support staff. Following the revolution, the Tunisian government has essentially focused on transitional justice, and little if any progress was made in reforming the justice system before the adoption of the new constitution. As result, the situation of the judiciary further deteriorated as illustrated in international benchmarking indicators (see Figure 18).

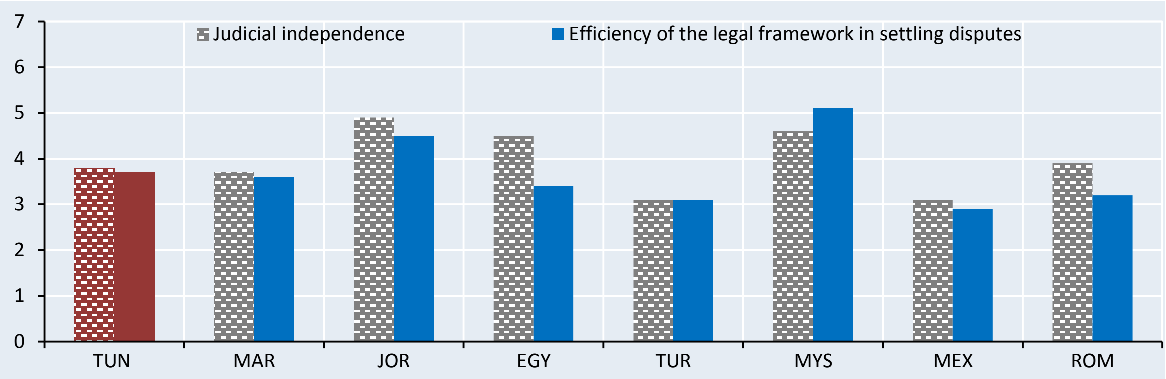
Figure 18: Worldwide Governance Indicator for the Rule of Law (2010-2015)



Notes : (1) Rule of law reflects perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence; (2) It measures percentile rank among all countries (from 0 to 100).
Source: The Worldwide Governance Indicators (WGI).

Moreover, the quality of the judicial system suffers from geographic inequality, with judges in the inner regions often complaining about the lack of resources and work overload, further worsening regional disparities. The poor quality of the judicial system is also a burden on private sector development and hampers competitiveness, as investors often complain about the slowness of the judicial system and the complexity of complaint mechanisms. According to a 2012 survey by the Tunisian Institute of Competitiveness and Quantitative Studies (ITCEQ, 2015), more than 50% of firms viewed the judicial system as corrupt or highly corrupt.

Figure 19: Quality of the judiciary framework (2015/2016 rankings). Ranking out of 140 countries



Note: Judicial independence (1 = not independent at all; 7 = entirely independent); Efficiency of the legal framework in settling disputes (1 = extremely inefficient; 7 = extremely efficient).
Source: Global Competitiveness Report - World Economic Forum.

Reform efforts

Since 2011, Tunisia has made significant progress in establishing mechanisms to fight corruption. This commitment is engrained in the new Constitution which, in its article 130, provides for the creation of a new anticorruption and governance authority: *"Instance de la bonne gouvernance et de la lutte contre la corruption"*. While such a constitutionally mandated authority is yet to be established, Tunisia has, since 2011, set up a government anticorruption agency (*Instance Nationale de Lutte Contre la Corruption*, INLCC). The INLCC is in charge of enacting general policy principles, providing advice on legislative and regulatory projects related to the fight against corruption, collecting data on corruption and facilitating cooperation between public sector, business and civil society, raising awareness and promoting an anti- corruption culture. The INLCC's budget was doubled in 2016. In addition, the government has established a ministry in charge of public sector reform and anticorruption as well as integrity cells in every ministry. A web portal is in place to facilitate the reporting of corruption in the public sector (http://www.anticorruption-idara.gov.tn). Finally, a number of legal measures have been adopted, including a Code of Conduct for State Officials (October 2014), and a decree organising and extending the missions of citizen-controllers in the detection of objectionable behaviour of public servants. As an UNCAC signatory, Tunisia has provisions in its criminal code covering bribery, embezzlement and abuse of functions, although there is currently no provision to criminalise illicit enrichment (UNCAC, 2015).

In the area of open government, Tunisia officially submitted its candidacy to join the Open Government Partnership[11] (OGP) in 2013. In this context, the government endorsed the Open Government Declaration and developed a national OGP action plan in September 2014 for the 2014-2016 period. The national action plan includes 20 commitments. The first OGP midterm review for the 2014-2015 period found that Tunisia is progressing towards a more open and transparent model although the reform process is slower than expected: progress was deemed substantial on 4

[11] The OGP is a multilateral initiative that aims to secure concrete commitments from governments to promote transparency, empower citizens, fight corruption, and harness new technologies to strengthen governance. The initiative was started in 2011 and it includes 70 OGP participating countries which have made over 2,250 commitments to make their governments more open and accountable.

commitments, limited on 12 others whereas the implementation of the 4 remaining ones did not start yet.

A crucial step for good governance and transparency has been the adoption in March 2016 of the Law on the Right of Access to Information (Organic Law No. 2016-22). The law guarantees free access to all information produced by government bodies and state-controlled institutions with very limited exceptions.

Progress has also been achieved in the area of justice reform. The Tunisian Constitution now enshrines the rule of law by guaranteeing the independence of the judiciary and mandating the reforms of courts, including the creation of a constitutional court and a Supreme Judicial Council that will be in charge of the proper functioning and independence of the judiciary system in accordance with the constitution and approved international standards. In 2014, the Ministry of Justice prepared a comprehensive strategy to reform the justice sector and penitentiary system, following by an action plan in 2015. This reform will be implemented by the Supreme Judicial Council that will preside and finally determine the reform process of the judiciary system in Tunisia. In 2016, the law on the creation of the Supreme Judicial council was passed and the election of one third of its members by magistrates took place in 2016.

Key priorities

Key priorities in the area of good governance, anticorruption and open governance include:

- Finalising the **national action plan** implementing the national anticorruption strategy, including the **establishment of the new national authority on good governance and anti-corruption.**
- Introducing **express tax legislation denying the tax deductibility of bribes** to national and foreign public officials and officials of international organizations in line with Article 12.4 of the UN Anti-Corruption Convention to which Tunisia is a Party.
- Completing key outstanding legislative reforms, including **draft laws on whistleblowing, illicit enrichment, asset disclosure and establishment of a financial judiciary branch dealing with economic offences.**
- Developing an integrated **national plan for ICT support to open government** and address the **two main challenges identified by the 2016 OECD Open Government Review of Tunisia** for the implementation of reforms in Tunisia: (a) adopt a whole-of-government approach to improve coordination across bodies and initiatives; and (b) improve the capacity of public officials in particular regarding citizens' consultation and engagement, recognising the need for new skills and a culture change (OECD, 2016c).
- Following the creation of the Supreme Judicial Council, accelerating the **implementation of the strategy and action plan for justice system reform.** This effort can be further supported by a scaling up of capacity-building programmes currently in place notably in collaboration with the EU, France, Italy, Spain and the UN. The establishment of the Constitutional Court should be prioritised.

C. Enhancing Domestic Resource Mobilisation and Public Financial Management

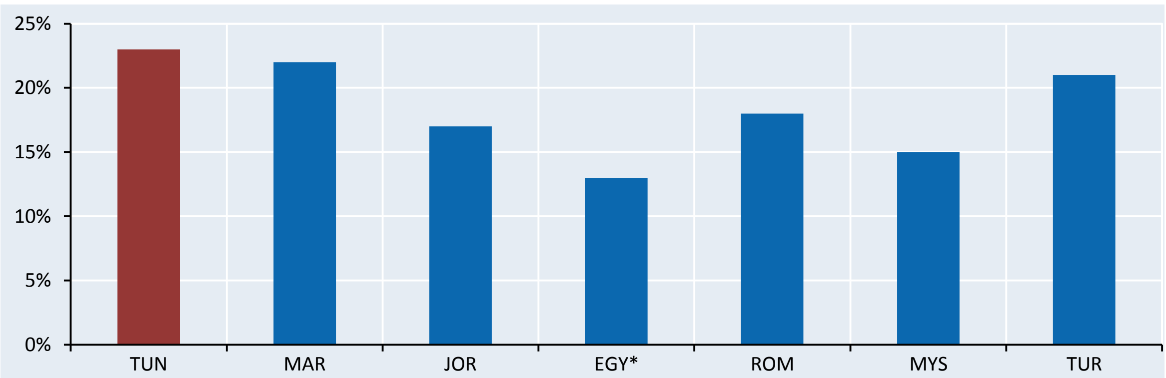
Tunisia's deteriorating fiscal position (see Country Overview) calls for a comprehensive reform of public financial management and tax policy and administration to increase the government's fiscal space for spending in priority areas for inclusive growth (e.g. public investment, social sectors). This section takes stock of government policies regarding tax and spending and identifies potential reform priorities.

a. Upgrading tax policy and administration to improve fairness and efficiency

Current situation

Overall, tax collection in Tunisia compares relatively well with similar countries in terms of revenue mobilisation and tax mix. In 2014, the country recorded a tax to GDP ratio of 31.4% (including social security contributions) compared with an average OECD ratio of 34.3% in 2014 and 28.5% for Morocco. When contributions are excluded, Tunisia also compared favourably with benchmarking countries (see Figure 20) and it is double the MENA region average according to the IMF (IMF, 2016b).

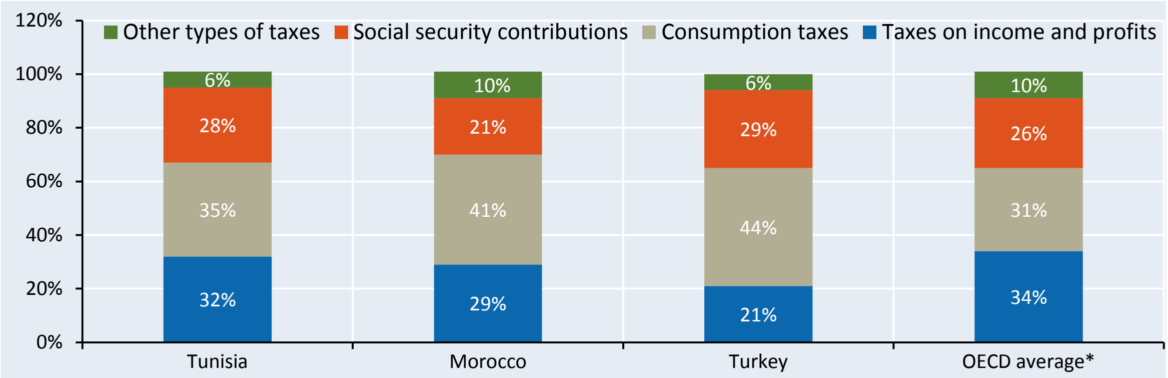
Figure 20: Tax revenue (percentage of GDP in 2014)



Notes: Tax revenue excluding fines, penalties, and most social security contributions; 2012 data for Egypt.
Source: Government Finance Statistics Yearbook, IMF Country Reports for Jordan, Malaysia, Morocco and Tunisia.

Tunisia also presents a mix of revenues that is comparable with OECD countries. Consumption Taxes/indirect taxes (including international taxes) represent the biggest contributors (35.3%) to tax revenue, followed by incomes and profits taxes (31.5%) and social security contributions (27.6%) (see Figure 21). Other taxes, including property and payroll taxes accounted for 6% of tax revenues.

Figure 21: Tax structures, 2014



Note: 2014 data for the OECD.
Source: OECD/ATAF/AUC.

However, the Tunisian system suffers from problems of unfairness, complexity and inefficiency. The tax system is overly complex and unstable; it is not transparent, distorts production, penalises the country's competitiveness and suffers from serious tax evasion and non-compliance (OECD, 2015a). Moreover, the tax system is highly fragmented, with a multitude of taxes and levies operating in an uncoordinated manner, and riddled with beneficial treatments which often have contradicting effects.

Indirect taxation is complex, inefficient and regressive. Complex regulation and tax exemptions hamper the efficiency of indirect taxation in Tunisia. The country's VAT efficiency collection ratio is low (IMF, 2015a) in comparison with Jordan and Morocco mainly due to the complexity of regulation and high levels of tax expenditure. The country's general VAT rate is 18%, with two additional rates applying to specific activities: 12% for tourism and recreation and 6% for health, while multiple activities benefit from VAT exemptions (those amount to circa 0.9% of GDP and benefit richer households (IMF, 2016b). Tunisia has also a low VAT turnover registration threshold compared to international standards, which exacerbates the complexity of the system.

Direct taxation burdens salaried employees and on-shore firms. The tax burden falls on a very narrow base due to tax incentives for offshore firms, an inefficient income tax system and unequal treatment between wage and capital income:

- **The Corporate Income Tax (CIT) falls heavily on domestic/onshore companies.** The CIT standard rate in Tunisia is 25% and is generally in line with international norms. However, this taxation falls primarily on domestic/onshore firms while off-shore firms benefit from extremely favourable tax treatment – a 0% tax rate for the first 10 years of operation and tax deductions for reinvested profits. This dual-taxation system creates a large distortion of economic activities and disincentives for the domestic investments and has a heavy cost for the economy as the total cost of these fiscal incentives for off-shore firms amounted to about 2 percent of GDP in 2012, according to World Bank estimates. Off-shore companies are often used to circumvent exchange controls and for tax evasion purposes. Payroll taxes and social security contributions are also high in Tunisia and are primarily supported by domestic firms, thus hampering their competitiveness and encouraging informality. Finally, capital earnings enjoy low or no taxation at all. The taxation of dividend was reintroduced in 2014 at a 5% rate.

- **Personal income taxes fall primarily on salaried employees notably due to the inefficiency of the "regime forfaitaire"**. Tunisia has a progressive personal income tax system and that ranges from 0% to 35%. The Finance Bill for 2017 has reduced the tax burden of lower-income taxpayers while increasing the tax burden of higher-income taxpayers. The bulk of the taxation (more than 80% of direct taxes according to Ministry of Finance estimates) is paid by salaried employees through wage withholdings whereas liberal professionals and small businesses account for the rest. This is mainly due to the "*regime forfaitaire*", a presumptive taxation system chosen by the majority of liberal professionals and the self-employed. Under this regime, the taxable income is equal to 80% of the gross income of professionals and self-employed and in the case of small businesses the tax represents a percentage of the turnover. This regime contributes to less than 2% of taxes in Tunisia. 90% of those subject to this regime declare a gross income inferior to 10,000 dinars per year (circa 2.5 times the minimum guaranteed salary). More alarming, is the behaviour of liberal professionals who tend not to register for tax purposes or not to declare their earnings; for instance less than 50% of lawyers comply with their tax obligations[12]. This presumptive taxation system is an important weakness of the Tunisian fiscal system, fails to cover about 400,000 potential taxpayers and is regarded by citizens as a key source of inequality.

Other taxes including property and international trade taxes have low contributions to revenue. Property taxes have a represent a low percentage of tax revenues in Tunisia (0.3% of GDP in 2014, well below Morocco at 1.9% and an OECD average of 1.9%). This is mainly due to an incomplete cadastre and outdated valuation techniques despite a relatively well functioning computerised property registry (IMF, 2015a). International trade taxes' contribution to revenue is also low (about 4% of total tax collection) notably due to preferential treatment for offshore companies.

The performance of the tax system is further impacted by inefficiencies within the tax administration. The work of the tax administration is made difficult due to capacity constraints, outdated IT logistical resources, cumbersome administrative procedures, as well as administrative fragmentation between several directions with limited inter-coordination. Furthermore, corruption perceptions hinder taxpayer trust. According to an ITCEQ survey, 14% of companies declared to pay bribes to tax officials in 2015 (ITCEQ, 2015).

Customs play a vital role not only for public finances but also for the security situation of the country, in particular given the growing cross-border trade market from Libya and Algeria (World Bank, 2014b). As of 2011, custom authorities were ill-organised, using outdated information systems and following complicated and opaque procedures. The custom authorities employ 7,000 people, compared to 3,000 in Morocco. In addition, an inadequate valuation system and discretionary application of the customs code encourages tax evasion through import valuation underreporting (estimated by the World Bank at about $1.2 billion dollars between 2002 and 2009 alone (Ayadi and al, 2013). Customs is mentioned as a major obstacle to doing business in Tunisia and the country has experienced a sharp deterioration in the customs indicator of the Logistics Performance Index (from 73rd in 2010 to 147th in 2016), making it the worst performer in the region.

[12] According to the Minister of Finance – December 2016

Reform efforts

The government has adopted an ambitious tax reform plan promoting transparency and fairness, improving administration and fighting tax fraud and evasion. The reform process started in May 2013. The government completed a diagnostic phase of its fiscal system and conducted consultations with stakeholders at the national and local levels. In November 2014, the authorities presented a plan for tax reform at the "*Assises Nationales de la Fiscalité*". Among the main recommendations are:

- The improvement of tax fairness through; (i) a gradual convergence of the on-shore and off-shore corporate tax rates: progressive reduction of the corporate tax rate further to 20%; (ii) increasing the rate of taxation on dividends from 5% to 15%; (iii) the development of a strategy that brings the informal sector in the tax net; (iv) the limitation of the beneficiaries of the «*régime forfaitaire*»; and (v) the improvement of the progressivity of personal taxation combined with increased tax deductions for low income households;
- The simplification and improvement of the tax system through: (i) an upgrade of taxpayers' services, (ii) the generalisation of the normal VAT rate of 18% and limitation of the special rates of 12% and 6%; (iii) the simplification of the taxation for small enterprises; and (iv) the modernization of the tax system to adapt to better governance rules;
- The improvement of the quality of services provided to citizens in order to encourage tax compliance and reduce transaction costs notably through the use of ICTs.
- The reinforcement of the tax administration notably through: (i) the integration of all tax services into a single administration to facilitate its modernization and supervision; (iI) the creation of a specialised structure to detect tax crimes; (iii) the improvement of international tax cooperation; and strengthening the large taxpayer unit and introducing a risk-based compliance system and
- The development of increased financial autonomy of local authorities

The implementation of the reform agenda is progressing slowly but steadily. The implementation of the tax reform agenda was planned for 2016 with an expected increase in tax revenue by 1.5 percentage points of GDP over the medium term. Since the *Assises*, several measures included in the tax plan were introduced in the budget laws, including a reduction in the dispersion of tax rates for offshore and onshore firms in 2014 (now 10% and 25%, respectively). Bank secrecy was lifted progressively, first for exchange of information purposes starting in 2015. The 2016 budget law included various measures to combat tax evasion, including the use of electronic billing and cash registers, or the launching of an SME taxation pilot project for the Greater Tunis area. A special structure to detect tax crimes and counteract tax evasion "la *Brigade des investigations et de la lutte contre l'évasion fiscale*" was created by the 2017 Finance Bill within the General Directorate of Taxes (DGI). The DGI is also introducing a risk based system for tax audit selection.

Tunisia is stepping up its international engagement to fight tax evasion and promote transparency. Tunisia signed and ratified of the *Multilateral Convention on Mutual Administrative Assistance in Tax Matters*, which entered into force on 1 February 2014, allowing Tunisia to exchange information for tax purposes with over 100 jurisdictions. Tunisia has already committed to the international standard on tax transparency and exchange of information (EOI) on request, when it joined the *Global Forum on Transparency and Exchange of Information for Tax Purposes* in 2012. Membership in the Global Forum includes a peer-based review of the country's ability to meet its commitments, the first stage of which (focusing on the legal and regulatory framework) was concluded in March 2016 (OECD, 2016b). Tunisia is now moving to the second stage, scheduled for the second half of 2018, which will look at the practical implementation of the framework). Tunisia is participating directly in the *G20/OECD Base erosion and profit shifting (BEPS) project*. Tunisia is receiving OECD support to strengthen international taxation rules and build effective transfer pricing/BEPS auditing skills in line with the international standards and adopting a number of other measures to protect its tax base against aggressive tax planning of MNEs.

Customs reform has received increased attention in recent years. A comprehensive reform programme for customs procedures and administration was launched after 2011 and it has gathered pace since 2015. The ongoing reform programme includes: (i) the simplification of rates (the 2016 budget law introduced a simple two-rate system) and procedures with an increased use of new technologies (e-procedures, which are expected to cover 80-90% of all procedures); (ii) mechanism to allow better risk assessment; (iii) a redeployment of custom services; and (iv) capacity building for custom officers.

Key priorities

Tunisia should **speed up the implementation of its tax reform programme** following the principles developed in the *Assises* in order to increase the fairness and efficiency of the tax system. Particular attention should be paid to the following priorities

- Accelerating **tax administration reform**, which has proceeded more slowly, including by unifying tax functions within a single administration. In this context, a good first step could be to improve the existing processes at the large taxpayer unit (80 percent of tax collection).
- Considering the promulgation of a **single tax code** simplifying existing provisions
- Addressing the **Recommendations of the Phase I Peer Review Report of the Global Forum** and in particular clarify the scope of the concept of attorney-client privilege to ensure consistency with the international EOI standard on request.
- Committing to implementing the **new international standard for automatic exchange of financial account information** according to a realistic timetable; and joining the Inclusive Framework for the implementation of BEPS and **implementing the four BEPS minimum standards** (i.e. model provisions to prevent treaty abuse, standardised country-by-country reporting, a revitalised peer review process to address harmful tax practices and an agreement to secure progress on dispute resolution).
- Continuing **customs reform and capacity enhancement**, with the overall goal of moving from an ex-ante to an ex-post control system at the customs.

b. Improving Public Financial Management systems to enhance transparency and efficiency in public spending

Current situation and reform efforts

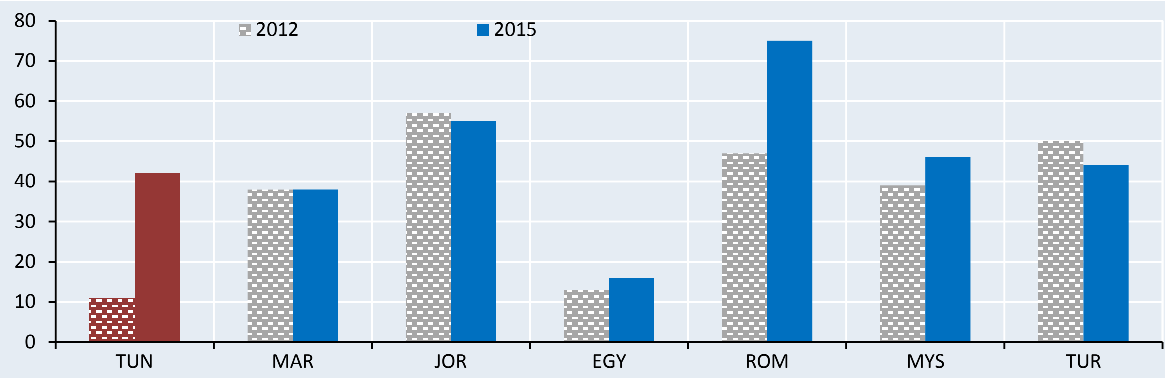
Since independence, Tunisia had a well-defined legal and administrative framework. After its independence, Tunisia adopted a PFM system largely based on the French model. The system was highly centralised and focused on maintaining budget discipline. The legal and administrative framework for the budgetary process in Tunisia was and remains governed by the following laws: (i) the Organic Budget Law; (ii) the Public Accounting Code; and (iii) the laws concerning the mission of the Supreme Audit Institution to oversee the public finances. The legislation governing the preparation and control of budget was founded on strong principles, such as the separation of authorising officials and accountants.

Pre-revolution systems suffered from significant weaknesses. During the Ben Ali regime, the budgets preparation, execution and control processes were well managed but opaque and exclusively driven by the executive. The Ministry of Finance had the lead in preparing the draft budget, despite the letter of the 1959 Constitution, the Parliament's role was merely symbolic. The budget preparation process was also entirely closed off to the public, with little opportunity to influence the budget proposal. PFM systems. The government also developed an effective system of internal and external financial controls. However, the administrative classification system diluted responsibilities and failed to develop a culture of performance, efficiency, and accountability. Moreover, the system relied on heavy ex ante controls and an extremely narrow definition of expenditure authorisations that limited the flexibility of the administration and its capacity to adapt and take initiatives (OECD, 2013a). The public accounting rules used were also consistent but applied a single-entry system, amounting to simple cash accounting.

Modernisation efforts have been underway for 20 years. In 1996, the government introduced objective-oriented management units to execute some projects and in 2004 it launched an ambitious reform to transform the entire public financial governance system following a performance-budgeting approach. A new Organic Law was adopted the new system ("Gestion du Budget par Objectif" – GBO) was piloted in five ministries in 2007. In addition, various legal amendments between 1996 and 2004 increased the scope of parliamentary overview. Yet, seven years since its inception, the GBO reform was still an experimental and preparatory stage and its implementation was deemed slow by experts (World Bank, 2012) primarily due to political reasons. For instance, the executive was reluctant to allow an actual independent functioning of the Court of Accounts – a key pre-requisite for the GBO reform. Lack of transparency was a key weakness of the budgetary process as the draft budget was never disclosed prior to its transmission to the parliament and audit account reports were also not public.

Following the revolution, the Government accelerated the pace of reform in particular regarding transparency. The Government introduced a participatory approach in the preparation of its budgets starting with the supplementary budget in 2012, which was subject to consultations with local authorities. Citizen participation in the budget process was reinforced notably through (a) the establishment in 2013, of a joint government-civil society committee on public finance transparency - chaired by the Minister of Finance; and (b) the establishment of a Citizens' Budget in December 2013 and the publication of the draft executive budget for the first time (OECD, 2015a). As a result, Tunisia's score in the Open Budget Index conducted by the International Budget Partnership (IBP), increased from 11/100 in 2012 to 42/100, placing the country 65th out of 102 countries, a 20-place improvement compared to 2012 (see Figure 22). In 2016, five of the eight key budget documents monitored by the IBP were released on time to the public. The Mid-year review and the auditing reports are published late or in soft or hard copies only and do not totally conform with the IBP standards while the country still fails to publish the pre-budget statement.

Figure 22: Open Budget Index scores (2012-2015)



Note: Scores: 0 least open) and 100 most open.
Source: International Budget Partnership

The GBO reform was placed at the heart of the reform effort and was significantly scaled up. The pilot phase was rapidly extended to seven pilot ministries and by 2016, 18 ministries (85% of the budget) were able to present their budget with a programmatic classification. As part of that reform, the budget documentation submitted to Parliament will be supplemented by financial analyses, annual performance reports, etc. Similarly, the draft law approving budgetary execution presented to Parliament after the end of the fiscal year will be accompanied by performance reports. Several ministries also started developing a medium-term expenditures framework (MTEF) a key pillar of Tunisia's PFM reform aiming at conveying more accountability on the results to be accomplished through programmes and projects. A *draft organic budget law* was also prepared and is currently under review by Parliament. The new organic budget law will notably allow the transition towards a new programmatic classification, transition towards an accrual accounting system for all flows, and adapt the budget preparation and execution process, the collection of budgetary information and the control and audit procedures to the new procedure.

Despite significant improvements, significant efforts are still required to complete the modernization of the PFM system, in particular to better monitor fiscal risks. In 2016, the IMF evaluated the transparency of fiscal transparency in Tunisia by comparing current practices to the IMF's Fiscal Transparency Code (IMF, 2016c). This evaluation found that, compared with the 36 principles of the code, 11 Tunisian practices are basic, 6 are satisfactory, 4 are advanced, 14 principles are not yet met. With regards to fiscal reporting, in most cases, the budgetary information exists but is fragmented among different entities, and the existing analyses are often for internal purposes and are not published. In addition, the coverage off fiscal reports should be expanded notably to include extra-budgetary entities such as SOEs and pension liabilities for the public sector (according to the IMF estimates, unreported expenditures for the extra-budgetary entities represent 2.1% of GDP).

Greater controls in public procurement is crucial to reduce corruption and increase efficiency. Public procurement in Tunisia accounts for circa 17% of its GDP and 40% of the state budget. The Head of the INLUCC recently estimated that corruption in public procurement costs the state losses estimated at about 25 % of the volume of public contracts i.e. 8 billion Tunisian Dinars. Since 2011, the government has committed to an ambitious programme of public procurement reforms. It adopted a new public procurement decree in March 2014 (Decree 2014-1039) that improves transparency, governance and complaint mechanisms. An online public procurement platform ("TUNEPS") was also introduced in 2014. This overhaul of the procurement system has already started to show results with a 76 percent increase in new contracts awarded in 2015. Over 2015-2016, the government also adopted a sound and comprehensive regulatory, institutional and budgetary framework for Public-Private Partnerships following international standards (see Pillar III).

The situation of CNRPS, the public sector social security and pension system, is particularly alarming situation and continues to deteriorate. According to the IMF, CNRPS registered a deficit amounting to 0.3 percent of GDP in 2014. Moreover, the situation is worsening fast with the deficit almost doubling over the last two years: from 664 million TND in 2015 to an estimated 1.1 billion TND in 2017. The sustainability of the Tunisian health and pension is structurally weak with a financing gap that should reach 15.9 billion TND by 2040 (18% of GDP in 2015).

Key priorities

The roll-out of the GOB system and the government's PFM reform plans should notably be accelerated and completed before 2021 to support ongoing fiscal consolidation efforts and improve public sector efficiency and accountability. Key priorities include:

- Speeding up the **adoption of the draft budget organic law and implementing regulations**.
- Improving fiscal transparency by **adopting the key recommendations of the 2016 IMF Fiscal Transparency Evaluation** concerning the quality, coverage and dissemination of fiscal reporting; the forecasting and budgeting process (including integrating social protection funds in the annual budget); and the analysis and management of fiscal risks (notably through the preparation of a fiscal sustainability analysis for the medium- and long term).
- **Streamlining control functions to avoid duplication and increase efficiencies.** For instance, these functions could be grouped under a single and efficient control body (instead of 3 bodies currently) while valuing the role of departmental inspections. It is also important to reinforce the capacities and competences of the Court of auditors and expand the competencies of the Financial Disciplinary Court.
- I**mproving parliamentary and public oversight concerning the budget process**, including by strengthening the capacity and resources of the parliamentary budget committee and allowing more time for the review of the draft budget, and promoting a wider engagement of citizens and civil society in budget debates at a local, ministerial and agency levels as well as in the auditing process.
- Ensuring the **full implementation of the TUNEPS e-procurement system**, for all government department and bodies by expanding the information made available on the platform to cover e.g. cover progress on projects awarded, disciplinary procedures and debarment; and **enhancing the complaint system**, including by building up the capacity of the Tunisian review body in dealing with public procurement complaints.
- Evaluating options to **reform the public pension scheme** to ensure if long-term sustainability.

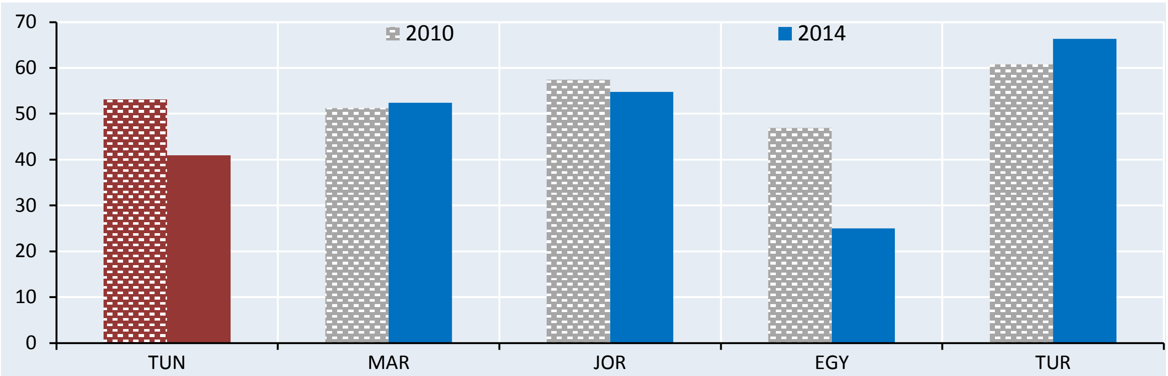
c. Improving regulation and competition frameworks

Current situation

Heavy and restrictive regulations as well as unfair competition are key barriers to investment and private sector development in the country. Tunisian markets are riddled with multiple regulatory restrictions and practices that limit competition. Protected firms benefited from rent seeking opportunities and excluded others, which were not able to grow based on innovation, performance and quality of their services. Moreover, insufficient competition, notably in the services sector impeded a deeper integration of Tunisia in the Global Value Chains (GVCs).

Regulatory quality, transparency and uniform implementation are hampered by flawed processes and institutional constraints. The development and implementation of sound regulations suffer from the absence of "whole-of government" approach due to the fragmentation of responsibilities, silo-based approaches and limited co-ordination and cooperation. Moreover, the quality of regulation is hampered by poor access to quality data and information and limited ex-ante and ex-post analyses of regulations' impact. All these factors contribute to a web of regulation that is not always appropriately implemented, enforced, or monitored. This situation is reflected in the World Governance indicator for regulatory which ranks regulatory quality where Tunisia ranks behind most comparable countries (see Figure 23).

Figure 23: Worldwide Governance Indicator for regulatory quality (2010-2014)



Notes: (1) Regulatory quality reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development; (2) It measures percentile rank among all countries (from 0 to 100).
Source: The Worldwide Governance Indicators (WGI).

Reform efforts

Since the revolution, the Tunisian government initiated a reform process aiming at modernizing as well as replacing part of the regulation inherited from the Ben Ali era. Legislative reviews were carried out to identify overlaps, duplication and conflicts between existing regulations. A regulatory guillotine program for administrative procedures, authorisation requirements and other regulatory provisions is also being implemented.

The government is developing a more inclusive and transparent approach in regulation reform. Citizens, civil society and business associations are often invited to comment on draft laws and consultations notably through the online consultation website (www.consultations-publiques.tn). However, the quality and use of public consultation varies vastly and a no mechanisms exist to ensure that comments received through consultations are taken into account while drafting the laws.

Despite the above progress, regulatory reform is proceeding slowly. The government is yet to adopt a whole-of-government approach to manage the stock and flow of regulations and improve regulatory frameworks and their implementation. The reform builds on multiple sectoral plans, including the 2016-2020 Sectoral Plan on Governance, Administrative Reform and Anticorruption or the

Administrative Modernisation Strategy 2016-2020, and requires additional co-operation and coordination. More generally, many reforms are experiencing long and protracted parliamentary discussions (e.g. the reform of the investment code took more than 4 years to materialise). Moreover, delays also occur in the development of secondary regulations to implement new laws.

Key priorities

Reform priorities to improve regulatory quality include:

- Further enhancing the participation of relevant stakeholders and the general public in the preparation and implementation of new laws and regulations, while drawing lessons from recent lengthy and difficult reform processes to **develop mechanisms facilitating the adoption of laws and regulation in a timely manner** including better information and dialogue with parliament and early preparation of secondary regulation.
- Adopting **ex-ante and ex-post mechanisms to enhance regulatory quality.** For example, line ministries could increase the use of quantitative analytical tools such as Cost-Benefit Analysis and Risk Analysis or Regulatory Impact Analysis (RIA) when assessing impacts and costs/burdens of regulations. The government could also conduct ex-post evaluations of regulation on a systematic basis to ensure regulations are achieving their policy targets.

Pillar III: Building an attractive environment for investment and private sector development

Private sector development is a cornerstone of Tunisia's development plan (2016-2020) as the main driver of economic growth and job creation. This pillar presents briefly the current situation and the main features of the private sector in Tunisia before analysing the government efforts since the revolution and challenges in key areas, and namely: (i) investment policy and regulation; (ii) trade facilitation and services; (iii) skills and innovation; and (iv) access to finance.

A. Landscape of the Tunisian private sector

Tunisia's private sector is characterised by fragmentation, low productivity and limited value addition. Private sector development was the main driver of Tunisia's robust growth of 4.5% per year between 1984 and 2010 and accounts today for about 70% of the workforce in Tunisia. It is however characterized by a high number of very small firms engaged in small-scale activity with limited productivity, mostly in low-added-value sectors (see Pillar I). In 2014, 80% of all Tunisian firms were one-person enterprises and only 0.3% of all firms employ more than 100 workers. These trends have increased in recent years (see Table 4).

Table 4: Distribution of Tunisian firms by size (2010-2014)

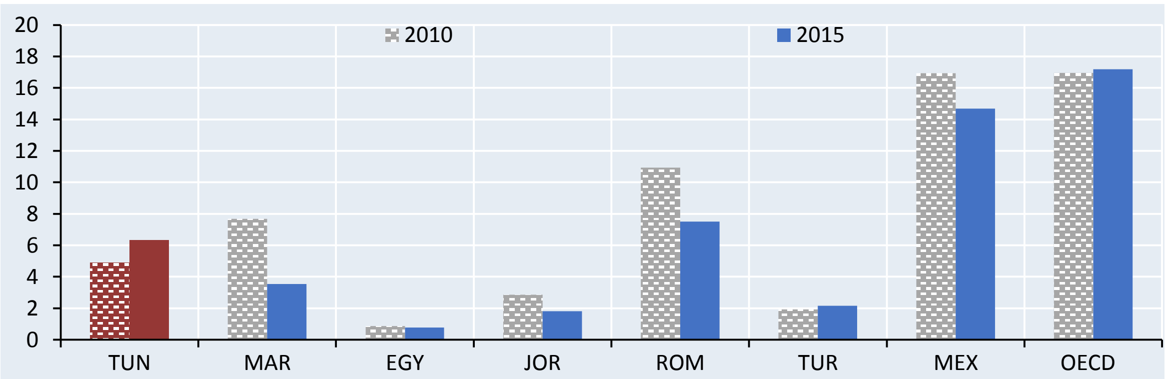
Firm size	2010 Number of firms (% of total number of firms)	2014 Number of firms (% of total number of firms)	Compound annual growth rate (2010-2014)
Micro enterprise (less than 6 employees including self-employed)	578 912 (96.9%)	661 428 (97,2%)	3.4%
Small enterprises (6-49 employees)	15 240 (2.3%)	15 395 (2,3%)	0.3%
Medium enterprises (49-199 employees)	2 619 (0.4%)	2 610 (0,4%)	-0.1%
Large firms (<200 employees)	826 (0.1%)	808 (0,1%)	-0.5%
Total	**597 597**	**680 241**	**3.3%**

Source: INS.

Tunisian firms do not operate on a level playing field given the prominent role of SOEs and the segmentation between onshore and offshore firms. Based on OECD Product Market Regulation data, the Tunisian government controls at least one firm in 19 sectors compared to an OECD average of 13 sectors and SOEs hold between 50 percent and 100 percent in key markets, including gas, electricity, railroad and air transport, fixed-line telecommunication services (World Bank, 2014d). This often constrains private sector actors as SOEs are mostly larger in size and benefit from privileged treatment through preferential regulation and subsidies, thus distorting competition. Moreover, the private sector is divided between (a) a relatively efficient off-shore sector (although highly dependent on a favourable regulatory and tax regime), which represent 3.2% of all enterprises but accounts for about a third of total employment; and (b) an on-shore sector dominated by a large number of micro, low-productivity, and often informal, enterprises which represent about 97% of all Tunisian firms and have achieved limited integration in the GVC and presents low productivity levels.

Tunisia's Integration into global value chains (GVCs) remains in low value-added sectors. The Tunisian economy is overall well integrated into GVCs, with exports representing circa 50% of GDP. Tunisia's pre-2011 industrial policy, contributed to the expansion of the export manufacturing sector but failed to promote a move towards higher value-added products. While over the last decade the structure of Tunisian exports has made some progress in terms of diversification, they are still concentrated on a small number of products and sectors (AfDB/OECD/UNDP, 2014). Four products of the top 20 exports belong to the garment, textile, and shoes sector, which accounts for nearly a quarter of total exports. Services continue to have a relatively low share of export composition despite accounting for 62% of GDP in 2015. Around 80% of Tunisia's service export revenues come from tourism, travel, transport services and ICT. The lack of diversification and limited production of higher-value-added goods for exports (see Figure 23) can, in part, be explained by the way in which Tunisian exports are integrated into GVCs: Tunisian exporters are for the most part subcontractors to foreign companies. As a result, Tunisian exporters continue to produce relatively simple goods that can be easily replaced with similar products from lower cost locations like China, India, and Bangladesh.

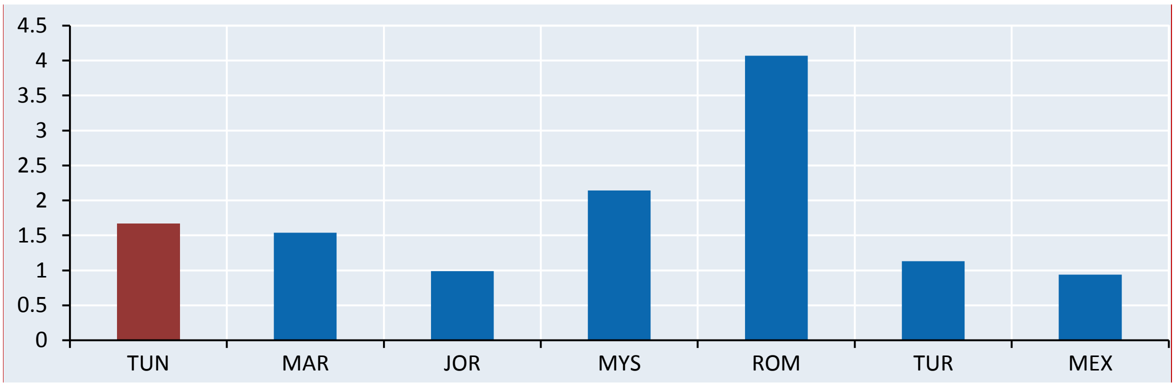
Figure 24: High-technology exports in 2013 (% of manufactured exports)



Note: High-technology exports are products with high R&D intensity, such as in aerospace, computers, pharmaceuticals, scientific instruments, and electrical machinery.
Source: World Bank, United Nations, Comtrade database.

Entrepreneurship is dynamic but firms are unable to grow and create jobs. The rate of new business creation has increased steadily over a decade (2003-2013), from 0.75 limited liability companies per 1,000 inhabitants of working age in 2003 to reach 1.67 in 2013 (World Bank, 2013). This rate is high in comparison to other countries in the MENA region (see Figure 25) but well below the OECD average rate 4.8 companies. According to the Tunisian National Statistics Institute (INS), the number of new businesses in Tunisia increased from 47,063 businesses in 2003 to 50,862 in 2013.

Figure 25: New Business Density (2014)



Notes: Data is provided on new business entry density, defined as the number of newly registered corporations per 1,000 working-age people (those ages 15–64); 2013 data for Tunisia.
Source: World Bank Entrepreneurship Database.

In the last decade, Tunisia has put in place a number of policies, mechanisms and institutions to support enterprise creation and growth. The country's policy framework for small and medium-sized enterprises (SMEs) is more developed than that of other MENA economies, according to a recent SME policy assessment (OECD et al. 2014), especially regarding business registration and access to public procurement. However, despite these efforts, Tunisian firms do not manage to grow and create enough jobs (see table 5): 40% of the jobs created between 1996 and 2010 were attributable to the expansion of self-employment, and only 4% of enterprises existing in 1996 had registered growth by 2010 (OECD, 2015a). Access to finance remain a key obstacle to the development and growth of Tunisian firms in general and SMEs in particular. In 2013 64.7% of Tunisian SMEs identifying access to finance as a major obstacle (IACE, 2016).

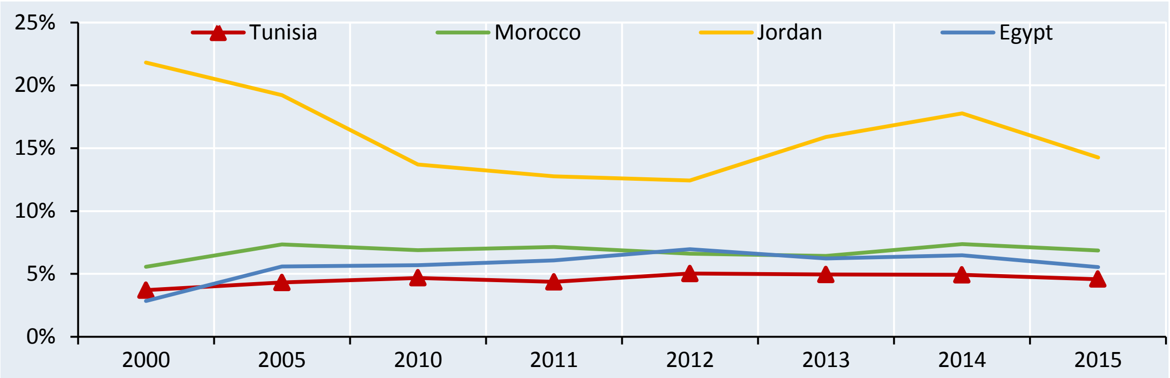
Table 5: Employment transition matrix for Tunisian firms between 2007 and 2011

Status in 2007	Status in 2011				
	Exited	1-person	Micro (2-9)	SME (10-99)	Large (100+)
1-person	22%	76%	2%	0%	0%
Micro (2-9)	9%	21%	67%	3%	0%
SME (10-99)	6%	11%	16%	63%	4%
Large (100+)	6%	11%	3%	15%	65%

Source: Schiffbauer and others (2015).

Immigration and remittances are also playing an important role in the development of the private sector. Tunisia has a diaspora of about 1.3 million primarily located in Western Europe (France, Italy and Germany) and Libya. Remittances were estimated at USD2 billion accounting for 4.6% of GDP in 2015 (see Figure 26). Remittances represent the 4th source of foreign currency, circa 25% of the national savings and an important source of investments. Following the revolution, the level of remittances slightly increased from USD 2.0 billion in 2011 to 2.3 billion in 2014. However, their levels were constrained by the weak growth in Europe and instability in Libya. Despite the crisis, the Tunisians diaspora played an important role in maintaining the Tourism industry afloat and could play an important role in the transformation of the Tunisian development model notably through skills and knowledge transfer. However, the government does not have a fully-fledged strategy to capitalize of the potential of the Tunisian diaspora.

Figure 26: Personal remittances, 2000/2015 (%of GDP)



Source: World Bank indicators.

B. Improving the regulatory level playing field for firms and reforming the investment framework

Current situation

Business regulation in Tunisia is complex, opaque and uneasy to navigate for local and foreign investors alike. This applies to basic regulatory requirements to start and operate a business. Despite government efforts, excessive regulation remains one of the primary obstacles to starting a business. According to the World Bank's 2017 Doing Business Report, Tunisia ranked 77th out of 190 countries, faring better than Morocco (68th), Jordan (118th) and Egypt (122st) but lagging behind benchmarking countries such as Mexico (47th), Malaysia (23th) or Romania (36th). More worryingly, Tunisia's distance to the world's frontier has widened slightly since 2010, which suggest that reform efforts have been outpaced by those of other countries including, e.g. Morocco (see Figure 27).

Figure 27: Doing Business (2010-2017) (Ranking)

Country	2011	2016	2017
Malaysia	21	22	**23**
Romania	56	35	**36**
Mexico	35	45	**47**
Morocco	114	68	**68**
Turkey	65	63	**69**
Tunisia	**55**	**75**	**77**
Jordan	111	119	**118**
Egypt	94	126	**122**

Note: The distance to frontier score benchmarks economies with respect to regulatory practice, showing the absolute distance to the best performance in each Doing Business indicator. An economy's distance to frontier score is indicated on a scale from 0 to 100, where 0 represents the worst performance and 100 the frontier. The rankings are benchmarked to June 2015.(*0=lowest performance to 100=frontier)*
Source: World Bank, Doing Business Report 2017-2016, 2016-2015, 2011-2010.

Tunisia fairs particularly badly in the Starting business dimension, ranking 103 th well behind Morocco (40th), Egypt (39th) or Jordan (106th). This is due a high number of required procedures to start a business (10) compared to other comparable countries (see Table 6). The high number of required procedures and long delays in these areas leave room for officials' discretion which may lead to petty corruption.

Table 6: Doing business - Starting a business by dimension 2016

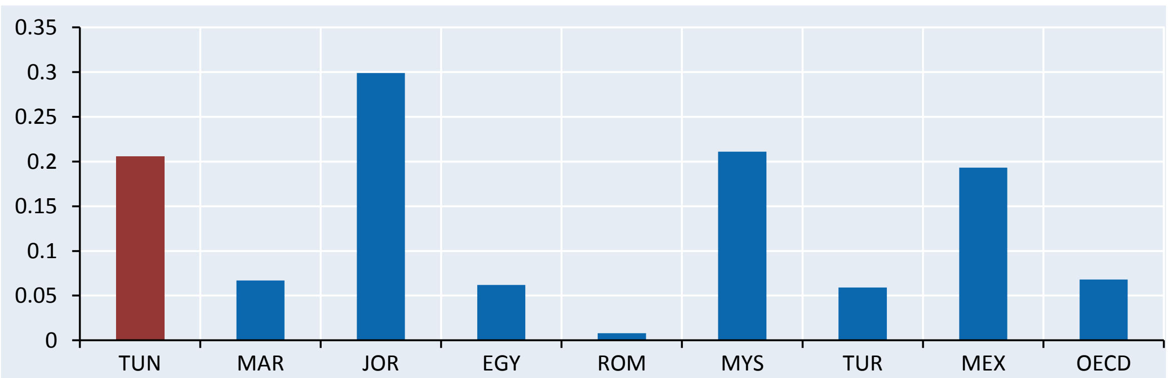
Country	Ranking (1-190)	Procedures (number)	Time (days)	Cost (% of income per capita)
Egypt	39	4.5	6.5	7.4
Morocco	40	4	9.5	7.9
OECD	46	4.8	8.3	3.1
Romania	62	6	12	2.0
Turkey	79	7	6.5	16.4
Mexico	93	7.8	8.4	9.8
Tunisia	**103**	**9**	**11.0**	**4.7**
Jordan	106	7.5	12.5	23.4
Malaysia	112	8.5	18.5	6.2

Source: World Bank, Doing Business Report 2017.

According to the most recent World Bank Enterprise Survey (2013), senior management spends 46.5% of their time dealing with the requirements of government regulations, well higher than Egypt (3.1%), Jordan (5.3%), Morocco (4.6%) or the wider MENA region (9.1%). According to the same survey, managers consider that regulation is unpredictable and unfair (e.g. 43% of managers do not believe these laws and regulations are applied evenly).

Tunisia's investment regime remains restrictive. Market competition in Tunisia is hampered by restrictions on firm entry and exit as well as by public monopolies. Market restrictions give undue advantage to incumbent firms, particularly state-owned or to a lesser-extent today to politically connected firms and suppressed productivity, aggregate growth, and employment growth (World Bank 2014d). Until very recently, the investment regime was also highly constraining as restricted sectors represented over 50 percent of the Tunisian economy. This is reflected in Tunisia's poor performance in the 2015 OECD FDI Regulatory Restrictiveness Index compared to OECD and non-OECD averages (see Figure 28), particularly for services sectors. Most of the barriers relate to foreign equity restrictions and prior-approval requirements in key services sectors, which accounted, respectively, for 50% and 38% of all statutory restrictions to FDI in Tunisia. In this context, opening services markets in Tunisia will offer a major opportunity to stimulate growth and jobs across all sectors of the economy. Recent OECD analysis using the Services Trade Restrictiveness Index (STRI) shows that even modest reforms to liberalise services can offer significant benefits (an increase exports by 3-7% and lower import prices by as much as 10%) (OECD, 2015a

Figure 28: OECD FDI Regulatory Restrictiveness Index 2015 (0 = open, 1 = closed)



Note: The OECD FDI Regulatory Restrictiveness Index covers only statutory measures discriminating against foreign investors (e.g. Foreign equity limits, screening & approval procedures, restriction on key foreign personnel, and other

operational measures). Other aspects of an investment climate are not considered (e.g. the quality of implementation of regulations or existence of state monopolies).
Source: OECD.

The institutional framework is fragmented and inefficient. The institutional framework for investment is similarly complex, fragmented and marred with inefficiencies. There are multiple institutions governing investment projects (Cepex, FIPA, Api, Apia, ONTT, etc.) and multiple funds for financing projects. These institutions report to different ministries and often work in silos adding difficulties for businesses to navigate the system. The same complexity applies to the myriad institutions and initiatives dedicated to entrepreneurship (incubators, business centres, etc.) which offer relatively undifferentiated services to start-ups and entrepreneurs (OECD, forthcoming) hindering the effectiveness of existing support.

Reform efforts

In particular since 2014, the Tunisian government has introduced several initiatives to streamline regulation and improve the overall business environment. While reform pace is slow mainly due to the prolonged reform process of the landmark investment code, significant achievements have been made.

Revision of the investment code. For more than two decades, investment in Tunisia was governed by the 1993 Investment Incentive Code, which relied heavily on tax incentives to encourage investment in certain sectors. However, the initial success in stimulating private sector development declined notably due to multiple revisions (some of them motivated by political goals and rent seeking objectives) and rendered the code extremely complex and a source of distortion for the country's economic development (World Bank, 2014d). A protracted reform process started in 2012 and involved extensive consultations with the private sector and civil society and support from development partners. A first draft was developed in 2013 and subsequently withdrawn. A revised version was submitted to the Tunisian National Assembly in 2015 and was approved in September 2016. The government has drafted three implementation decrees and the new framework is expected to come into effect in April 2017.

The new Investment Code represents a step forward towards a more transparent and efficient regime. It adopts a comprehensive approach that reduces investment incentives distorting competition, streamlines and channels tax incentives into the tax code, reinforces investment protection and improves investment market access by reducing key restrictions on FDI and introduces a simple institutional framework based on a policy-making authority chaired by the Prime Minister, an investment authority in charge of implementation and an investment fund centralising financial support and investment promotion activities.

Other regulatory reforms. A Public Private Partnership law was adopted in November 2015. It introduces a robust institutional, regulatory and budgetary framework for PPP, to foster private sector investment notably in the infrastructure sector. Implementing regulations were adopted in 2016. A new competition law was also enacted in in 2015 which aims at encouraging competition and reducing government intervention. It reinforces the role and the independence of the Competition Council (*Conseil de la Concurence*) and its enforcement role by increasing fine ceiling for firms in violation of competition laws. The Council will also be responsible for reviewing all legislation impacting competition and conduct market analysis to assess barriers to free market competition. A public procurement decree approved in 2014 together with the development of an online public procurement platform will help improve transparency, governance and complaint handling of public procurement and thereby facilitating access by SMEs (see Pillar II). Other reforms include sector based regulation notably the Renewable Energy Law to boost private sector investments and liberalise regulations to facilitate the production, network access and export of electricity generated by renewables, adopted in May 2015.

Administrative simplification and SME support. During the transition period, the government initiated a process aiming at reducing the complexity of its administrative procedures in these areas. 376 priority customs and tax formalities and 154 administrative procedures in various areas of activity have already been streamlined and the government plans to initiate a third streamlining phase of 372 administrative procedures – to be conducted over the next two years. Other developments aiming at fostering SMEs and entrepreneurship include: (i) improvement of the company registration process (ii) the introduction of a single identification number; (iii) the establishment of an electronic one-stop shop for import-export operations, and (iv) the expansion of the network of business incubators and technology parks.

Key priorities

The government's objective is to strengthen the business climate in order to climb 30 places in the Doing Business ranking (40th place) in 2020. Achieving this goal and increasing the levels of foreign and domestic investment will require a multi-prong strategy including the following actions:

- Accelerating the **implementation of the new investment framework** focusing in particular on (a) the approval of its key implementing regulations regarding in particular the negative list of sectors in which foreign investors do not benefit from freedom of establishment; (b) the implementation of the new institutional framework, including a clarification on the role of the new investment authority (i.e. absorbing the existing investment agencies or playing a coordinating role).
- Completing the **revision of the tax code** (see Pillar II).
- **Approving the missing implementation decrees for the competition law**, aiming in particular at reducing delays for anti-trust hearings and increasing sanctions for anti-competitive behaviour. The government could also could undertake in-depth reviews of some sectors and laws to evaluate competitive impacts of legislation and eliminate barriers to competitions.
- **Piloting PPP transactions** under the new framework to evaluate the feasibility and fiscal risks posed by new PPPs,
- Stepping up efforts to **streamline regulation, including transparency and predictability** regarding operating licenses, import licenses, construction permits, and electricity connections.
- **Strengthening public-private dialogue and coordination** to improve the business climate.

C. Facilitating trade and reinforcing infrastructure and services

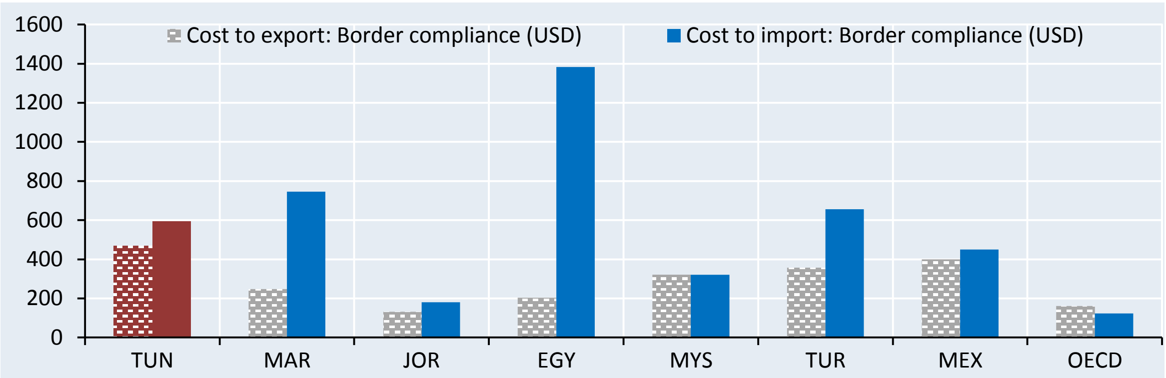
Tunisia is overall well integrated into global trade and some GVCs. However, its exports are concentrated both in terms of sector and geography. Greater emphasis is needed to upgrade trade facilitation, improve customs and trade regulations, and upgrade logistics and transport infrastructure.

a. *Promoting trade facilitation and streamlining trade regulation*

Current situation

Tunisia has lagged behind in trade facilitation and regulation reforms. Historically, Tunisia's costs to exports and imports were close to OECD standards while still accounting for a higher number of documents and longer delays to export and import than in OECD countries. After 2011, the country's trade competitiveness deteriorated as other countries speeded up reforms, increasing the gap with frontier performers. In 2016, Tunisia ranked 91st in the Doing Business Trading Across Borders indicator, behind countries such as Jordan (50th) and Turkey (59th). Tunisia fares particularly badly in terms of the costs of exporting and importing compared to the majority of benchmarking countries (see Figure 29). The same trend is reflected in longer overall time spent at the border and lower customs efficiency in the World Bank's Logistics Performance Index. Tunisia was ranked 146th out of 166 economies in 2016, a sharp decline from the 73rd position in 2010 and below Morocco (124th), (Egypt 122nd) and Jordan (83rd).

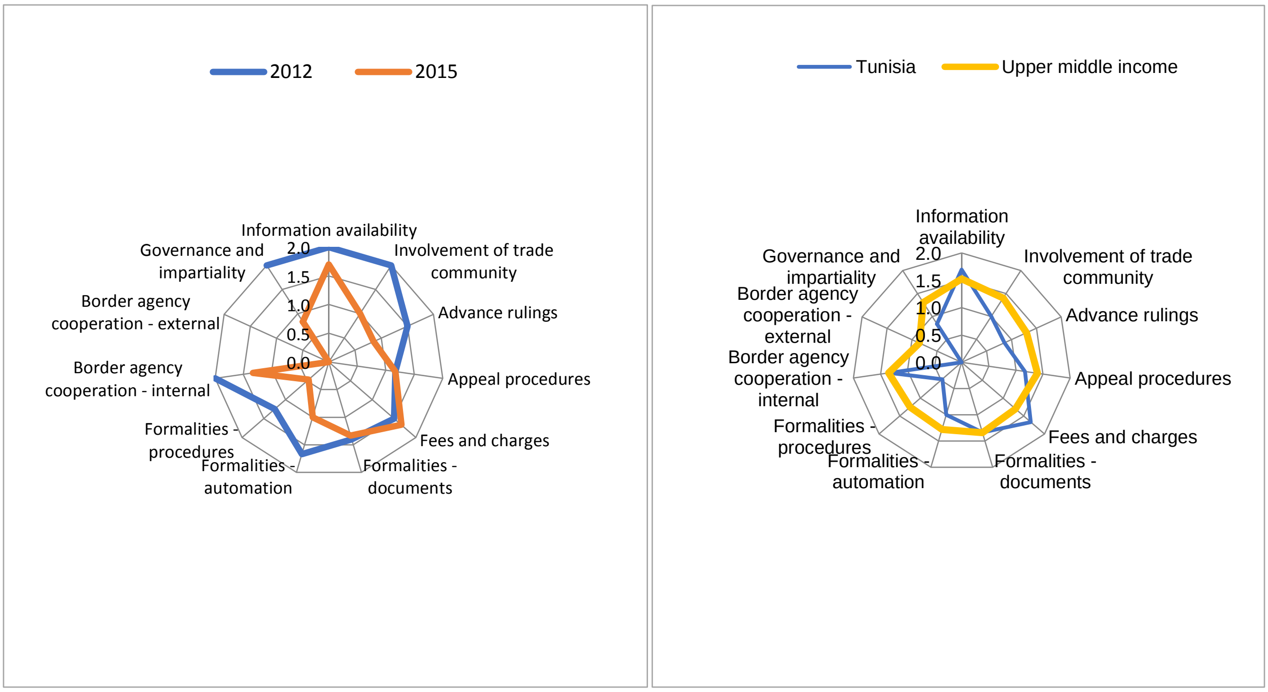
Figure 29 - Doing Business: Trading across borders and Exporting and importing costs, 2016



Source: World Bank, Doing Business Report 2017.

Moreover, Tunisia's performance in the OECD Trade Facilitation indicators shows deterioration over the 2012-2015 period (see Figure 30). This decline was sharper in the dimensions concerning governance and impartiality, internal border coordination, information availability as well as involvement of the trade community. According to a 2015 ITCEQ survey, exporting companies consider custom delays (25%), custom procedures (27%) and custom cost (25%) as major constraints to their operations (ITCEQ, 2015). Corruption may be an issue: 36 % of importers and 34 % of exporters declared that officials in the customs administration asked them informal payments to expedite procedures for these operations. In addition, an inadequate valuation system and discretionary application of the customs code encouraged tax evasion through import valuation underreporting (estimated by the World Bank at about $1.2 billion dollars between 2002 and 2009 alone (Ayadi and al., 2013).

Figure 30: Tunisia's trade facilitation performance (2015)



Source: OECD Trade Facilitation Indicators

Reform efforts

Tunisia has made significant progress on simplification and automation of border procedures in 2000-2010 notably through the export development program PDE (Programme de Développement des Exportation) supported by the World Bank. Important advances were made in trade facilitation notably with the implementation of a Single Window for Trade or the SINDA customs system. The third phase of the project PDE III (2011-2016) has one component focusing on trade facilitation aiming at improving standardisation, technical control of imports and customs procedures. However, pace of implementation pace of these reforms was slow as reflected by Tunisia's poor trade facilitation performances (OECD, 2015a). Most recently tax and customs reforms (see Pillar II) are simplifying customs rates, procedures and administrative requirements.

Key priorities

Going forward, the government should focus on the following priorities:

- Implementing the **customs reform programme**, including the required documentation for export and import operations, expand the use of "paperless customs procedures", upgrade the customs information system in order to reduce human intervention in customs activities.
- Leverage the ongoing **EU-Tunisia Deep and Comprehensive Free Trade Area negotiations** to improve standards in customs and trade regulation.
- Pursue further trade facilitation reforms to improve access of local firms to foreign inputs and facilitate the penetration of global markets. In particular, focus efforts on **shortening the average time spent at the border by all firms**, notably in the country's principal ports.

b. Enhancing infrastructure, transport and logistics to improve market connectivity

Current situation

Despite a historically good infrastructure base, the quality of transport and trade related infrastructure has deteriorated over the last decade. Moreover, infrastructure is inadequate to connect both inner regions as well as neighbouring countries. The construction of highways and railroads connecting the country with Algeria and Libya has been delayed, hampering intra-Maghreb trade. This is reflected by Tunisia's sharp drop in the 54^{th} to 93^{rd}, place in the infrastructure component of the World Bank's Logistics Performance Index (LPI) over the 2012-2016 period, caused by delays in the roll-out of key infrastructure projects, as well as shortcomings in the maintenance of existing infrastructure. The maintenance of existing infrastructure has also been neglected. For instance, in the energy sector, the lack of maintenance off the existing network increased losses in the transmission and distribution of electricity, which reached 14% in 2013 - its highest level in a decade. Maritime transport, which accounts for 95 % of Tunisia's exports is regarded as the main weakness of the infrastructure system. Radès, its main port, is saturated for container traffic and its equipment and the quality of service levels are below international standards. Projects aiming at upgrading the country's maritime infrastructure (e.g. Radès expansion and new deep-sea water port in Enfidha) are still on hold.

The quality of infrastructure services is overall poor and is still dominated by large SOEs facing difficult financial situation. The efficiency of SOEs such as Tunisair (the national airline company) and Stam (stevedoring and Handling company) are declining and effecting the performance of the economy. In addition, their dominance in the infrastructure markets significantly affects private initiatives. Restructuring the governance of SOEs while opening to competition is key to improving Tunisia's trade and integration into GVCs. According to the World Bank Enterprise Survey, electricity provision is increasingly perceived as a leading constraint to firm operations in Tunisia in some regions.

According to the Tunisian logistics plan, logistics costs amount to about 20% of Tunisian GDP (compared with less than 10% in some OECD countries), whereas the contribution of logistics to GDP represents only 5%. They also represent about 16% of total costs incurred by Tunisian exporting firms compared with 11% for developed countries' firms. Increasing costs for businesses over the past decade have also become a growing concern for foreign investors in Tunisia. The poor performance of the logistic sector in Tunisia has prevented Tunisian firms from relying on professional and external logistic services: only 10% of Tunisian firms, compared to 75% for Japan, externalise logistic services. The causes for this performance are multiple:

- A deficit in logistics infrastructure (deep sea water port, modern network of logistic zones ...);
- The quality of service and administration are below international standard at port levels;
- The absence of a coherent policy, regulatory and institutional frameworks as well as limited institutional coordination;
- Low contribution of Tunisian railways to transport goods.

Reform efforts

Following the Revolution, and in the absence of development plans, the implementation of infrastructure and logistics sector reforms have experienced significant delays. Government efforts focused on short-term actions aiming at restoring the performance of key infrastructure services notably in the Radès Port and improving the efficiency of SOEs. The Tunisian government developed a National Logistics and Transport Plan for 2016-2020. The plan focuses primarily on completing the objectives of the 2007 national infrastructure plan while reducing regional disparities. The national logistics plan also provides for the building of logistics zones with developed logistics facilities and warehouses, as well as the creation of a sound legal and institutional framework for the sector. It also highlights the need for a legislative and institutional framework dedicated to the development of the logistics sector. The plan will rely extensively on private financing and expertise through PPPs.

Key priorities

In order to address emerging logistics gaps, the government should prioritise key infrastructure projects and improve the policy framework by:

- On the **infrastructure front**, investing in critical land infrastructure to improve connectivity between the coast with less developed regions as well as maritime infrastructure (e.g. Radès);
- On the **policy front**, improving the quality of transport services through the liberalisation of the sectors and the reform of SOEs, and implementing the new National Logistics Plan, including the adoption of an adequate legal framework and an adequate institutional setting to coordinate the implementation of the strategy across sectors.

D. Upgrading skills and innovation to boost firm competitiveness and productivity

A key objective of the Tunisian government, as illustrated in its 2016-2020 development plan, is to foster the competitiveness of Tunisian firms through Innovation while progressing towards a knowledge-economy. This transition will require a general upgrading of skills and a clear strategy to address skills mismatches and low levels of innovation.

a. Addressing skills mismatches in the labour force

Current situation

Tunisia has a young and increasingly better educated population. Education has traditionally been a public policy priority in Tunisia. Education spending has averaged about 6% of GDP and 20% of government expenditure over the past decades. The country recorded important success notably with regards to increasing literacy and improving access to primary and secondary education. Similarly, enrolment rate in tertiary education reached about 35% in 2014, one of the highest in the MENA region, with the number of students increasing from 96,000 in 1993/94 to 330,000 in 2012/13 with an average of 76,000 new enrolments per year over the last ten years, according to the INS. This progress notwithstanding, the quality of education is an issue as illustrated in OECD PISA results.

However, firms regard poor or inadequate human capital as an obstacle for growth. The level of workers' skills and education is perceived as a major constraint to business, ranking fourth after political instability, practices in the informal sector and access to finance in the 2013 World Bank's Enterprise Survey (2013). 32.5% of the surveyed firms perceived the availability of skills as a major constraint in Tunisia, well about the averages for the OECD (17%) and the MENA region (20.4%). Furthermore, skill shortage is a higher concern for firms that have grown quickly and for medium sized firms, thus representing an obstacle for enterprise growth.

Skill mismatches along with labour market rigidity (see Pillar I) are major constraints to private sector development. Many graduates of higher education are facing difficulties accessing the labour market with evidence suggesting that the more educated young people face the higher risk of unemployment compared to their less educated peers. For instance, in 2012, 62% of tertiary graduates were unemployed compared to an unemployment rate of 38% among 15-24 year-old with secondary and 30% among 15-24 year-old with primary education. University programmes are not always adapted to the needs of the job markets and some fields of studies are characterised by longer-term unemployment and inactivity (OECD, 2015b). Limited involvement of the private sector in the design of educational programmes make the transition of graduates to the labour market particularly difficult.

Vocational education and training (VET) has long been neglected in Tunisia. Despite significant increases in recent years, the number of students graduating from VET programmes remains very low. VET is seen as an unattractive option, given the low status of *collèges techniques* at the lower-secondary-education level and the underdevelopment of high quality options at the upper-secondary level (OECD, 2015b)**.** It has also generally weak link with employers and social partners who are not systematically involved in the development of course content. Moreover, the VET system suffers from a highly centralised, yet very fragmented governance: for instance, six ministries and seven agencies are involved in supporting entrepreneurship in the VET system which complicates the coordination with the private sector (OECD, 2014a).

Skill acquisition in Tunisian firms is also insufficient. According to the World Bank Enterprise Survey (2013), only 28.9% of the respondent firms offered formal training to workers. This level is well below the OECD average (44.6%).

Reform efforts

A Plan d'Urgence pour l'Emploi (Employment Emergency Plan) was drawn up in March 2011 based on four key priorities: (a) job creation; (b) entrepreneurship promotion; (c) protection of existing and threatened jobs; and (d) boosting youth employability. Following national consultations, the emergency plan was replaced by the *Stratégie Nationale pour l´Emploi* 2013-2017 (National Employment Strategy) in December 2012, containing six strategic objectives, including enhancing the employability of the workforce (with particular focus on smoothing school-to-work transitions and building a training system responsive to the needs of the economy). The issue of employment and VET policy also featured centrally in the *Contrat Social* [Social Contract] signed on 14 January 2013 between the government and the main social partners as well as in ongoing social dialogue.

The government adopted in 2015 a National Plan for the reform of university and scientific research (2015-2025) focusing on upgrading teaching quality to improve the employability of graduates. The plan's main measures include: (i) the establishment of a council to coordinate the work of ministries in charge of education and professional training; (ii) improving the school counselling system; (iii) the implementation of a job information system aiming at identifying the needs of enterprises and adapting the curriculum accordingly; (iv) strengthening the role of entrepreneurship structures (incubators, springboards, technoparks, etc.) in all stages of education; and (v) strengthening entrepreneurial education. The government has also tried to improve the quality of university programmes through the establishment, in September 2012, of a monitoring and control agency, the "*Instance Nationale de l'Évaluation, de l'Assurance-Qualité et de l'Accréditation*" (IEAQA).

Key priorities

Greater emphasis in skills development and education-employment links is required, including through:

- Undertaking a **comprehensive reform of education system in cooperation with the private sector** to better align the system to labour market needs through the introduction of shorter and more practical training schemes. Links between the private sector and universities, schools, and training centres in the design and monitoring of academic and training programs should be encouraged.
- Promoting the **skills development within firms** by providing tax incentives to hiring young graduates without experience and to organise in-house training programs.
- Strengthening the **capacity and role of the National Employment Agency** (*Agence Nationale de l'Emploi et du Travail Indépendant*) to address labour mismatches by focusing active labour market policies on recent graduates and other vulnerable groups.
- **Reforming the VET system** to help young people acquire the necessary skills to work in growth sectors.

b. Scaling-up innovation policy to increase productivity and value addition

Current situation

Tunisia's innovation outcomes compare favourably with regional peers but offer room for improvement. Tunisia has a decent position in terms of innovation (see Figure 31) despite some modest decline during the political transition. Tunisia dedicates more than 1% of GDP to higher education, among the highest ratios in the Arab world, and has the highest density of researchers: 1.394 in full-time equivalents in 2013, compared to a global average of 1.083 according to UNESCO (UNESCO, 2015). Expenditure on Research and Development (R&D) in Tunisia is also relatively high compared to other countries in the MENA region. In 2012, Tunisia allocated 0.68% of its GDP to R&D, according to the World Bank, compared to 0.54% for Egypt or 0,42% for Jordan (2010 figure) and 0.73% for Morocco (id.). However, these figures remain low compared to the average of upper middle income countries (1.41% of GDP) and countries such as Turkey 0.92% or Malaysia 1.13%. R&D is mostly driven by government while business expenditure on R&D represented 20% of the gross domestic expenditure in 2013 compared to 29.9% for Morocco or 56.7% for Malaysia. Regarding patent applications, Tunisia's figures (when adjusted by GDP) have been falling in recent years, compared to a marked upward trajectory in other regional peers (e.g. Morocco).

Figure 31: Ranking Global Innovation Index

Country	2013	2016
Malaysia	32	**35**
Romania	48	**48**
Turkey	68	**42**
Mexico	63	**61**
Morocco	92	**72**
Tunisia	70	**77**
Jordan	61	**82**
Egypt	108	**107**

Note: First ranked = best performer. 2013 ranking out of 142 countries - 2016 ranking out of 128 countries.
Source: Global Innovation Index.

The government developed a policy aiming at fostering innovation and investments in higher value manufacturing industries. The 2006 – 2016 Industrial Plan promoted the development of technology clusters, industrial parks and techno-poles to attract and develop high R&D intensity products and sectors, such as aerospace, computers, pharmaceuticals, scientific instruments, and electrical machinery. One key aspect of the plan was to reinforce links between universities and innovative firms.

The institutional framework of the Tunisian innovation system is complex. The design of innovation strategies involves notably the Ministry of Higher Education and Scientific Research, the Ministry of industry and the Ministry of Communication Technologies and Digital Economy. Moreover, multiple government agencies and structures are involved in the implementation and financing of research and innovation programs including the National Agency for Promoting Scientific Research (ANPR), the National Committee for the Evaluation of Research Activities (CNEARS), the National Observatory for Sciences and Technology (ONST) and the Agency in charge of Promoting Industry and Innovation (API). The level of coordination between these institutions is limited and R&D programmes and initiatives is largely driven (and financed) by the government, with few examples of public-private cooperation. Access to innovation-focused private sector finance (e.g. venture capital) is very limited.

Reform efforts

At the legislative level, the new Tunisian constitution guarantees the protection of intellectual property. The government also introduced a new legislation in May 2015 establishing the Procedures for the Registration of and Opposition to the Registration of Trademarks and Service Marks, as well as the Procedures concerning Recording in the National Register of Marks.

At the policy level, the national plan for the reform of University and scientific research (2015-2025) includes a section dedicated to promoting research and innovation. In addition to measures aiming at improving the governance and quality of research, it develops a set of actions to enable a better use of research through reinforcing the links and cooperation between universities and firms including start-ups. In addition, Tunisia has started a reform programme aiming at reinforcing its national research innovation system with support from an EU project (*Projet d'appui au système de recherche et d'innovation*). The aim of the program is to; (i) improve the governance of the National

Innovation system; (ii) energize the research community, the economic environment and interfacing; (iii) develop actions "networking" at national and international levels and strengthen the capacity of Tunisia to integrate European research programs. As part of this programme, a web-portal has been developed (www.tunisie-innovation.tn/Fr/) to provide Tunisian private sector actors and researchers and academics with information and services to promote the development and implementation of innovation projects. Finally, Tunisia joined *Horizon 2020*, the EU's main innovation and research funding programme.

Specifically in the area of the digital economy, Tunisia created in November 2014 a consultative body ("*Conseil stratégique de l'économie numérique*") charge of setting-up a national digital strategy and monitoring its implementation. It is chaired by the prime minister and includes nine representatives from the public sector including the ministry of education, technology, etc. and nine representatives from the private sector. The Council adopted in 2015 *Tunisie Digitale 2018*, a national plan aiming at fostering the use of technology and innovative firms and entrepreneurship in the IT sector. It also aims at reducing the technology divide and encouraging the advancement of the e-goverment programme.

Key priorities

For Tunisia to seize the opportunities of innovation to modernise its economy, the government should consider the following priorities:

- Further **strengthening the governance and multi-stakeholder cooperation in the innovation field**, as promoted by the Eu-Pasri program.
- Establishing **financing mechanisms for R&D support that is not exposed to government fiscal volatility**, including a potential PPP-based endowment fund or R&D-focused tax breaks.
- Promoting **training of skilled labour in technology-driven fields**. The government should support programs such as the training program developed by the Association of Firms in Technology which provides training by ICT companies for in-demand skills.
- Developing mechanisms to **encourage equity investments and angel investors to invest in early start-ups and growing innovative SMEs**. This includes developing public-private investment funds, linking start-up firms to existing early stage financing funds, promoting diaspora finance in tech-oriented start-ups, and increasing the role of FAMEX/FIDEX to cultivate access to external linkages for foreign firms.
- Strengthening **intellectual property frameworks** and providing support to firms to manage Intellectual Property issues through government institutions including FAMEX, INNORPI, and Ghazala ICT.

E. Promoting access to finance by promoting competition and efficiency in the banking sector and developing alternatives to bank finance

Current situation

The Tunisian financial sector faces significant challenges preventing it from being an engine of inclusive, private-sector-led growth. In addition to issues related to sector stability (see Pillar I), a recent study has identified access to finance as a binding constraint to economic growth in Tunisia

(IMF, 2015b). This is due to significant weaknesses concerning the depth, access and efficiency of the country's financial sector, as follows:

- ***Small size and limited diversification.*** Financial intermediation in Tunisia remains underdeveloped. Private sector credit has remained more or less steady at a low level (79.6% of GDP in 2015 – see **Indicator 19**) relative to benchmark countries (e.g. Malaysia, OECD). Bank finance represents over 80% of assets, as capital markets and other alternative sources of finance (e.g. leasing) remain underdeveloped despite steady growth in recent years. The banking sector itself is relatively small: its total assets are equivalent to about 100% of GDP, a low level compared with Egypt, Jordan and Morocco.
- ***Weak competition.*** As of end-2015, the Tunisian domestic banking sector comprised 22 banks, 9 leasing companies, 3 factoring companies, 2 investment banks and 7 offshore banks. Bank concentration is not very high, with the three largest banks holding about 35% of assets. Yet, evidence suggests that competitive pressure is low. A recent analysis of competition indicators (e.g. H-Statistic) shows that Tunisian banks compete less intensely with one another than their Moroccan or Egyptian peers (World Bank, 2014d).
- ***Limited efficiency.*** In spite of limited competitive pressure, Tunisian banks do not post significant profits. Net interest margins by banks have remained comparatively low at about 3% for the last five years and profitability has deteriorated since the Revolution (average return on assets was 0.9% in 2014, below benchmarking countries, such as Turkey, Jordan or Morocco). Overhead costs are also high compared to other ACTs partly as a result of the atomised market structure but also due to significant inefficiencies amongst the largest state-owned banks (World Bank 2014). This performance, and in particular, the absence of adequate risk assessment and management mechanisms has also translated into a poor quality of the lending portfolio and significant levels of NPLs (see analysis under Pillar I).
- ***Low levels of financial inclusion.*** Only about 27% of adults have an account at a financial institution, compared with 39% in Morocco. Inclusion levels vary widely and interior regions remain underserved by financial institutions. For instance, coastal regions account for 86% of the country's 1 620 bank branches. The microfinance sector, which plays a fundamental role to promote inclusion amongst small firms and individuals in other countries, offers a limited range of products (e.g. micro-insurance and micro-savings are not yet commercialised in Tunisia) and has a coverage well short of its potential. Its approximately 300 000 active borrowers contrast with an estimated potential market of 2.5-3.5 million individuals (30-40% of the adult population) and 245,000-425,000 micro and small enterprises (World Bank 2015).

The above weaknesses constitute a major brake for economic growth and an obstacle for private sector and SME development in Tunisia. While lending rates are not high by comparative standards and Tunisian companies report having more loans than their MENA peers in firm-level surveys (see Figure 33), access to credit continues to be perceived as a major business barrier. In a 2014 enterprise-level survey, 27% and 40% of firms cited the availability and cost of finance, respectively, as major constraints to their operation, making access to finance the third most significant constraint after political instability and insecurity (IACE, 2015). Breakdown figures show that these perceptions are particularly prevalent amongst onshore companies and SMEs, particularly medium-sized firms.

From the perspective of lenders, SMEs represent only 15% of total loans granted by commercial banks, compared to 22% in OECD countries (OECD et al. 2014).

Despite progress since 2011, financial infrastructure in Tunisia lags behind that of other ACTs or benchmarking countries. While the CBT's credit registry covers 30% of adults in Tunisia (a relatively high figure compared with benchmarking countries), there are no credit bureaus operating in the country and the legal framework for secured lending presents significant gaps. Further, Tunisia has no unified collateral registry at present and collateral enforcement is notoriously slow and costly. As a result, the country's rank in the 2016 World Bank Doing Business "Getting Credit" indicator (126th) falls below that of Egypt (79th) and Morocco (109th) but is higher than Jordan's (185th). Likewise, until very recently, the insolvency framework presented major gaps with international best practices, with an average recovery rate of just 52 cents on the dollar, compared with over 72 cents in OECD countries. As a result of these weaknesses, banks are unable to properly price risk, in particular regarding SMEs, and resort instead to collateral. Firm level surveys suggest that, while access to bank lending in Tunisia is relatively high, such lending relies on collateral to a significant larger extend than in other countries. Indeed, Tunisia has the most stringent collateral requirements in the MENA region (see Figure 34).

Figure 33: Access to loans

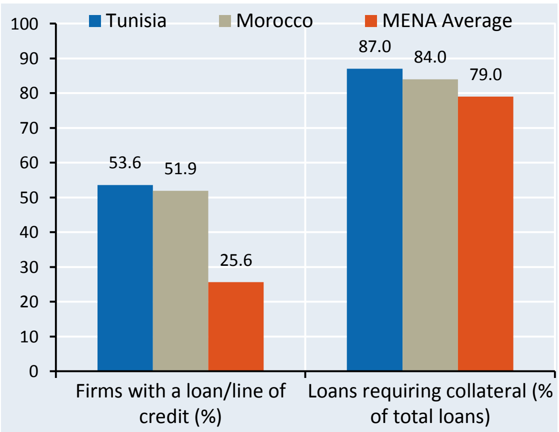
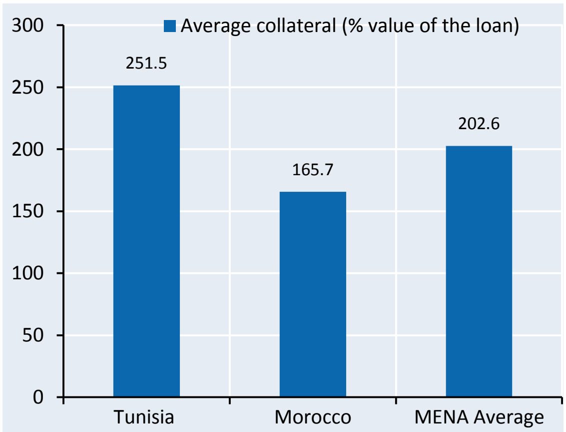


Figure 34: Access to collateral requirements



Source: 2013 World Bank Enterprise Survey.

Ongoing reforms and key priorities

Following the Revolution, much of the government efforts were directed towards addressing existing fragilities and strengthening the soundness of the Tunisian banking sector (see analysis under Pillar I), which is a precondition for improving access to finance. The authorities' focus has expanded in recent years and **an ambitious and comprehensive reform agenda for the whole financial sector has been included under the first pillar of the government´s National Programme of Major Reforms** (*Programme Nationale des Réformes Majeures 2016-2020*). A steering committee to drive the reform process was created in April 2016 under the chairmanship of the Minister of Finance.

In addition to the reforms identified under Pilar I aiming at restoring the soundness of the banking sector, the Tunisian authorities should design and implement additional initiatives to modernise and diversity financial markets as well as to promote access to financial services, in particular by SMEs. Key recommendations include:

Develop a strategic approach to financial inclusion. The government plans to develop a national strategy on financial inclusion. This strategy should be preceded by a detailed market study analysing the unmet financing needs of Tunisian firms and individuals and be accompanied by concrete initiatives to boost financial inclusion in Tunisia, such as the current plans to leverage the Postal Service's vast network in the country and current deposit-taking operations (which account for 24% of the market) to create a full-fledged postal bank. Another potential measure to increase inclusion could be to link the planned unique identification number for social protection programmes to the opening of a bank account.

Promote efficiency and competition in the banking sector, including by removing interest rate caps. At present, Tunisian banks cannot charge lending rates that are considered "excessive." These maximum rates do not take into consideration tenure, loan size or type of borrower. As a result, riskier but viable projects by some customers (in particular SMEs) may simply be turned down, particularly when the borrower does not have collateral. Banks are therefore unable to adequately price risks arising from specific borrowers or different maturities. The authorities have plans to increase these rate ceilings in the course of 2016 and, later on, introduce some flexibility to adjust the rates depending on the borrower type (e.g. large enterprises, SMEs, individuals). These measures should be pursued further and, over time, lead to the elimination of interest rate caps altogether. Finally, bank competition can also be promoted through vigorous enforcement of antitrust and consumer protection laws in the banking sector.

Further develop financial infrastructure. The full implementation of the new insolvency legislation requires the adoption of implementing decrees or complementary regulations (e.g. on the framework for insolvency practitioners). Likewise, Tunisia will greatly benefit from the adoption of a legal framework for private credit bureaus, which could complement the existing credit registry at the CBT (currently covering almost 29% of individuals and firms). Draft legislation is already in Parliament.

Enhance SME finance, in particular in lagging regions. Regarding the supply side, the government plans to merge different financing schemes (including *the Banque de financement des PMEs*, BFPME) into a "Bank of the Regions" with the objective of improving the effectiveness of financial support and the targeting of beneficiaries to focus in particular on providing much-needed long-term finance to projects in interior regions. Likewise, SOTUGAR's existing partial credit guarantee scheme could be made more effective (e.g. improving risk management and developing differentiated products for different types of SMEs) and scaled up either independently or as part of the new entity. These initiatives should be designed to complement (and not crowd out) the offer of commercial banks. Venture-capital is also underdeveloped (representing approximately 0.3% of GDP), victim of a limited product range and investor base (most *Sociétés d'investissement de capital à risque*, SICARs, are controlled by banks) as well as by legal restrictions on the types of entities that can receive financing from SICARs. A reform of the sector is therefore needed to increase its role financing innovation and start-ups. The government could contemplate a PPP approach to encourage the development of a VC fund in the country. Finally, it is also important to address demand-side issues. Existing SME support programmes could therefore focus on strengthening SME financial literacy and building the capacity of firms concerning the main bottlenecks for access to loans (e.g. accounting and auditing).

Exploit the potential of the microfinance sector. While a new law was adopted in 2011, the microfinance sector has grown without a clear vision and still presents significant weaknesses, including lack of product diversification, governance shortcomings, and weak risk management, resulting in increasing levels of NPLs since 2012. Legal changes since 2011 have created some uncertainty and the restructuring of the 289 small microcredit associations registered in the country is still pending. Decisive action is therefore needed to restructure the sector, upgrade regulatory standards regarding transparency, customer protection, risk management, and prudential norms.

Deepening capital markets as an alternative to debt finance. Capital markets remain underdeveloped in Tunisia. Stock market capitalisation over GDP has progressed very slowly from 18.8% in 2013 to 22.1% as of March 2016, well below comparator countries (e.g. Morocco at 45.8% in 2015). The Tunis Stock Exchange posted only two new listings in 2015 (compared with 6 in 2014 and 12 in 2013). Market participants are also not representative of the structure of the economy, with financial institutions holding a very prominent role. The adoption of a national medium-term debt strategy, which increases the transparency and periodicity of debt issuances, will be instrumental in encouraging the development of capital markets as a sovereign yield curve would provide a benchmark for the corporate bond market. Further regulatory improvements will also be needed to facilitate the access of SMEs to the alternative market and the participation of foreign participants (at the end of 2015, foreign investors represented just 25.6% of total stock market capitalisation). Over the medium term, a full-fledged reform of the 1994 financial market law will be necessary.

Pillar IV: Involving the public and civil society and the business community in decision-making

Since 2011, Tunisia has made remarkable progress at replacing an authoritarian model with a democratic system. A thriving civil society has emerged and the government has adopted a number of measures to improve the inclusiveness of public policy making as well as policy outcomes, focusing on youth, women and other disadvantaged groups and creating institutions and mechanisms for the participation of stakeholders and the wider public in decision-making process.

This pillar of the Compact discussed policy priorities regarding youth, women and public participation in policy making.

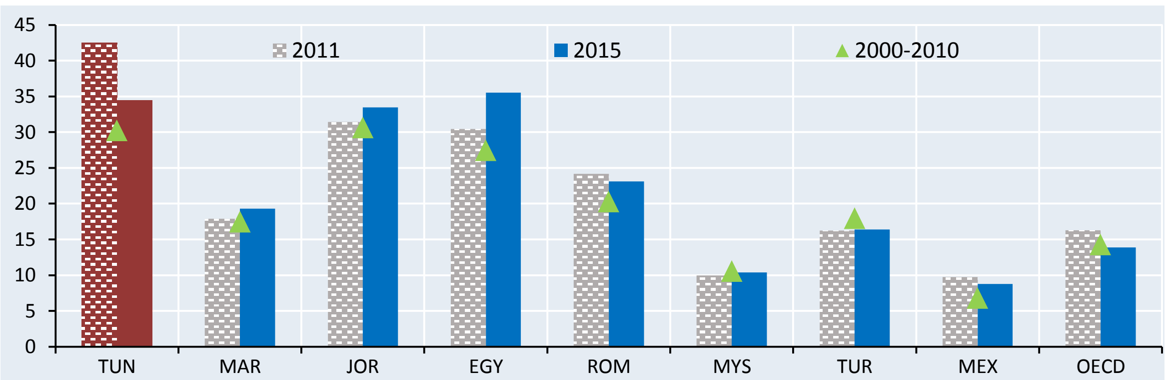
A. Fostering youth economic and political inclusion

Youth (those aged between 15 and 30) represents nearly one quarter of the Tunisian population and played a leading role in the 2011 Revolution. However, their inclusion in the post-revolution transition remains incomplete. Despite high levels of education, Tunisian youth suffers from lack of access to opportunities and voice and often feel neglected by the state. Against this background, the Tunisian government should approach youth inclusion from various economic, social, political and cultural dimensions.

Current situation

High youth unemployment is a major source of concern. Youth unemployment is a structural issue resulting from the Tunisian development policies over the last two decades, where the economy was unable to create enough jobs for a growing number of youth accessing the labour market (see Pillar I). Tunisia suffers from very high levels of youth unemployment and the negative trend has continued following the Tunisian revolution with youth (15-24) unemployment increasing from 29.4% in 2010 to close to 35% in 2015. This problem is shared with other countries in the MENA region such as Egypt (36%) and Jordan (34%) (see Figure 35), all of which are well above a world average rate of 13.5% (ILO 2014).

Figure 35: Youth unemployment rates 2010-2015



Source: ILO Key Indicators of the Labour Market database; OECD Labour Market Statistics.

Unemployed youth presents particular features. Youth unemployment in Tunisia affects certain demographics more intensely, namely: (i) youth living in the deprived Centre West and Southern regions of the country; (ii) young women (see below) and (ii) paradoxically, university-educated youth. Youth with tertiary education represented 37.1% of the total unemployment in 2015, compared to 28.6% in 2010. In addition, long-term unemployment affects youth disproportionally (36.3% of all young job seekers have been unemployed for one year or more) (OECD, 2015b). A high and growing share of youth is not in education, employment, or training (NEET). Estimated at 25% of total youth in 2010, this is well above an OECD average of 12.6% in 2012. It should also be noted that NEET varies by; (i) region (37.9% of youth in the Centre West are NEET compared to 19.3 in Greater Tunis); (ii) gender (30% of young women are NEET); and (iii) level of education (college graduates have lower NEET rates) (World Bank, 2014a).

School-to-work transitions in Tunisia are a challenge. An average job search period of two years and a half for graduates finding a job (see Table 7) and many young people never transition into employment.

Table 7: Job searching period for graduates finding a job

Duration of job hunt	< 12 months	12-29 months	30-48 months	>48 months
% of graduates finding a job	4.5%	41.8%	45.2%	8.5%

Source: IACE, 2016b

Employed youth suffer from low quality jobs. Even when youth are in employment, it is frequently in poor quality jobs. The great majority of employed young Tunisians work in low-skilled jobs in low productivity sectors: 82.5 percent youth in rural areas and 67.0 percent in urban areas work in jobs that do not require a secondary degree (World Bank, 2014). In addition, of those working with a contract, half have a temporary job. Finally, youth experience low pay and long working hours.

Entrepreneurship is not yet seen as an alternative for youth under 30. Only 4% of young people who had completed their initial studies reported this status (World Bank, 2014a). Entrepreneurship is even lower for young women, men being 2.4 times more likely than women to start a business (Belkacem and Mansouri, 2013). Entrepreneurial Activity is more common among VET graduates (7 %) than university graduates (2.5 per cent of all cases) (ILO, 2015). Access to finance remains the main obstacle to entrepreneurship for youth, lacking collaterals for getting credit (see Pillar III).

As a result, Youth turn to the informal sector. There are no official data regarding informality in Tunisia, however according to a survey conducted by the Global Fairness initiative in 2013, youth under 30 represent 37% of the informal sector's workers while other estimates suggest that one in two employed youths in Tunisia work informally (OECD, 2015b). Informal work is most prevalent in rural areas given the importance of agricultural employment and informal day-labour contracts for employment. Nonetheless, even in urban Tunisia, more than half of all working youth are employed informally (55.4 percent) (World Bank, 2014a). It is estimated that fewer than one in three young workers have a secure work contract and access to social protection (World Bank, 2014a). Job informality and exploitation are cited as the primary concern among employed youth in the qualitative research for the 2014 World Bank report.

Despite their important role in the revolution, youth political participation is limited. Evidence suggests that youth continue to shy away from participating in the post-revolution public life and continue to distrust the political system and institutions. Only 8.8 percent of rural youth and 31.1

percent of urban youth trusted the political system in 2013 (World Bank, 2014a). Very few young Tunisians are active in political parties while participating actively in demonstrations. Moreover, youth are seldom engaged in the blooming post-revolution civil society; only a small fraction of young Tunisians is active in civil society organisations (CSOs), and as little as three percent of rural youth participate in CSOs (World Bank, 2014a).

Reform efforts

Successive post-revolution governments have focused on youth unemployment. This question featured centrally in (i) in the National Emergency Plan for Employment (*Plan d'urgence pour l'emploi*) adopted in March 2011; (ii) the National employment strategy 2013-2017 (*Stratégie Nationale pour l´Emploi*) adopted in December 2012 (see Pillar I); and (III) in the Social Contract (*Contrat social*) signed in January 2013 between the government and the main social partners. Moreover, several programs and initiatives have been launched to improve youth employability, including: Forsati, *Programme d'accompagnement des promoteurs des petites entreprises, contrat emploi- solidarité, stages d'insertion à la vie professionnelle, contrat de réinsertion dans la vie active, contrat d'insertion des diplômés, etc.* Over the 2011-2015 period, 393,000 youth benefitted from various government programs according to the Tunisian Government.

The government is also encouraging young people to participate in political life. The 2014 Electoral Law tries to promote youth participation: in all electoral districts allocating four or more seats, lists should include at least one candidate under 35 to be granted full financial funding, otherwise they receive only half of the subsidy. This measure contributed to the election of 28 deputies (including 23 women) under 35 years old in the 2014 elections, representing 13% of the 217 deputies. The government is increasingly using internet and social media as part of its e-government strategy to reach-out the youth and engage them to participate in the social and political life. Moreover, the new newly nominated Prime Minister Chahed (who is 41) included 5 ministers under 35 in his cabinet. Finally, the municipal law adopted in February 2016 provided for a quota for youth and women in the electoral lists.

Key priorities

The government should develop a **comprehensive multidimensional youth inclusion policy** that focuses on building trust in institutions and reinforcing their participation in civil society while providing economic opportunities, including by:

- Promoting trust between youths and public institutions, such as local politicians, courts, police, and political parties through **communication and services friendly and adapted to youth needs**;
- **Integrating youth and youth organisations in consultations and policy making** in areas that concern them the most (e.g. labour market reform) and supporting youth-led CSOs;
- **Reforming the education system** to improve the effectiveness of vocational education and smoothen school-to-work transitions; improving job counselling services in secondary schools in partnership with the private sector and NGOs;
- Developing a **comprehensive strategy to tackle informality**;
- Strengthening **youth entrepreneurship promotion** initiatives.

B. Enhancing women empowerment

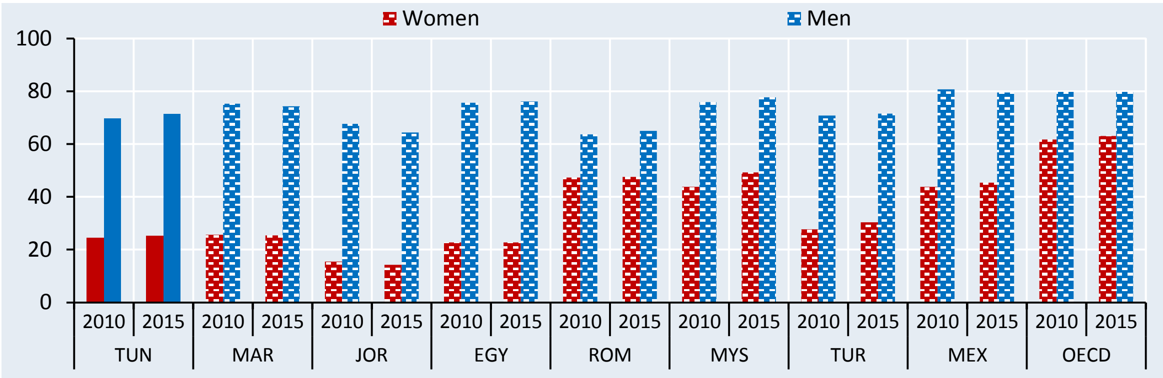
a. Increasing labour participation by women

Current situation

Despite progress in women education in Tunisia, with 60% of women with secondary or higher education, their integration in the labour market remains low. The country's legal framework does not discriminate against women in the labour market and in the workplace. However, women in Tunisia face: (i) low participation in the labour market (ii) high unemployment notably for tertiary graduates, (ii) low quality jobs, (iii) great labour market inequalities with men notably in terms of salaries, (iv) long and insecure school to-work transitions, and (v) low entrepreneurship levels.

Women levels of participation in the labour market have stagnated over the last 20 years, increasing slightly from 23% in 1995 to 25% in 2015 (compared to a participation rate of 71.3% for men in 2015). While the integration of women in the labour is slightly better than in other Arab countries, it is well below the average for OECD countries (63%) or even upper-middle income countries in 2014 (57%) (see Figure 36). This reveals a high level of marginalisation of women in the labour market representing a reservoir of untapped resources for the Tunisian economy.

Figure 36: Labour participation by gender 2010 and 2015 (% of population ages 15+)



Source: ILO Key Indicators of the Labour Market database; OECD Labour Market Statistics.

Women face very high levels of unemployment and the situation is worse for university graduates. Unemployment in Tunisia is also characterised by an important gender gap which reveals, according to the Gender Profile of Tunisia (European Union/ Tunisian Government, 2014), the existence of strong forms of discrimination against women in the labour market. This gap has widened since the revolution, with unemployment rates of 12.4% for men and 22.2% for women in 2015 compared to 10.9% and 18.9%, respectively, in 2010. Female unemployment rates remain above neighbouring countries such as Morocco (10.9%) and Jordan (19.5%) and far from Turkey (10.7%), for instance. The unemployment gender gap is even higher among tertiary graduates, for which women unemployment rates are twice men's unemployment rate (see Table 8). Moreover, half of women graduating from universities spend over a year to find their first job compared to 32% for men (Triki S., Touiti H, 2013).

Table 8: Unemployment rates among tertiary graduates per gender

	2010	1T 2016
Men	15.8%	20.3%
Women	32.9%	39.8%
Total	**23.3%**	**31%**

Source: INS

Women entrepreneurship is low. The legal framework relating to investment and entrepreneurship is not discriminatory against women. However, there are no specific rules or positive actions encouraging women's entrepreneurship either. Own-account workers and employers represented only 19.9% of active women and 27.9% of active men in 2014. Only 6.5% of the business owners affiliated with the main business association, UTICA, are female. According to the Banque de financement des PMEs (BFPME), a public development bank providing credit to SMEs, only 15% of credit applications are submitted by women, with a sectoral focus on the textile, furniture manufacturing and IT services. Women entrepreneurs suffer mostly from lack of collateral when applying for credit notably due to unequal inheritance rules and practices, the absence of measures to mitigate the impact of childcare, as well as from informal discrimination in administrative procedures (e.g. women can wait over 10 months on average to complete a business registration process, compared with just 6 months for men, (Adly, 2013). Women entrepreneurs often complain about gender bias in bank (EBRD, 2015) and are offered smaller amounts than men by micro-credit institutions.

An important gender-based salary gap exists in the private sector and limited access to high level positions. The Tunisian Constitution and the labour code guarantee, equal pay in Tunisia. However, in practice women earn less than men in the formal private sector as well as in the informal sector, where women are heavily involved. The wage gender gap in Tunisia is estimated at 28% (see Table 9). Women representation in private sector management positions is limited: over the 30 largest companies in Tunisia, only 11 have one woman or more in their board of directors.

Table 9: Non-agricultural wage and income gap between genders
Percentage of average women's wages compared with men's (2007 and 2011)

Formal sector	Public + private	71.8%
	Private	64.7%
	Public	103.0%
Informal sector	Wages	69.5%
	Income	65.0%

Source: INS, Les micro-entreprises en Tunisie, 2007 and CRES Database on wages registered at CNSS in 2011, EBRD Enhancing Women's Voice report, 2015

Reform efforts

Tunisia has implemented key legislative and institutional reforms aiming at reinforcing equality of rights and opportunities between men and women. The 2014 Constitution strengthened legal equality and opportunities between men and women and promotes gender equality in all elected bodies. In 2014, the government officially lifted key reservations to the UN Convention on the

Elimination of All Forms of Discrimination against Women (CEDAW), a key step toward realizing gender equality. Since then, the Tunisian government started to ensure that all domestic laws conform to international standards and eliminate all forms of discrimination against women.

Tunisia has established an institutional framework aiming at ensuring the equal opportunity in the labour market. The national Council for Equal Opportunities Between Women and Men (*Conseil des pairs pour l'égalité et l'équivalence des chances entre la femme et l'homme*), was established in 2016. Chaired by the Prime Minister and including public sector and civil society representatives, this consultative body aims at mainstreaming gender in budget planning, programming and evaluation as well as eliminating all forms of discrimination between women and men.

Various government programmes focus on women economic empowerment. For instance, in August 2016 the government launched the "Raida" National Plan for Women Enterpreneurship 2016-2020. The plan aims at increasing women participation in the labour market from 28.5% in 2014 to 35% in 2020. It includes two main components, one focusing on implementing regulations and measures to ensure equal opportunity and another providing operational and financial support to start-up projects.

Key priorities

In order to **achieve the ambitious objectives of the Raida National Plan**, the government should act in a coordinated way to remove the existing impediments to women entrepreneurship, introduce targeted social programmes (including greater support for childcare), and develop policy actions to eliminate discriminatory practices regarding hiring and pay (combining legal requirements with incentives).

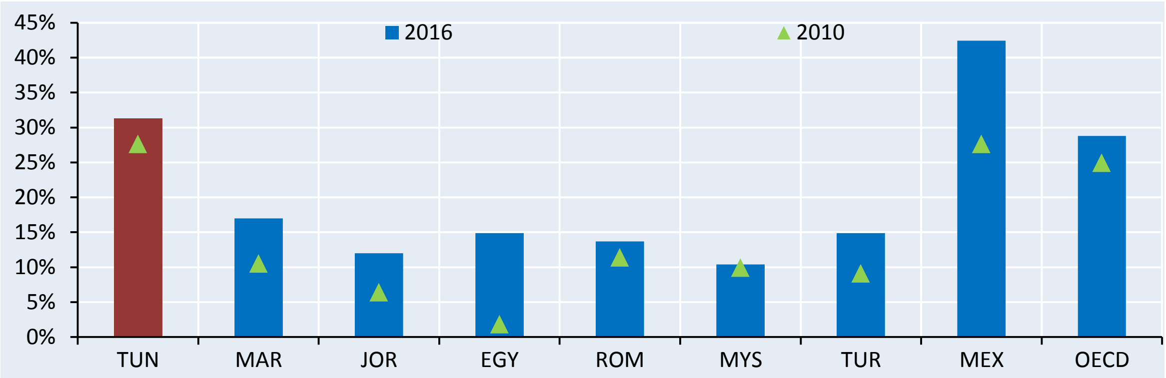
b. Women inclusion in the political and social life

Current situation and reform efforts

Since its independence, Tunisia adopted progressive social policies fostering women's inclusion in public life. The promotion of gender equality in all elected bodies is an explicit constitutional mandate since 2014. However, women's participation in government cabinets, public management positions, political parties or trade unions remains limited. Overall, women's participation in the political and social life in Tunisia, while improving rapidly, remains low compared to OECD countries.

Tunisia has made significant progress in expanding women presence in its Parliament. Even before the 2011 revolution, women presence increased over time, reaching 27.6% in the 2009 elections, the highest in the Arab world. Following the Tunisian revolution, the Tunisian transitional government passed a law mandating parties to have equal numbers of men and women on the electoral lists for the election of a Constituent Assembly in 2011. As a result, 27% of the seats in the Constituent Assembly were held by women. The electoral law for the 2014 legislative elections added a requirement for alternative positioning of male and female candidates on all major party lists. Women currently hold 31.3% of parliamentary seats, above the average of the Arab States (18.4%) and OSCE countries (25.8%) (see Figure 37).

Figure 37: Percentage of Women in National Parliaments (lower house or single house)



Source: Inter-Parliamentary Union as of March 1st 2016.

In contrast, women representation in governments and local councils is low. Women's participation in post-revolution government cabinets was also low. However, it has increased steadily from a very poor participation in the first cabinet resulting from the 2011 elections (7.3%) to 23.5% in the government formed in August 2016 (see Table 10). It is worth noting that Ms. Lamia Zbribi, appointed as part of the Chahed Cabinet, became the country's first female finance minister.

Table 10: Women Participation in post-Revolution cabinets

	Number of women Ministers/ total number of Ministers	Number of women Secretary of state/ total number of Secretary of state	% of women in Cabinet
Chahed cabinet (August 2016 - to present)	6/26	2/8	23.5%
Essid Cabinet (February 2015 - August 2016)	3/27	5/14	17.1%
Jomaa cabinet (January 2014 - February 2015)	2/21	1/7	10.7%
Larayedh Cabinet (March 2013 – January 2014)	1/24	2/6	10.0%
Jebali Cabinet (December 2011 - March 2013)	2/30	1/11	7.3%

Source: Tunisian Government

Before the Tunisian revolution, women held 27% of the seats in the municipal councils and 32% in the regional councils. Following the regime change, these councils were dissolved. Only one governorate out of twenty-four is currently headed by a woman. Pending the organisation of local elections, the Tunisian Parliament approved in June 2016 an amendment ensuring that women have greater representation in both municipal and regional elections by providing for both "horizontal" (across the country) and "vertical" (within each list) gender parity.

Women's representation in managerial positions in the public administration, or in trade unions and employer's associations remains generally limited in Tunisia. According to the "Tunisia Gender Profile" (European Union/ Tunisian Government, 2014), while women represented 37.4% of all civil servants in 2012, they only accounted for 8.9% of the members of the executive, the legislature and senior government officials; 17.4% of directors; and 10.8% of leaders and managers. As far as CSOs are concerned, a 2013 study of 700 CSOs promoting equal rights between man and women, showed that women represented 59% of the executive committees (CREDIF, 2013). The main employer association UTICA, is headed by women since 2011. In January 2017, a woman was elected for the first time to the executive board of the UGTT (Tunisia's main trade union). During the UGTT congress, various measures were announced to increase women representation in the union, including the introduction of a quota system.

Key priorities

Recent measures to promote women participation in public life in Tunisia constitute a best practice in the region. In this context, Tunisia should continue to set an example through increased participation of women in government and parliament. The country may also adopt electoral laws that guarantee parity and non-discrimination between man and women and adopt measures to promote female empowerment in political parties and CSOs, notably through training programmes for young female leaders and communication campaigns.

C. Promoting inclusive decision-making and participatory public-private dialogue

Building a solid framework for public-private dialogue and enhancing the policy advocacy role of the private sector and civil society is key to a vibrant democracy.

Current situation and reform efforts

For several decades, Tunisia has suffered from an opaque information system and a culture of secrecy. Access to information was restricted, associations were strictly controlled by government and the press was repressed. However, and despite the authoritarian nature of the old regime, Tunisia developed a strong tradition of formal tripartite negotiation processes that are conducted between the state, the workers' main trade union and the employers' main business organisation. Moreover, while the vast majority of civil society organisations were under the tight control of the regime, a handful of *historical*[13] maintained a strong position even during the Ben Ali years and played a major role in the transition process.

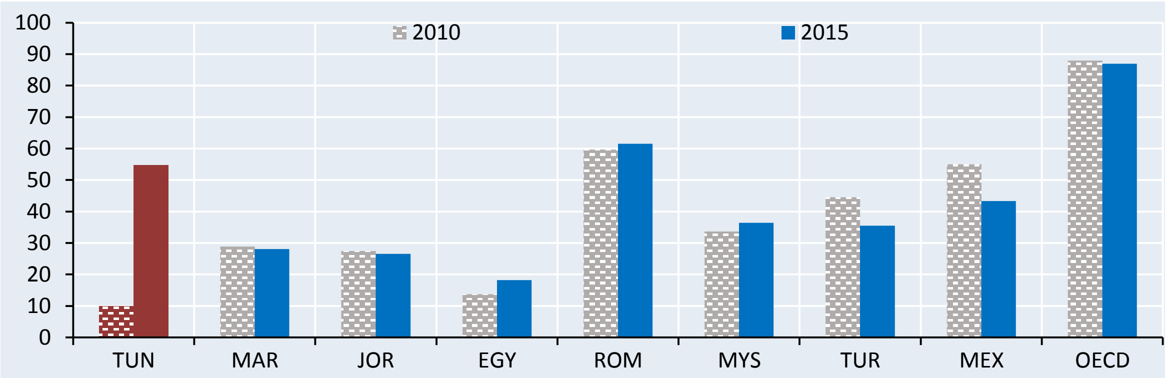
Following the Tunisian revolution, freedom of expression, access to information, voice and accountability have improved considerably (see Figure 38). Multi-stakeholder policy dialogue was reinforced and contributed positively to the success of the political transition[14]. In 2013, on the two-year anniversary of the start of the Arab Spring, government, union and employer representatives signed a key social stability pact in Tunisia, which paved the way for dialogue and consultations in various policy areas such as labour legislation and industrial relations, employment policies, vocational training and education, or social protection. However, public policy dialogue was

[13] Historical association include notably: Tunisian League for Human Right (LTDH), the Association against Torture in Tunisia (ALTT), the local chapter of Amnesty International, the National Council for Liberties in Tunisia (CNLT), feminist organizations such as TANF and AFTURD, trade unions and professional unions such as the UGTT and the Tunisian Bar Association.

[14] The quartet (the Tunisian General Labour Union, the Tunisian Confederation of Industry, Trade and Handicrafts, the Tunisian Human Rights League, the Tunisian Order of Lawyers) and were awarded the 2015 Nobel peace prize for their contribution during the transition period.

conducted mainly with *historical* and large non-governmental organisations, including the UGTT, employers' organisations the Tunisian League for Human Rights and the lawyers' and judges' association, and was unable to fully include a wider vibrant but young civil society.

Figure 38: Worldwide Governance Indicator for Voice and Accountability 2015 (0-100)



Notes: (1) Voice and Accountability reflects perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media; (2) It measures percentile rank among all countries (from 0 to 100).
Source: The Worldwide Governance Indicators (WGI).

Access to information and government accountability have been significantly increased since 2011. Freedom of expression improved drastically since the revolution. The Tunisian constitution guarantees freedoms of opinion, thought, expression, information, and publication. This progress is illustrated by the Freedom House's *Freedom in the World* index in which Tunisia's Freedom rating score progressed from 6.0 (not free) in 2010 to 2.0 (free) in 2016 (in a range from 7.0 to 1.0). Access to information is also guaranteed by the Tunisian constitution and has benefited from significant government efforts to promote open governance (see Pillar II). Key milestones include Tunisia's participation in the OpenGov since 2014 and the publication of a Citizen's Budget to provide timely and reliable budget information to the general public. Media freedom increased considerably since the Tunisian revolution. The new Constitution provides for the creation of a constitutional institution that is responsible for the audio-visual sector and that would replace the Independent High Authority for Audio-Visual Communication (HAICA). However, media still face limitations to their watchdog role. Despite progress in the Freedom House's press freedom score from 85 (not free) in 2010 to 48 in 2015, media freedom remains fragile notably due to the subsistence of some pre-2011 laws.

E-government tools have also been generalised. This is reflected in Tunisia's progress in the UN survey of e-government from the 103rd position in 2012 to the 72nd position in 2016. Overall, significant efforts have been made to improve government online communication with citizens and to improve its e-government governance. Draft laws are published online and website is dedicated to public consultations. The majority of governmental websites were improved to include friendly interfaces and useful information for citizens. Government also increased its presence on social media to connect notably with youth. At the local level, a website dedicated to providing useful information to citizens regarding the services and performances of the local authorities was has been established (www.collectiviteslocales.gov.tn).

More efforts are needed to better integrate an emerging civil society in the policy making process. The Tunisian transitional government adopted in September 2011, the Decree-Law No.2011.88 pertaining to regulation of associations, which reinforced the right to association and loosened the numerous restrictions imposed by the former regime. It notably replaced the Ministry of the Interior with the General Secretariat of the Government as the authority responsible for the creation of an association; eliminated the requirement of a licence and the waiting period; facilitated the functioning of the associations with no classification required and no limitation to the scope of action. Moreover, the criteria for membership are determined solely by the association. It also removed a number of restrictions on foreign associations and memberships. Since then, a high number of civil society organisations emerged in the public sphere. Their number almost doubled - from 9.700 in 2010 to 19.131 in August 2016 according to official government statistics. Foreign NGOs, while highly restricted during the Ben Ali regime, represent currently circa 5% of the total number of associations in Tunisia. This fragmented universe calls for greater support in the form of easier access to public finance, capacity building, and a more systematic engagement of CSOs in policy dialogue, which is currently still largely ad-hoc and limited to the design phase of public policies (as opposed to implementation and evaluation).

Key priorities

Prior to the Tunisian revolution, only few ministries and public bodies (notably the ministry of environment, agriculture or women) had experience dealing with civil society organisations. Inclusive policy making efforts will require a significant efforts and a change of culture in government organisations and public servants. The following priorities could be considered:

- Developing **structured and transparent mechanisms and platforms for public consultation and dialogue with stakeholders**, including the private sector and CSOs at all stages of the policy cycle, from design to monitoring and evaluation;
- **Strengthening the capacity of smaller and emerging CSOs** to participate in dialogue and consultations beyond the more established fora (e.g. tripartite negotiations);
- Creating the **necessary legal frameworks and funding mechanisms** to ensure autonomy for and independence of CSOs;
- Improve CSO-related statistics;
- **Reinforcing the independence of public media from the executive branch** through the development of dedicated legislation;
- **Accelerating the reform of the media sector** and revising restrictive pre-2011 regulations.

Annex I. Tunisia Compact Implementation Plan

Pillar	Short Term (1 year)	Medium to Long Term (> 1year)
I. Designing sound economic policies for an inclusive and sustainable market economy	1. Progress with **local and regional electoral process** and extend **communal coverage** 2. Improve **regional statistics and performance monitoring at the regional level** 3. Conclude a **National Employment Strategy** (NES) in partnership with social agents 4. Continue **bank restructuring programme**	1. Develop and implement a **vision and roadmap for decentralisation** 2. Address the weaknesses of Tunisian labour market institutions through the **continued implementation of the NES** (e.g. dualism, social insurance, etc.
II. Enhancing the transparency and efficiency of public institutions and processes	5. Finalise and adopt the **Public Sector Reform Strategy** 6. Continue implementing the **SOE Strategic Plan** and adopt an action plan on fiscal risks 7. Finalise the **Action Plan to implement the National Anticorruption Strategy**, including the establishment of the new *Haute Instance* 8. Complete key outstanding **legislative measures in the area of good governance** (e.g. draft laws on whistleblowing, illicit enrichment, asset disclosure and establishment of a financial judiciary branch dealing with economic offences) 9. Speed up implementation of **tax reform programme** based on the principles of the *Assises* 10. Adopt **draft Organic Budget Law** and implementing regulations	3. Implement the **Public Sector Reform Strategy** 4. Consider promulgation of a **single tax code** 5. Implement the **new international standard for automatic exchange of financial account information** and join the **BEPS Inclusive Framework** 6. Address key **remaining PFM weaknesses** (e.g. parliamentary oversight over budget, streamlining control functions, enhancing procurement complaint system) 7. Adopting **ex-ante and ex-post mechanisms to enhance regulatory quality** (e.g. RIA, ex-post evaluation systems)
III. Building an attractive environment for investment and private sector development	11. Accelerate the **implementation of the new investment framework**, including key implementing regulations (e.g. negative list) 12. Approve outstanding **implementation decrees for the Competition Law** 13. Continue implementing the **customs reform programme** 14. Adopt **national strategy on financial inclusion** 15. Improve **financial infrastructure** (outstanding bankruptcy regulations, legislation on private credit bureaus)	8. Operationalise **new investment institutional framework** 9. Improve **logistics performance** through new infrastructure projects (connectivity with interior region and ports) and liberalisation of sectors and SOE restructuring 10. Undertake **comprehensive education reform (including VET)** in cooperation with the private sector to reduce skills mismatch 11. Strengthen the **capacity and role of the ANETI** 12. Reinforcing **policy framework for innovation** (e.g. financing, governance framework, IP rights) 13. Enhance **SME finance and non-bank sources of finance**, including through reform of existing support schemes, developing VC, addressing demand-side constraints, restructuring of microfinance sector, capital market development
IV. Involving the public and civil society and the business community in decision-making	16. Develop **a multi-dimensional youth inclusion policy** 17. Implement **Raida National Plan for Women Entrepreneurship** 18. **Develop structured and transparent mechanisms and platforms for public consultation and dialogue with stakeholders** (including public-private dialogue)	14. Adopt a **comprehensive strategy to tackle informality** 15. Develop **social programmes and initiatives to boost gender equality** (e.g. childcare, voluntary equal pay incentives) 16. Reinforcing **media independence**, including through legislation

Annex II. The Compact for Economic Governance: Technical Aspects and Methodology

The Compact for Economic Governance

On 6 May 2015, Senior Officials of the Deauville Partnership unanimously adopted the **Compact on Economic Governance**. Following past action plans on topics such as open government, anti-corruption, asset recovery and SME development, the Compact provides a framework for reform efforts across Arab Countries in Transition (ACTs) aimed at promoting good governance and a sound business climate as preconditions to boost inclusive growth. G7 Leaders' welcomed the agreement on the Compact in the 2015 Schloss Elmau summit declaration as well as "the shared commitment to implement [it]" in the 2016 Ise Shima summit declaration.

The Compact was prepared by the German G7 Presidency with support from the OECD with the overall objective of identifying key policy objectives and reform priorities across four main pillars (see Figure 1).

Figure 1: Compact for Economic Governance: Overall Objectives, Pillars and Policy Areas

The Compact is designed not as a mere declaration but rather as an operational document to inform policy dialogue within the Deauville Partnership. Indeed, the Compact refers explicitly to "follow up" in the form of a "steady dialogue and consultation process", in particular through **a peer review and peer learning** mechanism supported by the OECD, the Deauville Partnership's international financial institutions (IFIs) as well as relevant coordination platforms. The Compact's priorities are to be operationalised through **country-tailored implementation plans** under which ACTs identify specific policy measures which could then be supported by G7 and partner countries through technical assistance (including under the umbrella of the MENA Transition Fund) and other supporting measures. Finally, the Compact underscores the need to measure and monitor policy effectiveness as part of these plans. To this end, both qualitative measures and internationally established indices are used to benchmark progress towards reaching policy objectives.

Overall Approach to the Country-Level Implementation of the Compact

With the support of the German Foreign Office, the OECD is assisting ACTs in the preparation and monitoring of country-tailored Implementation Plans, starting with Tunisia and Egypt as pilot countries. This support is structured as a two-step exercise:

- ***Phase 1 – Stock-taking***: The OECD supports ACTs in identifying priority areas for intervention by assessing and benchmarking the current state of play across the Compact's four pillars. This demand-driven assessment takes the form of a comprehensive **Stocktaking Report** for each ACT to be presented and discussed at a Deauville Partnership Senior Officials' Meeting. Under each of the pillars, these reports contain: (1) a *qualitative assessment of reform implementation* since 2011 (including both achievements and outstanding challenges); (2) an *indicator scoreboard* listing output and outcome indicators (with both baseline values and historic trends to allow comparison across ACTs but also improvement over time for each individual ACT); and (3) *policy recommendations* to serve as a basis for the Compact Implementation Plans through the identification and prioritisation of reforms.
- ***Phase 2 – Progress reporting:*** Building on each Stocktaking Report as a baseline assessment, the OECD will report annually on progress made by ACTs in the different dimensions of the Compact. This will be done through a brief Monitoring Report providing for each ACT: (a) a *description of achieved or ongoing reforms as well as emerging challenges*; (b) an *update on output and outcome indicators*; and, potentially, (c) a *thematic focus in one policy area covered by the Comp*act. Monitoring Reports will also be presented and discussed at Senior Officials' Meetings.

In parallel to both exercises above, ACTs will benefit from **capacity building** through the above peer-review exchanges, the involvement of government officials in the gathering and interpretation of relevant data and indexes, as well as specific capacity-building and knowledge-sharing meetings.

This Deauville Partnership tool will be complementary to, and aligned with, other instruments to support policy dialogue and reform implementation at the national level, including IMF programmes and budget support from IFIs and bilateral donors.

Stocktaking Reports: Overall Approach and Methodology

Stocktaking Reports are prepared by the OECD in consultation with each relevant ACT and in cooperation with Deauville Partnership IFIs. Drafts are circulated to each ACT for fact checking and to IFIs for comments. Draft Reports will be submitted by the OECD to the G7 Presidency for inclusion in the agenda of a Senior Officials' Meeting. A peer review discussion will then take place with the participation of other ACTs, G7 countries, as well as partner countries.

Stocktaking Reports are concise and relatively high-level. They comprise qualitative and quantitative elements.

On the *qualitative* front, the Reports identify key developments, challenges and recommendations across the four pillars. While following the structure of the Compact, each report is adapted to the specific circumstances of each ACT, as the relative importance of policy priorities and pillars varies from country to country. Given the extensive analytical work undertaken by various partners in most ACTs, Stocktaking Reports build on existing research and analysis, including reports and other materials produced by the OECD, the Deauville Partnership IFIs and bilateral development agencies from G7 and partner countries. Each report contains a list of references used in the analysis.

On the *quantitative* front, each Report contains an indicator scorecard comprising 32 indicators (see **Annex III**). The scoreboard combines macroeconomic variables, composite indices, and other indicators. Indicators have been carefully selected based on three criteria: relevance, availability, and comparability. As a result, the scoreboard includes well-established indices typically used in the evaluation of structural reforms and public policies, and which are available for all four reference ACTs (Egypt, Jordan, Morocco, and Tunisia) and updated periodically (on a yearly basis in most cases). In order to avoid comparability concerns, national statistics and other quantitative data are used in the qualitative assessment but are not part of the indicator scoreboard. Indicators cover both policy output and outcomes. In addition to values for ACTs, the scoreboard provides OECD averages and data from a set of comparator emerging economies from different regions (Malaysia, Mexico, Turkey and Romania) for benchmarking purposes. Depending on the indicator, baseline values will be 2010 or multi-year averages (e.g. 2000-2010).

The use of qualitative indicators is subject to important caveats. First, the indicator scoreboard is just part of the analysis and its results need to be analysed in combination with the qualitative assessment. Second, the Reports refrain from establishing a causal link between the implementation of specific reforms and the evolution of individual indicators. The indicator dashboard is thus used to provide an overall picture of the situation in each ACT and the evolution over time, not to measure the impact of a given reform. When available, data on the actual results of a given policy or reform are presented as part of the qualitative analysis.

Preparation of the Pilot Stocktaking Reports for Tunisia and Egypt

The preparation of the pilot Stocktaking Reports for Tunisia and Egypt took place in three stages.

First, the OECD conducted dialogue missions to Cairo (May 2016) and Tunis (June 2016) to present the proposed methodology and consult with the authorities regarding the overall approach and scope of the Stocktaking Reports.

Second, fact-finding and data collection were completed through thorough desk research as well as field missions to Tunis and Cairo, which took place in June/July and October/November 2016, respectively. Table 1, below, provides a list of stakeholders participating in this exercise.

Table 1: List of Co-ordinating institutions and stakeholders who participated in fact-finding missions

EGYPT	TUNISIA
Co-ordinating institution: Ministry of Foreign Affairs	**Co-ordinating institution:** Ministry of Development, Investment and International Co-operation
Other government stakeholders met: • Ministry of Finance • Ministry of International Co-operation • Ministry of Investment; General Authority for Investment and Free Zones • Ministry of Planning and Administrative Reform • Ministry of Industry and Trade • Ministry of Social Solidarity • Central Bank of Egypt	**Other government stakeholders met:** • Prime Minister's Office (General Authority for Public Programme Monitoring, Commission for the Monitoring of Major Reforms) • Ministry of Finance • Ministry of Public Service, Governance and Fight against Corruption • National Statistics Institute (INS) • Central Bank of Tunisia
Other stakeholders met: • World Bank • African Development Bank	**Other stakeholders met:** • International Monetary Fund • Joint development partner meeting including AfDB, EBRD, EU and G7 countries

Third, consultations with ACTs and other Stakeholders on the basis of interim drafts took place in February 2017. The reports were then presented, reviewed and discussed at a Senior Officials' Meeting of the Deauville Partnership held in Paris on 30 March 2017. The reports were then finalised after integrating the comments received from relevant ACTs and Senior Officials.

Annex III. Compact for Economic Governance Indicator Scoreboard

Number	Pillar	Indicator	Type (Outcome/ Policy)	Rationale	Source	Frequency and period of reference
1	Economic Policies for Inclusive, Sustainable Growth	**Real GDP growth (percent change)**	O	Basic macroeconomic framework (growth)	IMF World Economic Outlook databases	Annually (2000-2016)
2	Economic Policies for Inclusive, Sustainable Growth	**Inflation (percent change)**	O	Basic macroeconomic framework (price stability)	IMF World Economic Outlook databases	Annually (2000-2016)
3	Economic Policies for Inclusive, Sustainable Growth	**Labour productivity (GDP at PPP exchange rates per employed person; annual growth rate)**	O	Measuring efficiency with which inputs are used to produce goods and services; including absolute levels as well as y-o-y growth	Calculations based on ILO Key Indicators of the Labour Market database; OECD (for OECD average)	Annually (2000-2015)
4	Economic Policies for Inclusive, Sustainable Growth	**Employment-to-population ratio**	O	Basic macroeconomic framework (employment); Measuring share of employment for working age population	ILO Key Indicators of the Labour Market database; OECD (for OECD average)	Annually (2000-2015)
5	Economic Policies for Inclusive, Sustainable Growth	**Total investment/GDP**	O	Measuring gross fixed capital formation (public and private)	IMF World Economic Outlook databases	Annually (2000-2016)
6	Economic Policies for Inclusive, Sustainable Growth	**Current account balance/GDP**	O	Basic macroeconomic framework (current account)	IMF World Economic Outlook databases	Annually (2000-2016)
7	Economic Policies for Inclusive, Sustainable Growth	**General government gross debt/GDP**	O	Basic macroeconomic framework (fiscal); Measuring sustainability of government finances	IMF World Economic Outlook databases	Annually (2000-2016)
8	Economic Policies for Inclusive, Sustainable Growth	**(1) Gini coefficient and (2) poverty headcount ratio at $3.10 a day (2011 PPP) (% of population) (not available for Egypt)**	O	Measuring level of inequality in income distribution and poverty levels	World Bank World Development Indicators	Varying frequency; most recent data ranges between 2007-2012; poverty headcount data not available for Egypt

9	Economic Policies for Inclusive, Sustainable Growth	**CO_2 emissions (kg per USD 1,000 of GDP)**	O	Measuring efficiency in terms of energy consumption/environmental sustainability of growth	International Energy Agency	Annually (2000-2013)
10	Economic Policies for Inclusive, Sustainable Growth	**Exports of goods and services/GDP (for all ACTs); TiVA (for Tunisia)**	O	Measuring openness to trade; TiVA can be used in countries where it is available (at present only Tunisia) to measure value addition, participation in GVCs	OECD Trade in Value Added; World Bank World Development Indicators	Annually (2000-2015); Latest TiVA data is from 2011
11	Public Sector Transparency and Efficiency	**Tax revenue/GDP**	O	Measuring resource mobilisation efforts	World Bank World Development Indicators, OECD (for OECD average)	Annually (2000-2014)
12	Public Sector Transparency and Efficiency	**Government expenditure in (1) compensation of employees; and (2) subsidies**	O	Showing relative importance of government expenditures in key dimensions (civil service, subsidies)	IMF Governance Finance Statistics	Annually (2000-2014)
13	Public Sector Transparency and Efficiency	**Transparency International Corruption Perception Index**	O	Widely used composite index measuring corruption perceptions as a proxy for governance standards	Transparency International	Annually (2009-2016)
14	Public Sector Transparency and Efficiency	**Global Open Data Index score**	P	Composite index measuring legal and technical openness of government data	Open Knowledge Open Data Index	Annually (2013-2015)
15	Public Sector Transparency and Efficiency	**Open Budget Index**	P	Composite index measuring transparency in central government budget formulation and execution	International Budget Partnership Open Budget Index	Biennially (2006-2015)
16	Public Sector Transparency and Efficiency	**Worldwide Governance Indicators for (1) Government Effectiveness; (2) Regulatory Quality; and (3) Rule of Law**	P	Composite index measuring key aspects of governance based on various data sources (surveys, international organisations, NGOs)	World Bank's Worldwide Governance Indicators	Annually (2010-2015)
17	Investment Climate and Private Sector Development	**(1) FDI inflows; (2) FDI stocks (% of GDP)**	O	Measuring trends and relative positions regarding foreign direct investment attraction	UNCTAD database	Annually (2000-2015)

18	Investment Climate and Private Sector Development	**New business density (new limited liability firms per 1,000 working-age people)**	O	Measuring LLC incorporations based on business registry data as a proxy for overall entrepreneurial activity/business creation	World Bank's Entrepreneurship Survey database	Annually (2010-2014); not available for Egypt
19	Investment Climate and Private Sector Development	**Domestic credit to private sector/GDP**	O	Measuring depth of credit market for private sector as a proxy for financial sector development	IMF International Financial Statistics	Annually (2010-2015)
20	Investment Climate and Private Sector Development	**Financial inclusion (% of adults with an account at a financial institution)**	O	Measuring financial inclusion amongst the adult population as a proxy for overall access (no comparable data exists for SMEs)	Global Financial Inclusion (Findex) Database	Every three years (2011, 2014)
21	Investment Climate and Private Sector Development	**Resident patent applications per 100 billion USD GDP (2011 PPP)**	O	Measuring patent production relative to the size of the economy as a proxy for innovative activity	WIPO Statistics Database	Annually (2010-2014)
22	Investment Climate and Private Sector Development	**Evaluation of key transition policies: (1) large and small-scale privatisation; (2) Governance and enterprise restructuring; (3) Price liberalisation; (4) Trade & Forex exchange system; and (5) Competition Policy**	P	Measuring progress in areas for a successful transition to a market economy, as evaluated by the EBRD's Chief Economist Office	European bank for Reconstruction and Development (ERBD) Transition Indicator Database	Annually (2012-2014)
23	Investment Climate and Private Sector Development	**FDI Regulatory Restrictiveness Index**	P	Measuring statutory restrictions to FDI across sectors as a proxy for the openness of the FDI policy framework	OECD FDI Regulatory Restrictiveness Index	Annually (2010-2015)
24	Investment Climate and Private Sector Development	**Global Entrepreneurship Monitor (Average National Expert Survey scores of entrepreneurial ecosystem and total early-stage entrepreneurial activity) (only for Tunisia, Egypt, Morocco)**	P/O	Measuring (a) the strength of the overall environment for entrepreneurship (including several key variables); and (b) actual entrepreneurial activity based on survey data	Global Entrepreneurship Monitor	Every 2/3 years for National Expert Survey (2010, 2012, 2015); only 2015 for adult population survey on entrepreneurial activity; GEM data not available for Jordan

25	Investment Climate and Private Sector Development	**World Bank Doing Business Distance to Frontier**	P	Measuring performance in World Bank Doing Business dimension as a proxy for the overall business regulatory environment; distance to frontier measures absolute performance over time	World Bank DB, distance to frontier	Annually (2010-2017)
26	Investment Climate and Private Sector Development	**Average trade facilitation performance**	P	Measuring the policy framework for trade facilitation	OECD Trade Facilitation Indicators	Every 2/3 years (only 2015 data is available for ACTs)
27	Investment Climate and Private Sector Development	**Logistics Performance Index (overall score)**	P	Measuring performance in trade logistics	World Bank Logistics Performance Index	Biennially (2007-2016)
28	Inclusive Decision-Making	**Youth unemployment rate**	O	Measuring youth labour market outcomes	ILO Key Indicators of the Labour Market database; OECD (for OECD average)	Annually (2000-2015)
29	Inclusive Decision-Making	**Gender labour participation gap**	O	Measuring gender labour market outcomes	ILO Key Indicators of the Labour Market database; OECD (for OECD average)	Annually (2000-2015)
30	Inclusive Decision-Making	**Worldwide Governance Indicator for Voice and Accountability**	P	Composite index measuring strength of voice & accountability mechanisms based on various data sources (surveys, international organisations, NGOs); used to evaluate mechanisms for public participation in policy-making	World Bank's Worldwide Governance Indicators	Annually (2010-2015)
31	Inclusive Decision-Making	**Proportion of parliamentary seats held by women**	P	Proxy for women participation in policy-making	Inter-Parliamentary Union, OECD Gender Data Portal	Annually (2010-2016)
32	Inclusive Decision-Making	**Commonwealth Youth Development Index indicator for political participation**	P/O	Composite index measuring different aspects of youth political engagement, including policy inputs (policy framework) and outcomes (voter education and youth voice)	Commonwealth Youth Development Index	Every 2-3 years (2013, 2016)

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