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The Impact of Trade and Investment Policies on Productive and Decent Work

Country Report for Tunisia

Executive Summary

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Décembre 2022

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The development of exports and investment is an important pillar of Tunisia's national growth strategy. Within this perspective, the Tunisian Government has for several decades developed a set of industrial, trade and investment policies that have contributed to the gradual liberalization of its economy and to the attraction of domestic and foreign investment. These policies have been supported by the creation of several institutions to support the development of exports and investment. These efforts contributed to a surge in flows until the end of the late 2000s.

Despite this positive balance, the growth rate has not been able to resolve the structural imbalances in the Tunisian economy, illustrated by regional inequalities and persisting high unemployment rates, especially among women, youth and the highly educated, revealing its failure to ease the pressure on the labor market. These imbalances have been amplified by the succession of internal and external shocks over the past decade. The COVID19 pandemic put a strain on economic growth, which fell by 8.8%.

The population's social demands for access to decent jobs have contributed to shaping the National Employment Policies (NEPs) as articulated in the National Development Plan 2016-2020. Nevertheless, the NEP's outcomes remain invisible to this day.

The present study begins by outlining trends in trade flows, investment and employment in Tunisia, highlighting the main trends over the recent years. It then takes stock of trade, investment and employment policies and presents the various institutional mechanisms that have been implemented. Finally, this document outlines the challenges facing Tunisia and provides recommendations on trade and investment to enable the economy to generate more decent and productive jobs.

The first part of this study identifies two periods with different trends in Foreign Direct Investment (FDI), trade flows and employment. The period up to 2010 had benefited from several factors conducive to FDI growth such as economic and political stability and a thriving European economy. This growth was driven by two sectors in particular: telecommunications and energy. Exports also increased steadily from 2000 to 2008 and then fell sharply in 2009 by 17.6%, pointing out that the financial crisis first hit trade flows before impacting other economic drivers. Tunisian exports have not been able to recover from the pace of growth experienced before 2008. This growth rate remained very low, with the exception of 2010, when it reached an exceptional threshold of more than 10%. The end of this year was marked by the internal political transition, and saw a drop in investment. From 2016 onwards, there has been an improvement in FDI and exports, this time led by manufacturing industries, more particularly the mechanical and electrical industries. In 2020, the pandemic hit FDI hard with a one-third contraction between 2018 and 2020. The most affected sectors were tourism and real estate, followed by energy and manufacturing. In 2020, the contraction of the rate of exports was driven by the drop in the mechanical and electrical industries' exports (MEI), textiles and clothing, mining, phosphates and derivatives, and agro-food industries., **The structure of Tunisia's exports and FDI is very closely linked to European countries, which remain Tunisia's main investors and trading partners, followed by a few Arab countries such as Qatar, the United Arab Emirates and Libya**. Despite the strong predominance of Tunisian exports to European markets, their potential remains significant. Tunisia also has significant export potential to other markets, including the countries of the Arab Maghreb Union (AMU), sub-Saharan African countries, North America and other Arab countries (excluding the Maghreb Union countries), with a level of trade flows that remains well below the country's potential. The analysis presented in this document shows that the manufacturing sector, particularly the MEIs, presents the greatest untapped export opportunities.

On the other hand, the labor market is characterized by a low participation of women and a relatively high unemployment rate, especially among women and young people. The shock of the COVID-19 pandemic has dramatically exacerbated labor market indicators in Tunisia. The unemployment rate increased significantly during the second quarter of 2020 to reach a peak of 18% after being constant at around 15% over the previous five years. The high level of unemployment among women, young people and the highly educated has often been attributed to the high pressure on the labor market, the mismatch between the skills required by the labor market and those produced by the Tunisian education system, rigid and inefficient regulations, as well as relatively rigid institutions governing the labor market.

The weak dynamics of the Tunisian entrepreneurial fabric was also cited as one of the causes of the weak dynamics of job creation in the Tunisian economy. Indeed, the Tunisian entrepreneurial fabric is mainly composed of microenterprises (97%). The rest include Small, Medium and Large Enterprises (SMLEs). Nevertheless, SMLEs in the private sector in Tunisia cover nearly 90% of formal wage employment and about 95% of exports of goods. At the sectoral level, services occupy the first place with 52% of all the SMLEs. The manufacturing industries, which account for 38% of the total number of small and medium-sized enterprises rank second. Tunisian companies rebounded in 2013, followed by a drop in their performance in 2016. All companies, especially the smallest among them, were hard hit by the pandemic in 2020 in terms of labor productivity.

The second part sets out the institutional mechanisms and challenges that Tunisia faces. Several reforms are highlighted to strengthen the role of the private sector as the main driver of competitiveness and employment and the role of the State as a catalyst for private sector development. These recommendations are aimed at improving the business environment, facilitating access to bank finance for small and medium-sized enterprises and improving the efficiency of the credit guarantee system, encouraging innovation, research and development by acknowledging its role as an essential pillar in investment policies, developing the human capital skills needed to strengthen these sectors, consolidating competition and, finally, improving investment governance. With regard to exports, Tunisia would benefit from reducing its tariff and non-tariff barriers in order to unleash the potential of these enterprises, especially the smallest among them, and to strengthen the capacities of enterprises in terms of human capital and absorption of technology transfer. Tunisia should put in place an industrial upmarket-focused strategy.

In this regard, particular attention should be given to trade facilitation with the objective of making progress on the commitments made under the Trade Facilitation Agreement with the World Trade Organization. **This progress would have particular advantageous consequences for participation in the Global Value Chains (GVCs) and for the elimination of supply chain bottlenecks**. Tunisia also faces a double concentration of its exports, both in terms of its partners and in terms of its growth sectors. Diversification of partners and exported products, within sustainable limits, could help Tunisia reduce its vulnerabilities. Tunisian political decision-makers are already doing so, as reflected in the latest trade agreements ratified with its southern neighbors, such as the Common Market for Eastern and Southern Africa (COMESA) and the African Continental Free Trade Area (AfCFTA). However, these agreements will only bear fruit when supported with an optimal industrial and investment strategy.

Given the many opportunities on the European market, Tunisia should rather explore trade and investment agreements with its long-standing partner focusing on up marketing. These new agreements could help the country capture more added value in the GVCs while ensuring sustainability through the adoption of decent work standards, which in turn will allow the country to create more jobs that suit its educated workforce.