EXECUTIVE SUMMARY AND POLICY RECOMMENDATIONS

The Tunisian economy has long been praised for its strong "competitiveness", which in fact masked inequitable growth eventually leading to the events of January 14th

Tunisia has long been lauded as a star performer by the international community for its macroeconomic stability, economic competitiveness, and even the achievement of certain social goals. On the macroeconomic front, the country's fiscal position was stable – the public debt ratio fell significantly over the past decade and stands at around 43 per cent of GDP, on par with other emerging economies such as Argentina and Turkey. In terms of competitiveness, Tunisia had been given the highest ranking in Africa, and globally it was purported to be even more competitive than some European countries such as the Czech Republic and Spain. The 'doing business indicators' 2010 also reported Tunisia as among the top ten most improved economies in terms of changes to business regulation. Finally, the country ranked highly on a number of social fronts such as girls' educational attainment – one of the highest in the Middle East – and its broad-based social protection system. And yet, the events of January 14th revealed the structural weakness of these achievements: that economic growth was fundamentally inequitable. Opportunities to obtain good jobs, invest in dynamic sectors, and build a career have been unevenly distributed. Unemployment was high and rising, particularly among young people; regional development was unequal; and political clientelism, with the ruling Government having a commanding stake in key economic sectors, was widespread. Inequitable growth eventually led to an untenable social situation with spillover effects in other countries. Dubbed the 'Arab Spring', few had predicted such a rapid turn of events.

The purpose of this Report is, first, to provide an in-depth analysis of the contradictions that characterized inequitable growth. Second, the Report puts forward ideas for a new development model for Tunisia, based on equal economic and social opportunities, and therefore shared prosperity.

The global financial crisis had a limited impact on Tunisia…

Tunisia emerged from the global financial crisis relatively unscathed, performing better than the Middle East and North African (MENA) regional average. Economic growth slowed from 4.5 per cent in 2008 to 3.1 per cent in 2009, and by 2010 a relatively strong recovery had already begun. The unemployment rate was only moderately affected, increasing from 12.4 per cent in 2008 to 13 per cent in 2010. There were heavy employment losses in the manufacturing sector during the crisis – some 38,000 jobs disappeared between 2008 and 2009 alone – as the textiles and clothing sector contracted considerably, together with other important industries such as machinery and electronic components, but these losses were largely offset by jobs created in the public works sector, and by the reduction in working time in the service sector.

The short-lived impact of the global crisis is partly due to external factors such as the country's limited financial exposure, the rebound in exports, and stable remittances.

- Like other developing economies with weakly integrated financial markets, the Tunisian economy was buffered from the full financial impact of the crisis. Financial institutions in the country hold only a very small proportion of foreign assets (only about 8 per cent in 2009) and the export sector is mainly financed through offshore facilities.
- Exports, the main transmission mechanism of the crisis in Tunisia, experienced a strong recovery in nominal terms in 2010, growing by 1.7 per cent after falling by 24.8 per cent in 2009. The recovery was mainly owing to the mechanical and electrical industries and textiles.
- Tourism represents 13 per cent of export revenue. Although the sector was initially sharply exposed to the crisis, the downturn was short-lived. The number of tourist entrants began to flatten out in the third quarter of 2009, after dropping to a nadir of 5 per cent during the third quarter of 2008. Tunisia's image as an economical tourist destination for the European market helped to solidify its competitive position in the market during the downturn.
- In terms of remittances, although the main destination countries were experiencing an economic slowdown, migrant remittances (which represent 5 per cent of GDP) remained stable throughout the crisis.

Additionally, Tunisia entered the crisis with a relatively sound macroeconomic position. Economic growth had averaged 5 per cent per annum since 1990 and the fiscal position was relatively solid, permitting the adoption of new and on-going stimulus measures. The policy response consisted primarily of increasing and frontloading public investment projects, higher public sector wages and direct support to firms affected by the crisis (tax credits and guarantees, and a reduction in employer social security contributions for exporting firms). In total the country adopted some 43 revival measures by the end of 2008 (totalling 1.4 per cent of GDP) and there was still adequate fiscal space for additional policies.

… but revealed deeply-rooted structural imbalances…

Despite the quick recovery, the global financial crisis brought to the fore long-standing labour market concerns and inequality issues. Before the crisis, high emigration and the promise of public sector employment opportunities helped to quell labour market disparities by acting as a pressure valve on the growing labour force. However, as the downturn in Europe dragged on, employment opportunities in important destination countries, such as France, Germany, Italy, and Spain dissipated. This left a large number of unemployed, particularly university graduates, with even fewer employment opportunities.

Additionally, although there is broad social protection in Tunisia for the poor, there are few options for the unemployed to receive benefits while trying to gain a foothold in the labour market. Thus, the lack of adequate unemployment benefits and limited opportunities for entrepreneurship and self-employment left the unemployed in an untenable position, revealing the glaring inequities in the labour market.

… including dismal job creation and deteriorating job quality…

Between 2004 and 2007 (that is, even before the global crisis), there were 77,000 net new jobs created, the majority of which were low-skilled. This was far below the level needed to accommodate the labour force, which increased by nearly 190,000 and included many young university graduates entering the labour market for the first time.

Given the low-skill profile of the jobs created and their limited number, real wages have grown modestly. Between 2004 and 2007, real wages grew by a mere 2 per cent annually, which is less than the average annual productivity growth of close to 3 per cent during the same period.

Additionally, the modification of the labour code in 1996 eased hiring regulations and added to the decline in job quality by opening the door to large-scale usage of more flexible temporary contracts, with lower salaries and little or no social security. By 2001, 15 per cent of the labour force was under temporary contracts. More recent figures are available in the tourism and hotel sector where 58 per cent of employees had temporary contracts in 2008; while 68 per cent of the contracts in the textile industry were of a temporary nature, and 19 per cent were non standard. Only 13 per cent of contracts in the textile sector were defined as indefinite contracts.

… low labour force participation rates among women…

Despite improved educational attainment among women, the gender employment gap has been persistent. In 2010 the participation rate among women was 24.8 per cent, compared to 69.5 for men, owing in part to the even more difficult labour market conditions for women which discourages them from actively seeking employment. The unemployment rate for women increased from 15.3 per cent in 2007 to 18.8 per cent in 2009, as a larger proportion of women in the low-skilled export sector (80 per cent of workers in textile and clothing are women) witnessed significant job losses during the crisis.

Moreover, the increasing number of temporary contracts offering low salaries without any job security has occurred in parallel with the increase in educational attainment of women in the labour force.

… high unemployment among graduates…

As alluded to earlier, the problem of unemployment is particularly acute among young university graduates – as they are unable to find suitable employment matching their skills once they leave school. Unemployment is greatest among those with a higher education; for example, even as unemployment was declining among the non- and primary educated, it was rising for those with secondary and tertiary education. The unemployment rate for the college educated rose from 14 per cent in 2005 to close to 22 per cent in 2009, while during the same period it fell for those with no education.

The increase in unemployment among graduates is a shared issue throughout the oil-importing economies in the MENA region, as skilled job creation has lagged educational attainment. This is in contrast with developed economies where unemployment tends to decrease with increased schooling. In the United States and France, the unemployment rate among those with a tertiary education is 5 and 8 per cent respectively, while unemployment among those with less than a high school diploma is 14.6 per cent in the United States and among those with no education is 31 per cent in France.

… inequity in investment opportunities…

The Government's opaqueness in terms of investment decisions impacted adversely on both the equity and efficiency of resource allocation – the Government controlled a large portion of the investment decisions, and almost all decisions related to "strategic sectors." Consequently, private investment declined by 1.2 percentage points between 1990 and 2007 despite rising business profits and governmental policies to promote investment and support the private sector.

Additionally, the misallocation of resources created a dual economy of onshore and offshore enterprises, which also impacted on product market outcomes. As a result, private investment was, for the most part, confined to low-risk, technologically simple products. Thus, Tunisia produces goods that are mainly products at the lower end of the value chain.

…and high emigration.

Tunisia has been an important sender country since the second half of the 20^{th} century, and Europe is the main destination for Tunisian emigrants. Other MENA countries are also important destinations, particularly for low-skilled workers. Among the chief factors governing the movement of workers is the lack of decent work opportunities in Tunisia, coupled with the demand for additional workers in the destination countries. In 2010, emigrants represented 10 per cent of Tunisia's population and sent back remittances totalling some 1.9 billion US$.

Although, workers of all skill levels tend to migrate, the profile of workers has changed over the decades to represent more highly skilled workers. It is estimated that the number of qualified Tunisian workers in Europe doubled in the 1990s and this trend continues; for example, among male emigrants to France 18 per cent had tertiary education in 2007, while in 2008 this rate was 20.5 per cent. However, with the global crisis, several countries have reduced their quotas for foreign migrants (like Italy) or made the criteria for the admission more difficult (like France). With opportunities also drying up in Arab destinations such as Libya, the pressure on the labour market will grow even further.

Structural imbalances cannot be tackled solely by a broad-based social protection system

Tunisia's social protection system is rather comprehensive: not only is a majority of the working population legally covered, but social assistance programmes are also available for those who cannot profit from the insurance system established for workers. During periods of job losses or crises the system also provides financial aid, health care, and family allowances to the unemployed through its social assistance programmes.

There remain several challenges: firstly, in terms of social protection for workers, the effective rate of coverage by an insurance scheme is much lower than the legal rate, which means that many citizens receive no benefits and there are important inequalities between schemes for different groups of workers. Secondly, social assistance programmes leave out a substantial portion of the poor. This is mainly due to entitlement criteria that are too vaguely defined, preventing many families from registering. Finally, demographic pressures are straining the financial viability of the country's pension scheme, which is already in deficit.

Furthermore, in spite of the country's high unemployment rates, unemployment insurance benefits do not exist. The state does provide unemployment aid, a form of social assistance, but this only covers a small proportion of unemployed people – for instance, the percentage of the unemployed receiving unemployment benefits was only 3 per cent in 2008, corresponding to only 13,000 people.

The challenge is to address the Achilles' heel of Tunisia's economy: a lack of good jobs

Addressing the labour market challenges requires a stronger emphasis on promoting job creation in the private sector, improving the mechanisms for social dialogue, and improving the coverage and efficiency of social protection. Policy responses so far have not been adequate; the policy response to the global crisis was timid and did not attempt to address structural issues in the labour market. The interim Government's recently enacted 17 Point Action Plan has gone a step further by reactivating and implementing a number of measures to improve job creation, particularly for young people, but by definition these are mainly palliative short-term measures. Policies need to be further reaching, and more importantly, a national dialogue on the institutional response to inequities in the labour market needs to take place.

First and foremost better quality jobs are needed: jobs with rights, benefits, and wages that provide workers not only with a stepping stone out of poverty, but with an opportunity to considerably improve their standard of living. As the country moves forward, there is considerable scope for new policies and institutions to attain these goals.

A way forward is possible, first by unlocking the investment potential...

Economic control by a small group tends to have a direct impact in terms of innovation and productivity, but also affects public policies regarding property rights protection and capital markets. For the new Government to spur investment, it is important to loosen the government's grip on resource allocation.

Foreign Direct Investment (FDI) can and should also play a stronger role in the development process. It is well established that FDI not only has a positive effect on economic growth in the host country, but can also improve employment creation through spillover effects on productivity, and working conditions in domestically-owned firms. Yet when there are institutional barriers in the host country (such as corruption and prohibitive bureaucratic processes), the benefits of FDI tend to be lower.

There is a need for more transparency in governance and business practices, and social dialogue must play a crucial role in this regard. The recently announced stimulus measures aimed at improving investment are steps in the right direction, but more can be done to:

- *Improve transparency and oversight:* The Multi-Donor Governance Trust Fund, financed by Norway and Switzerland, has already implemented two projects aimed at improving transparency in Tunisia. The first project will develop a network of oversight at the regional level to support public parties and facilitate the exchange of experiences and good practices; while the second is designed to improve the performance of social services and the use of public funds, as well as increase citizens' role in matters of governance.
- *Strengthen the fight against corruption:* In other African countries such as Ghana, renewed efforts against corruption have been rewarded with fairer and more efficient investment opportunities.
- *Further encourage financial market development, which is especially beneficial for small firms:* As part of the 2010 reform package, the Government created

a specialized financial institution that provides financing to SMEs. It is important to ensure that the allocation of resources is governed by efficiency criteria and not the concerns of interest groups as happened in the past. Another challenge is for the Government to further incentivize the public listing of companies in the Tunisian stock market. This can be done using tax incentives to lure companies into listing publicly, a practice that has been done in some developing and emerging economies such as Cambodia, Thailand, and Viet Nam with impressive results.

- *Relaxing the restrictions on investment:* Private investment is still largely dependent on the express authorization of the public authorities, namely in the sectors that are deemed to be "sensitive." Liberalizing investment in some of these sectors could lead to more dynamic investment activity, particularly in areas that would move Tunisia up the technological value chain.

… second, encouraging stronger job creation through well-designed national level policy…

The interim Government's emergency plan targets young graduates through additional support, while preparing them for public sector employment; however, a more dynamic private sector is needed in order to provide the necessary jobs for Tunisia's fast growing labour force. In this regard, short-term measures could be combined with longer-term industrial development strategies.

A coherent nationwide policy to strengthen the links between education, innovation and the economy is sorely lacking in Tunisia. Currently there are a plethora of small programmes to promote investment and entrepreneurship and there is ample room to unlock new areas of investment and growth, with the government as an enabler, rather than the maker of investment decisions.

There is also adequate fiscal space for the Government to engage in explicit promotion of high growth sectors. Investment needs to focus on identifying domestic sources of growth and designing policies to promote these sectors. Incentives like investment tax credits, accelerated depreciation allowances, and public-private partnerships could be used to promote investment in new growth sectors. For example, the Government of Morocco partnered with the private sector to develop sectoral strategies for new growth clusters comprising of several sectors of the economy. The Emergence Plan (2005) identified six industrial sectors with high growth potential (i.e., offshoring services, automotive, aeronautics, electronics, foodstuffs, craft industry) and stressed the development of infrastructure and training facilities in these sectors.

… third, improving the efficiency and solvency of social protection…

In spite of its strengths, Tunisia's social protection system has several weaknesses that have reduced its efficiency and coverage. These are mainly related to the governance of social assistance schemes, which do not have an objective criterion for benefit allocation. Improved transparency and better targeting are therefore essential.

The system can also be made more attractive to workers in the informal sector. Some emerging countries such as Brazil succeeded in formalizing workers by supporting formal job creators such as municipalities and SMEs. Member-based organizations such as in India and Ghana might also be an option to provide comprehensive social protection to informal workers in the least-developed regions. Although financially supported by the State, such organizations may help reduce the pressure on welfare funds and are in some cases more efficient in reaching informal workers.

Demographic changes have placed pressure on the financial solvency of social protection schemes, notably the pension system which is already in deficit. The broadening of the contribution base, by facilitating the creation of formal jobs, is thus essential.

… fourth, boosting job quality …

In addition to creating higher-skilled employment, job quality can be improved by modifying the current labour legislation. This creates the need to re-adapt the 1996 Labour Code in order to limit the abuse of such contracts and ensure decent work and greater opportunities for workers to defend their rights. Policies in this regard could focus on:

- *Promoting employment rights through robust social dialogue:* Given that previous labour market reforms have adversely impacted non-standard workers by increasing the widespread use of fixed-term contracts, future dialogue should work towards providing better employment protection for these workers, including seeking ways to promote a better transition from non-standard to standard work.

- *Improving minimum wages:* Minimum wages, which have been decreasing in real terms for the past 5 years, should be reviewed. Even though such a rise might be seen as an obstacle to competiveness, it is necessary to maintain domestic demand especially in the current context of diminishing exports. In Brazil, despite the crisis, minimum wages were increased and such an intervention contributed to the maintaining of economic activity.

- *Extending social protection:* Social protection should be extended to populations who are not effectively covered. This can be done by easing administrative procedures and contributions for the most vulnerable workers. Informal workers should, however, not be the only focus, the protection of temporary workers should also be ensured.

- *Better support to the unemployed:* A more comprehensive unemployment benefits system should be implemented. More equitable distribution of economic gains may contribute to the financing of unemployment benefits via increasing contributions. Moreover, such a venture can be made cost-effective, as was done in the Republic of Korea, which implemented the new unemployment insurance in 1995 by using existing facilities and staff to administer and initiate it in its first year.

...and finally, engaging in a new social dialogue.

Such changes can only be effectively achieved through formulating and implementing common strategies with the participation of all partners. However, social dialogue was ineffective in Tunisia during the successive authoritarian regimes; with the change in Government, and as a way forward, there is a new opportunity for social dialogue in Tunisia to reflect on structural solutions to structural problems.

First, this will require a broadening of the membership base to better reflect the working-age population. One initial step in doing this would be for the Government to change the labour code to recognize unions from all enterprises, regardless of size. Second, there should be recognition of the newly-created trade unions and resources provided to them. Third, unions need to increase their organizational competence and become truly independent (without any political interference). This will require the Government to respect the collective arrangements previously implemented.

The use of social dialogue in other economies during democratic transitions times of crisis – such as Poland and Slovakia – shows how growth can be made both equitable and sustainable.