Tunisia

Systematic Country Diagnostic

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Middle East and North Africa

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Abbreviations

AfDB	African Development Bank
ALMPs	Active Labor Market Policies
AMC	Asset Management Company
AMG	*Assistance Médicale Gratuite*
APII	Agency for the Promotion of Industry and Innovation
BoP	Balance of Payment
CBT	Central Bank of Tunisia
CEPEX	Centre for the Promotion of Exportations
CNAM	*Caisse Nationale de l'Assurance Médicale*
CNRPS	*Caisse Nationale de Retraite et de Prévoyance Sociale*
CNSS	*Caisse Nationale de Sécurité Sociale*
CPF	Country Partnership Framework
CPI	Consumer Price Index
CSOs	Civil Society Organizations
DPL	Development Policy Lending
DPR	Development Policy Review
DSA	Debt Sustainability Analysis (IMF)
ENB	*Enquête Nationale sur le Budget*
ENBC	*Enquête Nationale sur le Budget et la Consommation (des Ménages)*
EU	European Union
FDI	Foreign Direct Investments
FIPA	Foreign Investment Promotion Agency
GDP	Gross Domestic Product
GNFS	Goods Non-Factor Services
GoJ	Governance, Opportunities and Jobs
GoT	Government of Tunisia
GPs	Global Practices
HK	Human Capital
IC	Investment Climate Assessment

ICT	Information and Communication Technology
IFC	International Finance Corporation
ILO	International Labor Organization
IMF	International Monetary Fund
INS	*Institut National de la Statistique*
LFS	Labor Force Survey
MENA	Middle East and North Africa
MFI	Micro Finance Institutions
MFN	Most Favored Nation
MIGA	Multilateral Investment Guarantee Agency
MOF	Ministry of Finance
MOH	Ministry of Health
MSME	Micro, Small and Medium Enterprises
NCA	Tunisian National Constituent Assembly
NTBs	Non-Tariff Barriers
NTMs	Non-Tariff Measures
OECD	Organisation for Economic Co-operation and Development
ONTT	Office National du Tourisme Tunisien
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PMR	Product Market Regulation
PPD	Public Private Dialogue
PPP	Public Private Partnership
PSD	Private Sector Development
SBA	Stand-By Agreement
SCD	Systematic Country Diagnostic
SCET	*Société Centrale pour l'Equipement du Territoire*
SNCFT	*Société Nationale des Chemins de Fer Tunisiens*
SOB	State-Owned Banks
SOE	State-Owned Enterprises
SPS	Sanitary Phytosanitary
STEG	*Société Tunisienne de l'Electricité et du Gaz*
TFP	Total Factor Productivity
TIMSS	Trends in International Mathematics and Science Studies
TND	Tunisian dinars
U-MICs	Upper Middle Income Countries
VAT	Value-Added Tax
WBG	World Bank Group
WDI	World Development Indicators
WEF	The World Economic Forum

Executive Summary

Context

The Tunisia Systematic Country Diagnostic (SCD) seeks to identify the challenges and opportunities to achieve the twin goals of reducing poverty and boosting shared prosperity in a sustainable way. This SCD takes into account Tunisia's historical sociopolitical context and the political economy of past reforms to provide the context for the challenges and opportunities that exist today to make progress toward the twin goals. The economic policies of the two decades preceding the 2011 revolution delivered widely recognized achievements, including growth rates above the regional average, impressive progress in human development indicators and reduced poverty. However, they failed to address, and even exacerbated, the deep-rooted distortions in the economy that closed the channels—in particular, productive employment and job creation—for a more equal and inclusive society. These distortions were also grounded in a tightly controlled social and political space that favored the elite while repressing others. This development model proved to be economically and socially unsustainable. With a new constitution adopted in 2014 and a democratically-elected government established in 2015, there is today an unprecedented window of opportunity for Tunisia to embark on deep structural reforms to open the channels conducive to a more equal and inclusive society and put the country on a path of more sustainable development. The SCD identifies key opportunities to build on Tunisia's multiple strengths and economic potential to help guide future development policies. It highlights the importance of social and political stability (as well as domestic security) as prerequisites for critical reforms to be undertaken, as well as the importance of voice, transparency, and accountability in all economic and institutional spheres for those reforms to be sustainable.

An Economic "Success" Story Hindered by Social and Economic Exclusion

Tunisia's economic policies over the two decades preceding the revolution delivered widely recognized achievements. One of the first countries in the region to embark on early structural reforms that contributed to the successful economic performance since mid-1990s, Tunisia saw in parallel significant progress in social and human development indicators. In the two decades prior to 2011, the country benefitted from growth rates[1] above the regional average, sustained progress in access to primary education (today almost universal)

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[1] Real GDP grew at an average of 5 percent yearly between 1995 and 2008. Growth was mainly driven by large public investment and strong domestic demand, coupled with more dynamic exports and a sharp increase in FDI inflows. Tunisia also benefitted from an improved macroeconomic management since the 1990s, when a first wave of structural reforms started. Strengthened management of monetary and fiscal policies allowed containing the fiscal deficit (lower than 3 percent of GDP between 2000 and 2008) and inflation, safeguarding in this way most of the real purchasing power of the poor.

and health care, and a tremendous reduction in overall poverty incidence, which was halved in the decade between 2000 and 2010.[2] As of today, Tunisia remains one of the most progressive countries in MENA in terms of women rights and female emancipation.[3]

The very same policies, however, failed to generate inclusive growth in its most comprehensive sense. Economic progress was often seen as the main priority in the several development plans that followed since independence[4] while socio-political stability was frequently obtained at the price of denied civil liberties and political freedom. High economic growth and a generous and committed (especially in straining circumstances) social policy[5] were the foundations of the unwritten social contract between the state and its citizens, which promised to deliver socio-economic development and welfare**.** The gains in welfare would compensate for the lack of basic civil liberties and political freedom. The vast majority of the population was excluded from active social, political and economic engagement. The pre-revolution Tunisia was labeled "not free" by the international observers and think tanks: Freedom House reported the lack of guaranteed freedom of association and the fact that citizens' participation in the elections was purely nominal; Global Integrity ratings indicate that Tunisia was one of the most repressive regimes in the world in terms of media freedom. The lack of adequate participation, transparency, and accountability in the management of public affairs,[6] which reached its peak during the decade preceding the revolution, undermined the economy's ability to take off and bring prosperity and good jobs to all.

Economic and social exclusion eventually prevented the country from joining the path of a strengthened and sustainable economic growth. Tunisia's growth performance, although good compared to its regional peers, was substantially weaker than other upper middle-income countries, particularly from 2000 to 2010. Tunisia's economy grew at about 3.4 percent per year in real per capita terms between 1990 and 2010 and was the second fastest growing country in the MENA region since 1990. Nevertheless, other upper middle-income countries (U-MICs) on average grew at 1.5 times that speed over the last decade. Well-performing U-MICs such as China enjoyed double-digit growth over the same period. Unlike many of its peers Tunisia did not experience an economic take off during the past two decades. This diagnostic argues, based on the most recent analytical evidence available, that economic performance has been hindered by a protected regulatory environment resulting in lack of competition and large bureaucratic burden, a financial sector hampered by governance failures, labor rules that paradoxically promote job insecurity, and industrial, agricultural, and natural resources management policies that introduce distortions and deepen regional disparities.

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[2] Poverty rates (based on a national poverty line estimated at 1,077 dinars in 2010, date of the most recent poverty survey which amount roughly to $3.42 per day (2005 PPP). Based on a $2 per day poverty line, poverty rates stand at 4.3 percent.

[3] Tunisia has been at the forefront in the Arab World in terms of legal reforms relating to women's equal status and protection under the law. In the 1990s, a series of legislative reforms accorded greater rights to women in personal status, civil status, employment opportunities and family law. Women have equal citizenship rights to men and have the right to vote and to be elected into office. They also have equal rights in marriage, divorce, custody, and ownership of property, including land, even though this right is rarely exercised in practice. Furthermore, the law protects women's personal security: violence against women is a crime and punishable by law. Finally, a 2002 amendment to the nationality law gives women married to foreign citizens the right to pass on their nationality to their children.

[4] In 1956.

[5] See box A4.1 in Annex IV.

[6] Global Financial Integrity estimated that the amount of illegal money lost from Tunisia due to corruption, bribery, kickbacks, trade mispricing, and criminal activity between 2000 and 2008 was, on average, approximately two percent of GDP per year (approximately US$1.2 billion per annum). With a population of approximately 10.6 million that means a loss of almost $110 per person per year in the unrecorded transfers of illegal capital (Global Financial Integrity 2011).

A slower pace of growth has important consequences on the ability to contain poverty and increase shared prosperity. Shared prosperity is strongly correlated with overall prosperity. This would mean that policies that are important to generate and sustain growth remain relevant and a necessary condition to achieve progress toward the twin goals. In Tunisia, despite the overall reduction in poverty rates, the probability for many households to fall into poverty remains substantial. The bottom 40 percent has one chance in four of falling into poverty. The revised poverty estimates show that in 2010 almost two million people remained in impoverished conditions, half a million of which were below the extreme poverty line. Preliminary analysis of the poverty trends[7] shows also how the gains realized in the past decade remain fragile. For instance, many households' consumption levels in 2010 remain just above the poverty threshold, making them very vulnerable to exogenous shocks, such as employment loss or hikes in the prices of essential goods.

Wide regional disparities have persisted and even increased during the past decade. Though there is less inequality in consumption expenditures within regions, the gap between regions has widened. In 2010 poverty rates ranged from a low rate of 8–9 percent in the Center East region and Grand Tunis to a high of 26 and 32 percent in the North West and Center West regions respectively. Extreme poverty has become more concentrated than before: the poorest region of the country, namely the Center-West, was in 2010 home to more than 40 percent of the extreme poor living in the country. Despite substantial progress in increasing access to basic services and infrastructure in Tunisia in the decade prior to the revolution, substantial disparities (across space and socio-economic and demographic characteristics) persist in access to, and quality of, basic infrastructure and services provided by local and central governments. The pre-revolutionary centralized governance structure stifled accountability and social equality. Despite the importance of country's cities (roughly 70 percent of the country's eleven million citizens live in towns and cities, accounting for a significant portion of country's national income), Tunisian local governments have had few responsibilities, did not have meaningful decision-making powers, and did not have a real connection with their citizens. The highly centralized oversight system of "tutelle" which subjected elected local governments to central government administrative supervision, and required central government approval for key local government mandates has sharply constrained service delivery on the ground, deterioration in municipal services and prevented the emergence of accountability and citizen participation.

Wide spatial and income disparities persist in access to basic services, such as education, transports or water and sanitation. Differential access to opportunities translates into unequal human development and labor market outcomes. Tunisia has one of the largest rural connectivity deficits in MENA: 39 percent rural access compared to a 58 percent average in MENA. Access to public transportation is much lower in the interior regions: 87 percent of households in urban Tunis live within a 15 minute walk to the nearest bus station and in the North-West and Mid-East, the proportion falls to 54 percent and 65 percent respectively. In rural areas, only 55 percent of the population has access to piped water and 52 percent to improved sanitation (compared to near universal access in urban areas) and only 55 percent of women have access to at least four prenatal visits compared to 75 percent in urban areas.[8] Access to education services is also widely unequal between (and within) regions: more than one fourth of students in the interior governorates of Sidi Bouzid, Kasserine, Kairouan, and Siliana are at more than three kilometers from the closest primary school, compared with a national average of 12 percent. Those four governorates have the worst access indicators in almost all fronts including qualification of teachers, multi-grade classes and internet access.[9] Differential access to opportunities

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[7] INS 2012.

[8] MICS 2011–12.

[9] Ministry of Education—*Indicateurs de performance du système éducatif*—March 2014.

translates into unequal human development and labor market outcomes. While aggregate human development indicators improved, progress was limited in remote regions. In rural areas: (i) children are more than twice as likely to be stunted (10 percent in rural areas versus four percent urban); (ii) fewer women get prenatal services or treatment for high-risk pregnancies; (iii) maternal mortality rates are three times higher (70 versus 20 deaths per 100,000 live births); (iv) pupils face higher levels of repetition and drop-outs (20.1 percent repetition and 12.7 percent drop-outs in Kasserine at the upper secondary level); and (v) levels of unemployment ranged in 2013 from 20–22 percent in interior regions to around 7–11 percent in coastal areas).

The Way Forward Towards a More Open, Inclusive and Prosperous Society

Significant strides toward a more open, inclusive, and transparent society have been achieved since the 2011 revolution, laying the foundations for a new social contract embodied in the new 2014 Constitution. Tunisia successfully implemented a sometimes rocky, but altogether remarkable democratic transition. Since the revolution, policies have mainly focused on the most immediate challenges (first and foremost combating security threats), while ensuring a most-needed successful democratic transition, thereby leaving many of the structural economic and social challenges unaddressed. Boosting shared prosperity will require a concerted effort to further strengthen the social contract, particularly in the area of promoting equality of opportunity. In the case of Tunisia, this will mean first and foremost re-establishing trust in public institutions and ensuring active citizen participation in political and social affairs. Significant progress has been made during the 2011–2014 political transition to strengthen transparency and participation, particularly by enhancing civil and political rights as highlighted by the first free and fair elections in the country, increased freedom of press and association, easing restrictions on the operations of civil society organizations and other associations, and improving economic governance. These major advances in terms of institutional, legislative and judicial framework, and the recognition of rights which are now enshrined under the 2014 Constitution,[10] will set the stage for furthering social progress and strengthening opportunities.

Having successfully completed a historical and remarkable democratic transition, Tunisia can now embrace an unprecedented opportunity to unlock the economic and institutional reforms necessary to put the country on a faster and more inclusive development path. Tunisia, as many middle income countries, has made considerable strides in meeting the basic needs of the population (as shown in the improvement of human development indicators). However, the need to strengthen the link between growth and social progress, notably through the channel of more and higher quality employment opportunities, remains an imperative and will determine the extent to which Tunisia could embark on a more robust, sustainable, and inclusive growth path. Advances in terms of citizens' participation and agency, and improved governance in the economy and in the society at large would in fact unleash the potential for higher growth thanks to a more dynamic private sector, higher productivity and innovation and a more efficient public sector, all enhancing human and social capital. The opening of the political and social space brought by the new democratic setting offers an unprecedented opportunity to build on a participative social and economic dialogue to identify channels to strengthen the link between growth, welfare, and citizen participation. This dialogue, conducted

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[10] The new Constitution recognizes the right of access to information as a prerequisite for transparency and accountability of the government, allowing citizens to make informed choices, and safeguarding them against mismanagement and corruption. It also strives to guarantee that adequate check and balance processes are in place. Among its main achievements, the new Constitution preserves and further guarantees women's rights and equality of female and male citizens and confirming the right to conscious and limits the parliament in restricting freedoms and fundamental rights, especially through the newly created constitutional court.

by domestic stakeholders with the technical support of international partners as needed, will reinforce the design and implementation of policies to deliver higher growth and inclusion.

Substantial and timely action is now required to trigger the structural transformation of Tunisia's economy, which would ensure sustained, sustainable, and inclusive growth. Growing evidence suggests that improving access to economic opportunities and social services and tackling disparities are not only about "fairness" and building a "just society," but also about realizing a society's aspirations of economic prosperity. Progress toward increased and shared prosperity will depend on whether or not specific groups can participate in, and benefit from, economic growth. The extent of real and perceived inclusion can have significant impacts on overall sustainability. Strengthening the social pact that weaves together all Tunisians, a primary challenge of the post-transition period, will be therefore another crucial prerequisite and condition to the long-term sustainability of the desired inclusive economic model. However, while reinforcing security for citizens and businesses will continue to be a major policy focus in the medium-term, deep structural reforms, including promoting value creation and innovation, and continuing to dismantle undue economic rents and privileges, remain crucial to enabling a lasting economic recovery, and to join the path of upper MICs in other regions, which have performed much better than Tunisia over the past two decades. These reforms would need to tap on the country's underlying capabilities and realign incentives to facilitate sustained and inclusive growth. In this context, this Systematic Country Diagnostic identifies the promotion of private-sector- driven growth (and job creation) and the improvement of equality of opportunities as the two key drivers of change where it is advisable to decisive policy initiatives.

Tunisia Systematic Country Diagnostic

This Systematic Country Diagnostic identifies some key areas where opportunities that build on Tunisia's multiple strengths arise, which could help guide the future development policies of the country. The SCD is meant to support preparation of the upcoming Country Partnership Framework (CPF) 2015–2020 for Tunisia. The diagnostic has been placed in the country's historical socio-political and geographic context to better understand the political economy of past reforms and future opportunities. To seize these opportunities a (non-exhaustive) platform for reforms actions to address some of the most binding constraints to growth and inclusion is presented in this diagnostic, based on the strength and depth of their potential development impact in the medium term, but with a view also to the long term development goals of the country. The feasibility of implementation as well as the conditions in place for the sustainability of reforms are taken into account—together with the results of the technical analysis—in the identification and selection of areas where opportunities for advancement toward the goals are most compelling. The next sections summarize the main areas where the SCD sees Tunisia's strengths and opportunities, and where ongoing reforms or dialogue on reforms would sustain progress toward more inclusive growth and a new development model.

Sustain Reforms of the Business Environment to Stimulate Productive Investment and Prevent Elite Capture in the Future

Government regulations, actions and monopolies in Tunisia are distortive of market development and generate unintended barriers to competition. Contestability of markets is weak given significant barriers to entry (especially legal and administrative measures), widespread pricing policies and restrictive practices. Pervasive restrictions to the number of firms allowed to operate in the market are coupled with many legal (public) monopolies and undue regulatory constraints in network sectors, severely limiting competition. In fact, sectors in which investment faces restrictions account for over 50 percent of the Tunisian economy, whether through the Investment Incentives Code, the Competition Law or specific sectoral legislation. Many of these sectors at present remain de facto closed to competition. In addition, there are legal constraints on the sale of the stakes held by the government in publicly controlled firms in some of these sectors.[11]

The widespread lack of competition has far reaching implications for the performance of the economy. Firms in these sectors de facto benefit from rents that arise because they face limited competition. These firms remain profitable largely thanks to the protection they enjoy in the domestic market—at the expense of the consumers who are forced to buy more expensive and lower quality goods produced by the uncompetitive onshore firms—further reducing investment and productivity. The Competition Law does not in fact support competition and the weak governance of SOEs further undermines the operations of markets. Beyond the measurable direct and indirect costs that the heavy regulatory and bureaucratic burden imposes on firms, there is a significant issue related to how policies and regulations are applied today. This problem appears to be most prevalent in the administration of both customs and tax, suggesting these services require significant regulatory simplification reform (aiming to reduce the room for discretion). Discretionary implementation of customs regulations and tariff evasion results in an estimated annual revenue loss of at least US$100 million (approximately 0.15 percent of GDP). Moreover, import-monopolists (i.e. firms that are the only firms that import particular products) on average underreport in the magnitude of 131 percent relative to firms that are not.

Reforms in the business environment have great potential for growth, job creation, and ultimately inclusion. Removing the barriers to entry and competition would substantially improve the performance of the Tunisian economy and boost the ability of the most productive firms to grow and create good quality jobs, thereby contributing to the establishment of a genuine "economic democracy" where entrepreneurs access resources on the basis of the merits of their projects. This is the time where the socio-political space for this type of reform is open and therefore the opportunity to advance is the greatest. The removal of barriers to market competition would open up investment in these sectors, and should start with backbone services sectors, which were the most shielded from competition in the past, and sectors with high potential for jobs creation, notably commerce and telecommunications.

The gains from heightened competition in Tunisia would be considerable and result in faster jobs creation. There is ample empirical evidence internationally on the substantial benefits of allowing greater competition. The empirical analysis presented in the 2014 Tunisia DPR found that a five percentage point decrease in firms' profit margins (driven by greater competition) would translate into additional GDP growth of around 4.5 percent per year and approximately 50,000 new jobs per year. Since the 2011 revolution, important measures have been taken to enhance competition and promote a level playing field. For instance, a draft competition law that reinforces the role and independence of the Competition Council is under consideration and is expected to be adopted in 2015. The Council can play a key role in stimulating competitive forces to the benefit of consumers, including lifting barriers that may be preventing retail and wholesale prices from falling toward their competitive levels. Similarly, revisions of the Investment Code—whose draft is currently under review- will be crucial to re-align incentives and dramatically improve the investment climate. Key reforms are being undertaken at the sector level, for instance in telecommunications, to allow for more service

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[11] Network sectors such as gas and electricity; water mobilization, treatment, and distribution; and rail transport (infrastructure operation, passenger and freight transport) as well as other sectors such as the tobacco supply chain are legal/state monopolies. In these same sectors, regulatory barriers to international telecommunications and air transport entail de facto monopolies or oligopolies. Even segments of markets in gas, transport, and telecoms where private sector participation is feasible are closed in Tunisia compared to comparator countries.

providers to be able to enter the markets. Other important areas of reform to improve the investment climate include tax reform, the alleviation of the regulatory burden, the fight against corruption and the acceleration of public infrastructure programs, notably through the increased recourse to public-private partnerships (PPPs) in infrastructure.

An open and engaged public-private dialogue should accompany deeper regulatory reforms. However, many of the regulations and practices that create market power rents still exist and many companies continue to benefit from them. A drastic simplification of the pool of regulations hindering private sector activity with a view to reducing the room for discretion in their implementation is critical for a private sector-driven growth and ultimately inclusion. Moving forward, it will be crucial to build on a strong public-private sector dialogue on regulatory reform and develop tools to ensure that existing and new regulations are fit for the purpose and serve the public and private interests.[12]

Develop and Implement a National Financial Sector Strategy to Increase Economic Opportunities

Access to finance remains underdeveloped at both household and firms levels in Tunisia. According to Findex data,[13] fewer than five percent of adults save at a formal financial institution although 25 percent save informally and 32 percent report has access to an account at a bank or the post. The non-salaried population, despite being very large,[14] is not served by financial institutions. The reliance on informal financial services also suggests that the supply of financial services targeted to the poor is not adapted to financial needs, leaving a significant market gap. Access to finance was indicated as a major constraint by 34 percent of Tunisian firms, the second highest leaving aside concerns about political and macro uncertainty (which are exacerbated in the post-revolution transition phase)

The banking sector suffers from a severe lack of competition, despite a large number of banks. The Tunisian financial sector is small and dominated by banks, with assets equal to about 115 percent of GDP. The Tunisian banking system is characterized by limited profitability, inefficiency, low credit intermediation, and significant vulnerabilities. The absence of long term refinancing resources for banks mainly through capital markets limits long-term domestic lending and impacts credit affordability. As a result, financial deepening has been limited over the past decade and remains well below potential, the performance of the loan portfolio is very weak and increasingly poses a risk to the stability of the financial system, and progress in product

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[12] Detailed areas of opportunities where reforms are already ongoing or where conditions might be in place for their implementation are provided in Annex I.C.

[13] According to Findex 2011, about 32 percent of adults in Tunisia have access to an account (39 percent among men and 25 percent among women; and 26 percent among young adults). This level of financial inclusion is higher than regional 18 percent level (13 percent for women and 13 percent for young adults), however it is lower than the average H-MIC level of 57 percent (53 percent for women and 49 percent for young adults). The access to accounts is significantly lower among women, young adults, rural population and population with primary or less education; the access to account among these groups are 25–26 percent in Tunisia. It compares favorably to MENA benchmarks for these categories; however, in the other U-MICs these indicators are at about 50 percent or more on average. Only 16 percent of those in the bottom 40 percent of income have access to accounts, which is worse than any other groups (youth, women, rural, etc.) taken separately. The benchmark for U-MICs is 42 percent for this category, and it shows that the access to accounts for bottom 40 percent is very non-inclusive.

[14] 1/3 of non-farm employment, est. 430,000 households and including creditworthy segments (average estimated household income: 2.5*minimum wage).

innovation and quality service has generally been low. The low level of competition in the banking sector appears due to an environment fraught with weak regulatory practices, and substantial failures in the corporate governance of, in particular, state owned banks (SOBs). In addition, inadequate bankruptcy procedures enable inefficient firms to survive (instead of having to restructure or exit), therefore (and to the advantage of the less productive units) slowing down the success of productive firms and the rechanneling of resources toward more productive uses

Nonbank financial institutions could play an important role in providing credit, savings, and insurance services (among other financial services) to segments of households and firms not traditionally served by banks but development has so far been limited. The non-bank financial sector accounts for around 20 percent of financial systems assets in Tunisia. Tunisia has a small insurance sector, with 19 companies primarily focused on nonlife activities (85 percent of premiums) and annual premiums to GDP of about 2 percent. The equity and fixed-income markets are still small, with a market capitalization equal to 24 percent of GDP, lower than in regional peer countries such as Jordan (112 percent) and Morocco (76 percent). Private equity remains small and the leasing sector, accounted for 15.5 percent of private gross fixed capital formation in 2010.[15] Flaws in the institutional, legal, and regulatory framework prevent greater growth of NBFIs, instruments, and markets

Improving access to financial services for both households and firms is critical to catalyzing private sector development, improving access to essential services increasing economic opportunities for the most vulnerable.[16] Strengthening access to credit for firms, particularly those with no credit history and limited collateral (mostly MSMEs and startups), and developing alternative sources of financing, will enable resources to be channeled to the most productive projects and allow companies to expand and invest productively.[17] Some programs to improve access to finance for high value added exports have been already implemented, with support of the WBG.[18] There is indeed opening for additional support and instruments to be tested with a sector-specific focus and with a more inclusive lens (for instance focusing to address regional disparities in access to finance). To improve the efficiency of the banking system and competition within the sector, the most compelling reforms should focus on the restructuring and/or privatization of state owned banks (SOBs), strictly enforcing bank regulations, and revising procedures to deal with banks in financial difficulty.

At the household level, increasing financial inclusion (access to and usage of formal financial services such as accounts, consumer and housing finance, and insurance) is critical to support access to basic services (housing, education, etc.), spur income generation and employment as well as help manage economic shocks. Financial inclusion is also positively correlated with financial stability and greater efficiency of financial intermediation, both important pre-requisites for job creation and private sector development. Further reform and expansion of the microfinance sector should be pursued together with the development of innovative financial instruments and approaches to cater the needs for non-salaried and low-income households. The development of a national financial sector strategy and its immediate implementation represents a clear opportunity to determine a feasible road map of actions to achieve both sector development and stability objectives.

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[15] Source: Tunisia Financial Sector Stability Assessment, International Monetary Fund, August 2012.

[16] More details on reform areas in Annex I table C2.

[17] Better performance in the banking sector could increase the level of credit to the private sector by at least 10 percent of GDP, which could generate in excess of US$10 billion in additional investments to be injected in the economy over the next 10 years, corresponding roughly to an additional 38,000 additional jobs per year (Tunisia 2014 DPR).

[18] These include the third Export Development Project and the MSME facility.

Design and Implement Policies to Stimulate Growth and Job Creation in Sectors Where Tunisia Holds a Strategic Advantage

In an effort to modernize past industrial policies, a new type of sector-focused strategic development policy coupled with reforms to incentivize formal employment would support the structural transformation of the economy and advance progress toward a more inclusive growth.[19] The government can play an active role in the development of high potential sectors through enabling the investment climate by correcting sector-specific regulatory and coordination failures. Policies to improve the overall business environment could be complemented with targeted interventions aiming to create jobs in specific sector and regions. Indeed, as discussed in this diagnostic, higher investments alone do not necessarily guarantee that the economy will create the jobs needed to improve the opportunities and standards of living of all Tunisians. It is important, therefore, that the government, in close consultation with concerned stakeholders (private sector, labor organizations) also identifies sectoral policies geared to stimulate investment and employment. This implies mapping key sub-sectors and value chains within the economy to understand the potential for job creation and the types of bottlenecks and regulatory failures that would need to be removed to achieve it. This mapping would provide information about the types and level of investments that are necessary, the quantity of jobs that can be created, their composition in terms of skills, and their regional distribution.

These policies will need to be accompanied by reforms to remove "horizontal" constraints to employability. Strengthening the quality and availability of skills for the private sectors would address a key constraint for the private sector and contribute to increase competitiveness of Tunisian firms. Lack of adequate skills is considered a leading constraint[20] for firms in the private sector and should be taken into consideration in the mapping of strategic sectors and, more widely in any comprehensive jobs strategy. In addition to the quality of education, the relevance of graduates' skills is crucial for employability. At present, a serious skills mismatch, together with low quality of educational outcomes, prevents a full utilization of the human capital. The skills and competencies acquired by graduates do not seem aligned with those in demand by the private sector. For instance, about 63 percent of all students enrolled in tertiary education institutions in the academic year 2010/11 were in the fields of humanities and social sciences. Such skills, however, are not very attractive in sectors where employment demand for graduates is highest, such as health, ICT, agro/industrial, financial services and telecommunications. Strengthening the quality and relevance of education at all levels—a medium to long term agenda but that can be tackled also in the short term with appropriate and targeted programs—will alleviate a key binding constraint highlighted by the private sector, and significantly increase competitiveness.

Reforms to consolidate social insurance regimes and align labor regulations will also incentivize formal employment and better protect living standards. In terms of social insurance, greater harmonization among private and public sector regimes, improving portability, enhancing the governance and management of social security schemes, and aligning financing with benefits more explicitly will help to improve incentives for job creation, sustainability, and coverage. In terms of labor regulations, curbing the growth of labor costs,[21] while improving income protection and services to workers would go hand in hand with social insurance reforms. Employment protection legislation plays a critical role in shielding workers from the negative consequences

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[19] Industrial policies pursued will have to change their nature that has so far not targeted market failure and have favored firms, rather than sectors.

[20] Investment Climate Assessment for Tunisia (2012).

[21] Reducing the tax-wedge, rationalizing redistributive arrangements, reforming dismissal procedures, and reducing discretion in the setting of the minimum wage.

of arbitrary actions by employers, and facilitates industrial stability along with the build-up of firm-specific human capital and innovation. When employment protection and contracting is too rigid, however, firms' ability to respond quickly to changes in technology or market demand in terms of hiring or retraining is hampered. Moving forward, it is important to accompany the targeted investment policies with the flexibility of employment policies, as well as better targeted Active Labor Market Policies (ALMPs), that are crucial for efficient job reallocation, greater job creation, and economic growth. Strengthening inclusive social dialogue will help support the development of an integrated social protection and labor system needed to achieve the right balance between flexibility and security.

Use the Social Dialogue to Catalyze the Adoption and Implementation of More Effective Social Assistance Policies and That Will Improve the Equity and Efficiency of Social Assistance Programs

More rational targeting of universal price subsidies and social safety nets will improve equity and fiscal space needed to jump-start graduation programs to productive livelihoods. Strengthening Tunisia's social safety net system is a necessary complement to pro-growth reforms in order to effectively protect the poor and vulnerable from unforeseen shocks, and maintain purchasing power and living standards. As is the case in other countries of the region, the current excessive outlay on untargeted subsidies fails to reach the poorest and paradoxically largely benefits the better off, thus exacerbating inequality. Existing cash transfer and health cards programs, which benefit some of the poor, can be better targeted by further developing the recently conceived unique identification system for all social protection and labor programs and introducing exit strategies to ensure equitable access and transition to work for the able-bodied. Combined with the fiscal deficits facing the social security system (pensions and health insurance), inadequate coverage and sustainability of social protection programs highlight the need for comprehensive reform beginning in the near term. The new "Social Contract" signed between the Government and social partners in 2013 shows the commitment of the Government to developing the policy dialogue on important reforms such as labor regulations, social security reform, subsidy reform, social assistance reform, reform of employment programs, and investment policies targeting lagging regions. Further steps in this direction (as already demonstrated by the progress on the social protection reforms with the development of a unified social registry and a unique identification system with a link to the national identification card) are needed, and are likely to have a significant impact on growth and inclusion.

Decentralization as a Gateway to Increase and Equalize Opportunities

Inclusive growth can be promoted by policies aimed to at addressing spatial inequalities in access to and quality of basic services, access to good infrastructure, and more generally targeting institutional failures that generate unequal "opportunities." This diagnostic argues that equal opportunities are a crucial part of the "shared prosperity" goal**.** Increasing parity of access to quality basic services (notably water, health, education and municipal services) in lagging areas will improve people's employment opportunities, their quality of life, and ultimately contribute to long-term economic growth. Improving the governance, institutional, and regulatory framework to allow both more accountable and efficient services would incentivize investment and allow more viable service provision, hence reducing enduring inequality in access and quality across regions.

The government commitment to decentralization could improve provision of services at the local level. Despite capital investments in the pre-revolutionary period to support basic infrastructure delivery, municipal service delivery has been deteriorating in most cities, particularly in lagging regions with significant impacts on quality of life, urban environment, public health, as well as on key economic activities such as tourism. Both a recent cross-sectoral scorecard undertaken on public services and a pilot municipal opinion survey undertaken in Tunisia showed widespread dissatisfaction with service delivery by municipalities and exceptionally limited engagement of citizens with their municipality. Appropriately, the new Constitution includes clear commitments to decentralization, local governance, and empowered local entities as a response to these. The provisions of the new Constitution create the framework for fully devolved and empowered local government with autonomy for executing their mandates of providing local services according to transparent principles of participation by, and accountability to, their electorate.[22] The expansion of formal authority of local governments requires reform of the intergovernmental fiscal transfer system and measures to increase the capabilities of local governments including through measurement and public dissemination of local government performance. Proper implementation of the decentralization agenda also requires the central government agencies to be restructured and transformed, to move them away from a role of control to a role of coordinator and enabler. Over time, these measures are designed to lead to better provision of services and infrastructure and improved governance in part through greater accountability of local governments to their electorate and to the central government

Sustainability of a Long Term Development Trajectory

Whether Tunisia can sustain the progress observed in previous years while moving on the path of higher and more inclusive growth depends on the extent to which attention is paid to critical socio-political, economic, and environmental issues. On all these fronts, emerging issues are overlapping with ongoing structural weaknesses and, together, could threaten the effectiveness and impact of identified reforms. There are however also new and unique opportunities to move forward and to strengthen the link between specific policies and a long-term development vision. Challenges and opportunities to maintain socio-political and economic stability are presented below.

Political and Social Stability

Tunisia has suffered from increased instability following the revolution. Restoring and maintaining security is key for sustained reforms. Besides the generalized spread of violence in everyday life (increases in burglaries, petty crimes, and assaults), there has been an upsurge in explicitly socially, politically, and religiously motivated violence. The unrest intensified during 2013 with the assassination of two prominent opposition politicians. Although slightly improved in 2014 with installment of a technocratic government and the agreement of the new constitution and ultimately with the peaceful conclusions of the elections at end 2014, the situation has suddenly deteriorated. The brutal terrorist attack in March 2015 in the Bardo area is yet another blow at an already fragile security situation. Issues of reforming the police and security services

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[22] To this end, the Constitution lays down the mandate for LGs to achieve the following: (i) financial and administrative autonomy; (ii) participatory local democracy and open election of municipal representatives; (iii) formal assignment of functions according to principles of subsidiarity; (iv) own source revenues and transparent, objective and predictable systems of inter-governmental fiscal transfers, including consideration of issues addressing equity, equalization and national policy priorities; (v) governance structures that ensure participatory governance and accountability of municipalities to electorates in decision-making and program implementation; (vi) inter-municipal cooperation in metropolitan areas and (vii) restructuring of the *tutelle* system to play an ex-post rather than an ex-ante oversight role.

will be extremely complex and delicate, and the former have occasionally gone on strike to protest efforts to sanction their members. This uncertain security, political, and policy environment has significantly impacted investor confidence in Tunisia since the revolution, affecting both domestic and foreign investments. Continued uncertainty on these fronts will undoubtedly affect the sustainability of Tunisia attracting necessary private investment into the country over the coming years.

The volatile regional environment and the difficult security situation, coupled with an economy that is still struggling to take off, might contribute to weaken the initial support of the Tunisia population for democracy. A recent poll from the Pew Center[23] highlights how today only about half of Tunisians (48 percent) believe that democracy is preferable to any other kind of government, against a vast majority (63 percent) in 2012, soon after the revolution. About a quarter of the respondents replied that in some circumstances a non-democratic form of government is preferable (26 percent) or that the type of government does not matter (24 percent).[24] According to the poll, a great part of the public's discontent is explained by the economy. Fully 88 percent describe the country's economic situation as bad, and 56 percent say it is very bad. But a majority is optimistic that the economy will turn around soon: 56 percent expect it to improve in the next year. Instability also plays an important role: when asked which is more important, having a democratic government with some risk of political instability, or a stable government with a risk it will not be fully democratic, 62 percent of Tunisians say they prefer stability. This has increased dramatically since 2012 when just 38 percent said they would prefer stability to democracy. The toned down enthusiasm and engagement is reflected in the voter turnout for the most recent—October 26, 2014—parliamentary elections, where participation was estimated at 62 percent of the 5.3 million registered voters. Contrary to some international media, which characterized participation as a success, the local feeling is that it is a disappointing turnout, as the absolute number of voters is below that of 2011. Reports suggest very weak youth participation, especially in the inland/lagging regions.

Despite waning confidence in democracy's ability to produce results, Tunisians continue to want key features of a democratic system, such as a fair judiciary, competitive elections, the right to protest, and equal rights for men and women. A strong majority—94 percent—believe that having a judicial system that treats everyone in the same way is very important for the country's future, up 13 points since last year. Similarly, 92 percent of Tunisians say having honest, regularly held elections in which people have a choice of at least two parties is very important, an increase of 21 percentage points in just a year. Law and order is a priority for most Tunisians: 81 percent believe that stability is crucial for Tunisia's future. More than six-in-ten also think that certain freedoms are critical for Tunisia's future: the freedom to peacefully protest (68 percent), equal rights for women (66 percent), freedom to criticize the government (64 percent), and an uncensored media (63 percent).

A whole new approach to transparency, media, and civil society will facilitate sustainability of reforms by facilitating citizen engagement. The post-revolutionary period has seen an unprecedented expansion of free expression. Safeguarding the progress made in protecting fundamental citizens' rights will be crucial to

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[23] The latest survey in Tunisia by the Pew Research Center is based on face-to-face interviews conducted with 1,000 respondents from April 19 to May 9, 2014. The poll results were released on October 15, 2014.

[24] Findings in Tunisia closely reflect those in Colombia and Thailand, the former in partial transition from conflict and the latter in a state of chronic political upheaval. Attitudes in transition countries often reflect the dichotomy of the public's interest in balancing stability with rights and freedoms. In periods of political turmoil citizens may be more willing to trade enhanced rights for greater stability. However, without public engagement and pressure difficult reforms are less likely to be addressed effectively. Implementation of reforms will be heavily dependent on a civil service, which in the past has lacked efficiency and effectiveness.

guarantee social stability, and a continued and informed dialogue between stakeholders and society at large will facilitate the implementation of much needed—although at times unpopular—reforms.

Macro and Fiscal Sustainability

While Tunisia has remained vulnerable to shocks, lower growth and greater external unbalances threaten macroeconomic and fiscal sustainability. For the three years since the revolution, Tunisia has been running down its policy buffers. The macroeconomic space for expansionary policies has now vanished. While public and external debt remained at an acceptable level compared to international standards, they are expected to reach unsustainable levels if reforms are not implemented.

Fiscal sustainability

Expansionary fiscal policy since the revolution resulted in growing fiscal deficit and public debt. The fiscal deficit increased from 1 percent of GDP to 6.2 percent between 2010 and 2013 and the public debt from 40.7 percent of GDP to 44.8 percent during the same period. While this increase was an acceptable range, public debt is expected to reach 56 percent of GDP by 2017 before slowly declining over the medium term, according to the baseline scenario of the most recent debt sustainability analysis.[25] This baseline scenario assumes the fiscal consolidation and growth pick up in 2015, however if fiscal consolidation reforms are not implemented, it would result in growing public debt that could reach around 62 percent of GDP by 2019, while a permanent negative growth shock would increase public debt to about 67 percent of GDP by 2019. Public debt dynamics are vulnerable to a slower adjustment path, lower growth, a marked depreciation of the exchange rates, or a shock on contingent liabilities.[26]

In addition, since the revolution, the budget has remained centered on the growing current spending rather than investment. Notably the wage bill and subsidies continued to increase until 2013, despite freezes for salaries and hiring of public servants, and a gradual increase of subsidized fuel prices. In 2013, the wage bill accounted for 12.5 percent of GDP (against 10.6 percent in 2010), and subsidies and transfers represented 7.8 percent of GDP (against 3.6 percent in 2010). Only in 2014, the was the expansionary policy put to a halt, leading the way to a medium-term fiscal consolidation, by slowing down the increase in current spending and progressively improving expenditure composition. In particular, spending on subsidies should decrease by 0.6 percent of GDP in 2014, thanks to the initial phase-out of energy subsidies. Measures have also been taken on the revenue side, including streamlining exemptions and widening the tax base. Assuming the intensification of fiscal consolidation over the medium term, the deficit is expected to gradually decline from 6.5 percent of GDP in 2014 to 3.2 percent in 2019. The fiscal consolidation will require continued action on wage bill discipline in the public sector, further phase-out of subsidies, SOE restructuring, and reforming public sector pensions system. To mitigate the social costs of reforms, a better-targeted social safety net system and a new strategy for the financing of social security should be quickly put in place.

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[25] IMF December 2014.

[26] A key segment of possible fiscal sustainability is the municipalities, accounting for about 1.2 percent of GDP compared with 15 percent in Morocco and 20 percent in Turkey. Growing this underexploited segment will be important in enhancing fiscal sustainability.

Macroeconomic sustainability

Tunisia's external position has gradually eroded in the face of the expansionary policies favoring domestic consumption, delays in structural reforms to support exports, political uncertainly, and exogenous factors. The trade balance deficit widened from 10.4 percent of GDP in 2010 to stand over 13 percent in 2014. Tourism receipts have been very volatile since the revolution, as the price competitiveness of Tunisian destinations has not offset concerns over the security situation until recently. Remittances have, on the other hand, quite steadily sustained the current account by about US$2.2 billion a year, but the overall imbalance has increased from 4.8 percent of GDP in 2010 to over 8 percent by 2014. Foreign direct investment has been negatively impacted by political uncertainty and the delays in reforms. The Central Bank has used up significant reserves since 2011, dropping from about US$9.5 billion at the end of 2010 (or 4.4 months of GNFS imports) to approximately US$7.3 billion toward the end of 2014 (or 3.1 months of GNFS imports) to support the currency first, before limiting interventions to manage an orderly depreciation. While the exchange rate depreciation should sustain exports and the decline in international energy prices provides temporary relief, external imbalances will remain a source of vulnerability over the medium-term that can only be addressed by reforms favoring an adequate supply side response when foreign markets recover, especially in Europe.

Environmental Sustainability

Sharing prosperity with future generations requires addressing the sustainability of Tunisia's development model. Tunisia's ecosystems support its economic development and provide income and jobs to most vulnerable population. For example, the coastal zone is home to over 65 percent of Tunisia's population and to its major industries; it also supports its tourism sector, which relies in its mass on mass beach activity, and which contributes 7 percent of GDP (2008) and provides employment opportunities for 380,000 (10 percent of Tunisia's active population). Tunisia's water and soil ecosystems support its agricultural activity that contributes 8 percent of GDP and employs 16 percent of the national workforce. Tunisia's development path is, however, depleting its natural resource stock. The adjusted net savings (ANS) measures the real difference between national income and consumption. It takes into consideration investment in human capital, depreciation of fixed capital, depletion of natural resources, and damage caused by pollution. While Tunisia's ANS rose from 2.6 percent of GDP in 1980 to 19 percent in 1999, it steadily declined over the next decade to reach –3.2 percent by 2012 due to energy depletion, local pollution damage, and mineral and forests depletion (WDI 2014).

The unsustainable use of natural capital reduces the flow of economic and social benefits such that it is more difficult to achieve sustainable development, poverty reduction and other development goals. The linkages between these issues are stronger in Tunisia because an important proportion of the population is dependent on natural capital. It is therefore important to ensure an inclusive and participatory approach to: (i) consider natural resources as an integral part of a more comprehensive and sustainable socio-economic development paradigm, whereby these resources would be viewed as key support for improved livelihoods; (ii) consistently improve current practices characterized by slow, inefficient, and top-down decision-making processes; and (iii) significantly reconcile broad environmental protection concerns and local socio-economic priorities, as well as optimally balance potential gains in natural capital and productivity including at household level. Furthermore, the approach should be put on strengthening and enhancing sustainable and low-carbon local development practices (by reducing greenhouse gas emissions), improving the capacities of natural ecosystems to sequestrate carbon, maintaining and improving the value of goods and services of natural ecosystems, and reducing the pressures facing these ecosystems.

Conclusions

The next five years represent an unprecedented window of opportunity, as Tunisia stands at a crossroads to close its disparities and capitalize on its assets and potentials, by implementing sustained reforms. Now that the democratic transition is coming to an end and many path-breaking reforms have been initiated, Tunisia can now “shift gears” and proceed to implement the next generation of reforms, including deep and vital changes that will span from the economic structure to the overall governance dimension of the socio-economic and political context. This new development model, underpinned by the renewed social contract enshrined in the Constitution and a dialogue promoting accountability and opening up of the policy space would unleash the potential to achieve higher growth and shared prosperity. The success of this large agenda of reforms will depend on the ability of the new and more complex political and social landscape of Tunisia to work efficiently, combining adequate consultation and participation with decisive implementation that minimizes the gap between the adoption of reforms and the results they deliver on the ground. This will further require institutional changes, notably in the public sector, to best serve the economic transformation and social inclusion agenda.

Introduction

A comprehensive diagnostic of Tunisia's development model cannot be detached from an understanding of the country's institutional, social, and political context. With the State playing an active—and at times dominant—role in economic development since independence in the late 1950s, Tunisia represents in a most emblematic manner the complex relation between economic policies, institutions, and political change. While economic policies over the two decades preceding the revolution delivered widely recognized achievements, such as growth rates above the regional average, impressive progress in human development indicators and a reduction in overall poverty incidence, they failed to address, and even exacerbated, the deep-rooted distortions in the economy that prevented operation of the channels for a more equal and inclusive society (productive employment and job creation above all). These distortions, grounded in a tightly controlled social and political space that favored the elites, have limited citizens' active political, social, and economic participation, and therefore hampered the long-term economic and social sustainability of the country's development model.

The lack of adequate participation, transparency, and accountability in the management of public affairs, which reached its peak during the decade preceding the revolution, undermined the economy's ability to take off and bring prosperity and good jobs to all. Tunisia failed to create inclusive growth in its most comprehensive sense. Unequal opportunities stemming from favoritism and elite capture translated into wide disparities in terms of socio-economic achievements. The deep-rooted dichotomies of the Tunisian model expanded in several dimensions: in the *economy* (for instance with the duality between the more dynamic exporting offshore sector and the protected and stagnant onshore sector where vested interests shielded key sectors from competition); *spatially* between the thriving coastal regions and the impoverished interior areas; in *the labor market*, between the insiders that benefitted from secure jobs (mostly in the public sector) and the outsiders, increasingly young and educated Tunisians who experienced growing unemployment rates and jobs insecurity. Growing inequality and unequal access to opportunities and assets eventually fueled a rising resentment among the population, undermining the implicit social contract that was holding the development model in place, which eventually imploded with the revolution of January 2011.

Significant steps toward a more open and transparent society, an accountable public sector, and a more inclusive economic system have been taken since the 2011 revolution. Boosting shared prosperity will require a concerted effort to strengthen the social contract,[27] particularly in the area of promoting equality of

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[27] The term "social contract" refers to some degree of societal consensus over the basic principles of the operation and role of the state vis-à-vis the private sector and citizens. In this usage, social contract refers to some aspects of a social equilibrium, including the beliefs and actions of citizens, key groups, and state actors.

opportunity. Growing evidence[28] suggests that improving access for all and reducing inequality of opportunities are not only about "fairness" and building a "just society" but also about realizing a society's aspirations of economic prosperity. In the case of Tunisia, this will mean first and foremost re-establishing trust in public institutions and ensuring active citizen participation in political and social affairs. Significant progress has been made by the transition governments to strengthen transparency and participation, particularly by enhancing civil and political rights as highlighted by the first free and fair elections[29] in the country, increased freedom of press and association, easing restrictions on the operations of civil society organizations and other associations, and improving economic governance.[30]

Substantial action is now required to pave the way for an economic transformation and the dismantling of undue economic rents and privileges in order to ensure sustained and inclusive growth. Deep structural reforms are now needed to enable a lasting economic recovery, following the path of other upper MICs that have performed much better than Tunisia over the past two decades. These reforms would need to tap into the country's underlying capabilities and realign incentives to facilitate sustained and inclusive growth. The next few years represent an unprecedented window of opportunity, now that the democratic transition is coming to an end and many path-breaking reforms have been initiated. Tunisia needs now to "shift gears" and proceed to implement the next generation of reforms,[31] deep and vital changes that will span from the economic structure to the overall governance dimension of the socio-economic and political context This new development model, underpinned by a renewed social contract and a dialogue promoting accountability and opening up of the policy space, would unleash the potential to achieve higher growth and shared prosperity. The success of this large agenda of reforms will depend on the ability of the new and more complex political and social landscape of Tunisia to work efficiently.[32]

In this context, the World Bank Group (WBG) has undertaken a Systematic Country Diagnostic (SCD) to identify the main constraints to and opportunities for progress toward a more inclusive development model. The SCD is meant to support preparation of the upcoming Country Partnership Framework (CPF) 2015–2020 for Tunisia. The diagnostic has been placed in the country's historical socio-political and geographic context to better understand the political economy of past reforms and future opportunities. Given the importance of economic growth for sustaining any efforts in the area of poverty reduction and shared prosperity, this SCD is organized along opportunities for: (i) accelerating growth and private sector-led job creation (ii) improving equality of opportunities and increase resilience.

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[28] See reference in Narayan et al (2013).

[29] The first free elections were held for the Transitional Constituent Assembly held in 2011 and more recently in October 2014 for the parliamentary elections, to be followed by the presidential elections in November 2014.

[30] Noteworthy also is the requirement for citizen participation at the local government level in municipal planning, which is a good indication of the nationwide implementation of the spirit of the new constitution. Moving forward, the key will be to strengthen the capacity of the central government and local governments to implement citizen and civil society engagement.

[31] The reference is to the "second generation" of reforms that was invoked after the "first" waves of structural reforms during the 1990s to gradually open the economy.

[32] The recent progress in the democratic transition should not be seen as the end of the process but rather as its very beginning. For instance, even though laws are now in place to allow freedom of expression, in a few occasions representatives of the media and unions have been tried by military courts (which lack fair trial safeguards) for defaming and insulting the military, which could be seen as an attempt to stifle open criticism. Tunisia also adopted a comprehensive transitional justice framework aiming to address past human rights abuses and prevent future ones. On the latter, it aims to establish a framework for guiding transition from an authoritarian state to a democratic system that guarantees protection of citizens' rights. However, the institutional arrangements and supporting regulations to implement this framework are not yet fully in place.

1 Context

The Political Economy of Growth and Inclusion in Tunisia

Tunisia is often seen as one of the leading performers in the MENA region in terms of economic and human development outcomes. Tunisia was one of the first countries in the region to embark on early structural reforms that contributed to the successful economic performance of the past decades and allowed substantial progress on human development indicators. As of today, it remains one of the most liberal countries in MENA in terms of women rights and female emancipation;[33] it has a great wealth of human capital thanks to a comprehensive system of public education, and a universal healthcare system. It benefits from a generally adequate infrastructure and a long tradition of a strong administration. All these features are the legacy of decades of investment and focused policies since independence (for more details on the historical background please refer to Annex IV).

Past policies, however, are also at the origin of the deep-rooted constraints we observe today in the country economic model. The concentration of state power dates from the early years of post-independence, while the link between government and business and the extraction of profits by privileged insiders became a pattern since the early process of liberalization of the economy, and in the 1970s, reaching a much larger scale under Ben Ali. Tunisia's regulatory framework was conceived during the main era of privatization at the end of the 1980s and, although modified in 1996 and 2002, it is still plagued with the same major problems even three years after the revolution. It is also during this time that regional disparities increased, notably with the implementation of an arsenal of investment incentives under the investment code (many still in force today), which introduced a dichotomy between an open exporting sector (offshore) and the inward-oriented domestic sector.

Economic progress was often seen as the main priority in the several development plans that followed since independence while socio-political stability was frequently obtained at the price of denied civil liberties and political freedom. High economic growth and a generous and committed (especially in

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[33] Tunisia has been at the forefront in the Arab World in terms of legal reforms relating to women's equal status and protection under the law. In the 1990s, a series of legislative reforms accorded greater rights to women in personal status, civil status, employment opportunities and family law. Women have equal citizenship rights to men and have the right to vote and to be elected into office. They also have equal rights in marriage, divorce, custody, and ownership of property, including land, even though this right is rarely exercised in practice. Furthermore, the law protects women's personal security: violence against women is a crime and punishable by law. Finally, a 2002 amendment to the nationality law gives women married to foreign citizens the right to pass on their nationality to their children.

straining circumstances) social policy (see box A4.1 in Annex IV) were the foundations of the unwritten social contract between the state and its citizens, which promised to deliver socio-economic development and welfare**.** The gains in welfare would compensate for the lack of basic civil liberties and political freedom. The pre-revolution Tunisia was labeled "not free" by the international observers and think tanks: Freedom House reported the lack of guaranteed freedom of association and the fact that citizens' participation in the elections was purely nominal; Global Integrity ratings indicate that Tunisia was one of the most repressive regimes in the world in terms of media freedom.

However, even from a pure economic standpoint, these policies were not sustainable. The welfare gains in reality were not equally distributed; in addition, these policies led to macroeconomic imbalances that undermined further economic progress and required reliance on foreign official assistance and critical structural reforms. For instance, the heavy social system created to include the population in the economic progress of the country created high fiscal deficits, while the reliance on foreign capital and remittances rendered Tunisia highly vulnerable to external shocks.

A Closer Look at Tunisia's pre-Revolutionary "economic Success Story"

The implementation of the structural adjustment program in late 1980s represents a turning point in economic policymaking in post-independence Tunisia and the beginning of the Tunisian economic success story as we know it. This program was aimed at: (i) preserving the stability of the macroeconomic framework and financial balances; (ii) integrating Tunisia into the world economy; (iii) redistributing income by reconciling social and economic policies; and (iv) reducing poverty and broadening the "middle class" group. The reforms were expected to boost economic growth that would trickle down to the population, in order to improve income levels and employment. While often disparaged today for the austerity measures in entailed, the program reached its macroeconomic objectives.

Building on these reforms, Tunisia indeed experienced an average 4.5 percent growth rates between 2000 and 2010, positioning itself among the leading performers of the region. Growth was mainly driven by large public investment and strong domestic demand, coupled with more dynamic exports and a sharp increase in FDI inflows. Tunisia also saw an improved macroeconomic management and a more stable macroeconomic environment from the 1990s forward. Strengthened management of monetary and fiscal policies allowed inflation to be kept under control, thereby safeguarding most of the real purchasing power of the poor. The average inflation rate was close to five percent in the 1990s, declined subsequently to less than three percent in the period 2000–07 and was kept at bay even during the food and fuel price hike in 2008. The budget deficit as a share of GDP was also brought down from an annual average of almost five percent in the 1980s—when social spending and generous increases in government salaries resulted in macroeconomic disequilibria—to less than three percent, on average, in 2000–08. Employment growth accelerated,[34] leading to a decrease in unemployment from almost 17 percent in 2000 to 13 percent in 2010,[35] albeit remaining high, even in comparison to the regional average.

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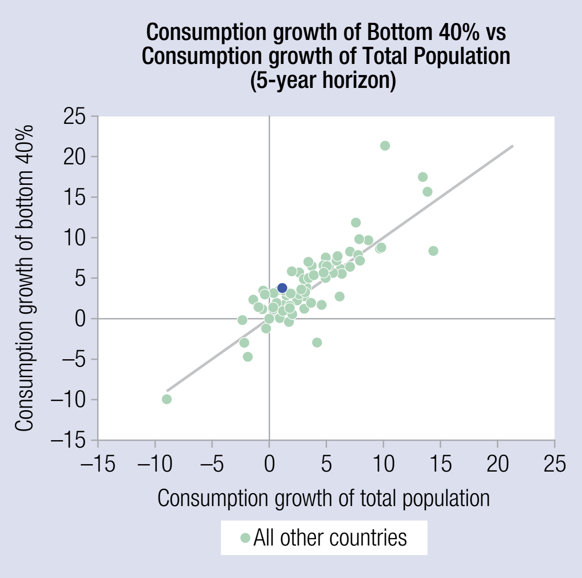
[34] Employment creation was mostly concentrated in low value-added sectors. Construction, assembly manufacturing, and services such as tourism have been the main sectors for employment for low and semi-skilled workers, while public administration has been the main single source of jobs for skilled workers.

[35] This decrease was particularly pronounced for unemployment among low-skilled individuals as the Tunisian economy created jobs for low-skilled individuals at faster rates than their entry to the labor force.

The good economic performance of the 2000s enabled the country to experience rapid poverty reduction. Macro indicators suggest that GDP growth has trickled down to households. According to national accounts, household final consumption growth closely followed that of GDP, averaging five percent during the decade. Poverty incidence declined substantially: poverty rates in 2010 stood at 15.5 percent, compared with 23.3 percent in 2005 and 32.4 percent in 2000.[36] The extreme poverty rate was estimated at 4.6 percent for 2010 compared with 7.6 percent and 12.0 percent in 2005 and 2000 respectively. An extensive system of subsidies, transfers, and social protection contributed, despite great inefficiencies, to keep the cost of basic necessities affordable for the poor and protect them from shocks. Sustained investment in key infrastructures contributed to open access to basic needs for the poor. Tunisia also performed well on most development indicators, improving along key nonmonetary indicators of deprivation over the decade. Economic growth and public investments in human development contributed to impressive improvements in school enrollment, infant and maternal mortality rates, and child malnutrition at the national level, while contributing to improved access to services such as water source and sanitation facilities (Table 1).

FIGURE 1: Growth Trickled Down to the Bottom 40 Percent



Tunisians, however, did not perceive themselves as benefitting from the country's economic success. Fewer Tunisians were "thriving" in the past three years preceding the 2011 revolution, according to a 2011 Gallup poll (Figure 2). Data also highlight a sense that ordinary citizens were running out of options, such as starting their own entrepreneurial endeavors, when it came to unemployment challenges. Tunisians'

TABLE 1: Tunisia Key Social Indicators 1990–2010

Indicators	1990	2000	2008	2010
Primary school enrollment rate (%)	92.4	95.6	97.7	98.7
Progression to secondary school (% of primary)	—	75.3	83.9	74.5
Ratio of girls-to-boys in primary & secondary education (%)	83.5	97.6	101.2	101
Prevalence of malnutrition (Stunting %)	—	16.8	12	10
Infant mortality rate (per 1,000 live births)	40.3	24.7	16.4	14.8
Maternal mortality ratio (per 100,000 live births)	130	84	60	56
Access to improved water source (%)	81	90	94	96
Access to improved sanitation facilities (%)	74	81	85	94
Life expectancy at birth (all/women)	70/72	73/75	74/76	75/77

Source: WDI

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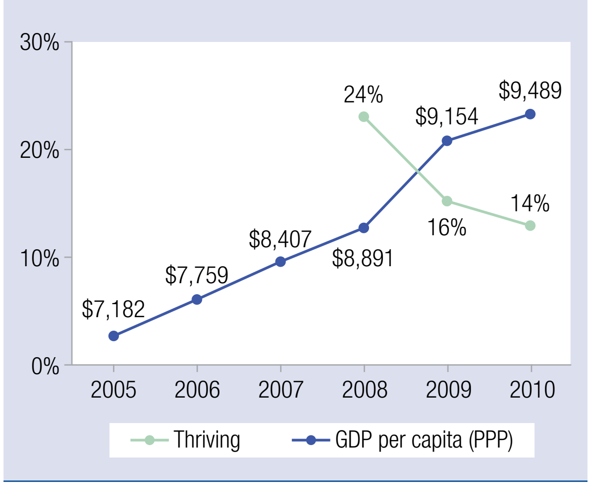
[36] Revised estimates. See Annex III for more details.

worsening perceptions and mounting frustration with such domestic challenges increased noticeably at the end of the decade. In particular, there was increased dissatisfaction with the provision of basic infrastructure, services, and worsening perceptions about whether the government would allow (small, independent) businesses to flourish.

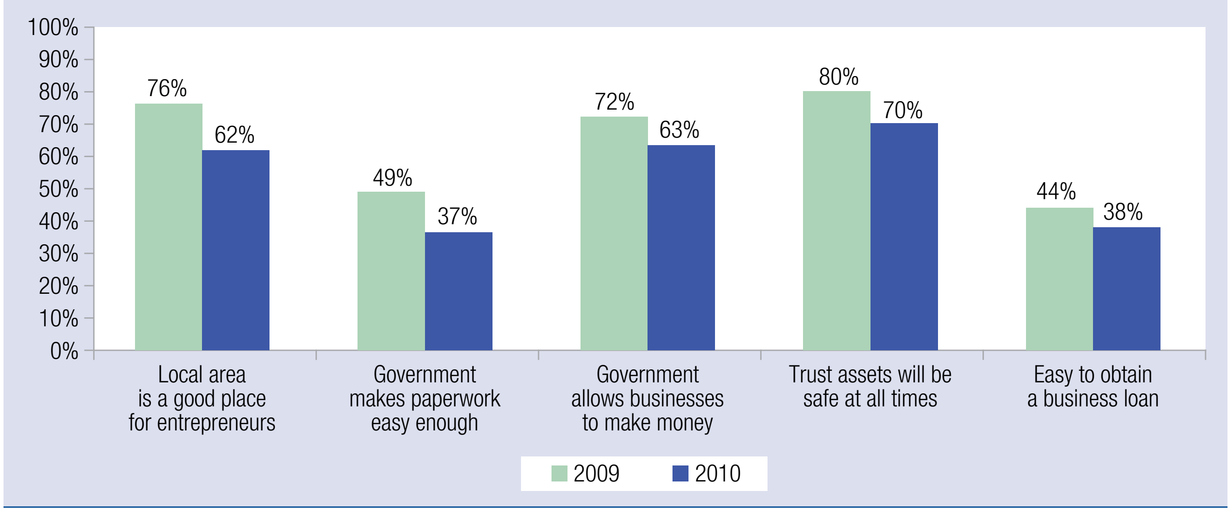
FIGURE 2: Well-Being Worsens as GDP Rises pre-2011



Source: Gallup.
Note: GDP per capita (PPP) estimates are from the international Monetary Fund's World Economic Outlook databse.

Lack of transparency, social accountability, and citizen participation in government's affairs contributed to social and economic exclusion. Social and economic exclusion goes beyond the narrower conception of material poverty, whether conceived in terms of income or the fulfillment of basic needs. It is first and foremost about exclusion from the political process. Despite a system of generous social policies established by the regime to compensate for the lack of civil and political liberties, economic, social and political exclusion exasperated all forms of inequality and unequal access to opportunity eventually gave rise to resentment among the population and broke the underlying social contract that was holding the development model in place leading to the well-known *Jasmine Revolution* of January 2011.[37]

FIGURE 3: Tunisians' Perspectives on Business Environment Immediately Before the Revolution



Source: Gallup.

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[37] Ironically, Ben Ali's promotion of the ICT sector for the development of the country (despite the imposed restrictions) was the accelerating power of his demise. Tunisian youth movements, through social media (Facebook) exposed the world to the discrepancy in the views promoted by the regime and the country's harsh reality. Youth movements and civil society continue to play a significant watchdog role, although they still lack a presence within mainstream political institutions.

2 Framing the Issues

The Tunisian economy is increasingly affected by distortions and misallocation of resources. The structural weaknesses of the economic model are coupled with a volatile external environment. The global economic slowdown and the regional political instability create additional challenges to progress toward the twin goals of reduced extreme poverty and increased shared prosperity and threaten also the pace of much needed reforms. Below we present an overview of the main issues faced by the country as well as new challenges in the current context.

Economy Stuck in Low Productivity Equilibrium – Less Prosperity for All

Tunisia's growth performance, although good compared to its regional peers, was substantially weaker than other upper middle-income countries, particularly from 2000 to 2010. Tunisia's economy grew at about 3.4 percent per year in real per capita terms between 1990 and 2010 and was the second fastest growing country in the MENA region since 1990. Nevertheless, other upper middle-income countries (U-MICs) on average grew at 1.5 times that speed over the last decade. Well-performing U-MICs such as China enjoyed double-digit growth over the same period. Unlike many of its peers Tunisia did not experience an economic take off during the past two decades.

A slower pace of growth has important consequences on the ability to contain poverty and increase shared prosperity. Shared prosperity is strongly correlated with overall prosperity.[38] This would mean that policies that are important to generate and sustain growth remain relevant and a necessary condition to achieve progress toward the twin goals.

Gains in Terms of Poverty Reduction Remain Fragile and Unevenly Distributed

Despite the overall reduction in poverty rates, the probability for many households to fall into poverty remains substantial. The bottom 40 percent has one chance in four of falling into poverty. The revised poverty estimates show that in 2010 almost two million people remained in impoverished conditions, half a million of which were below the extreme poverty line. Preliminary analysis of the poverty trends[39] shows

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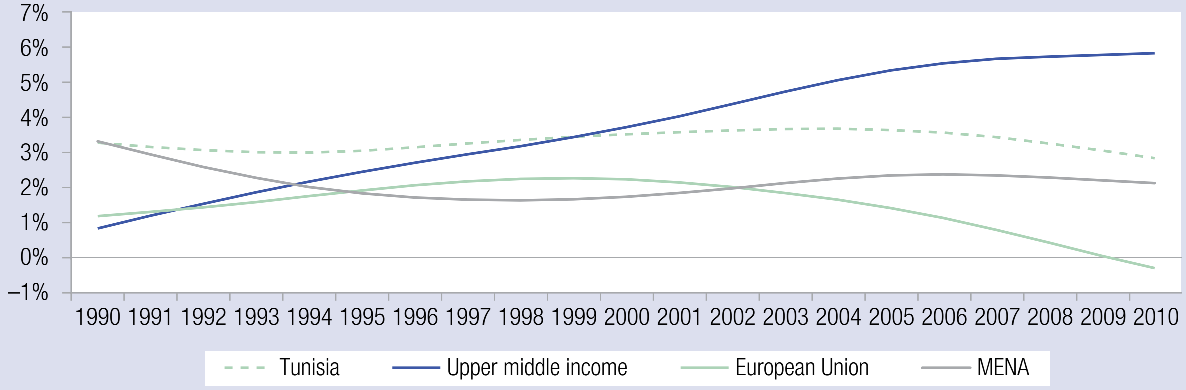
[38] See Narayan et al (2013).

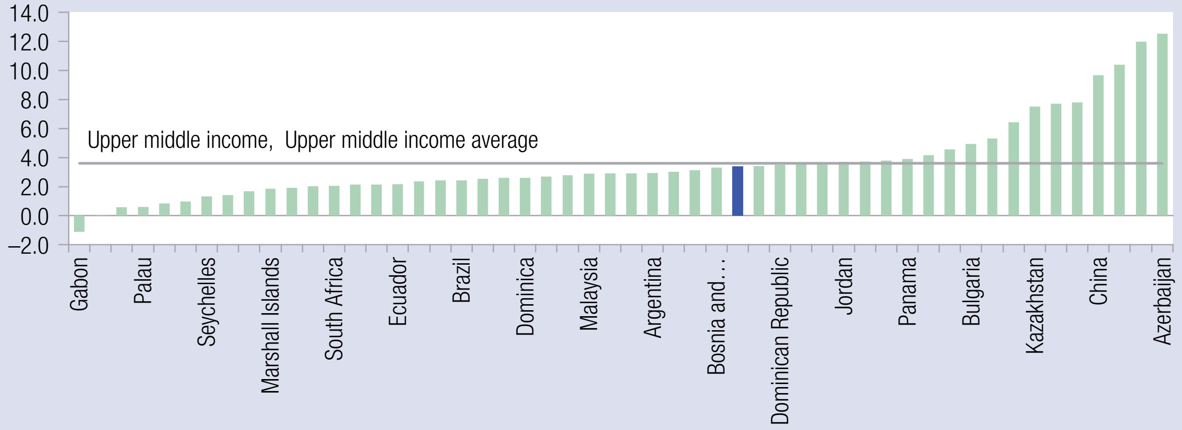
[39] INS 2012.

FIGURE 4: Tunisia's Economic Development Did Not Take Off Compared to its Peers

a) Real GDP annual growth rate per capita (in %) 1990–2010



b) Tunisia's Real GDP per capita (annual growth) comparison to upper middle income: 2000–2010



also how the gains realized in the past decade remain fragile. For instance, many households' consumption levels in 2010 remain just above the poverty threshold, making them very vulnerable to exogenous shocks, such as employment loss or hikes in the prices of essential goods. Wide regional disparities have persisted and even increased during the past decade. Though there is less inequality in consumption expenditures within regions, the gap between regions has widened. In 2010 poverty rates ranged from a low rate of 8–9 percent in the Center East region and Grand Tunis to a high of 26 and 32 percent in the North West and Center West regions respectively. Extreme poverty has become more concentrated than before: the poorest region of the country, namely the Center-West, was in 2010 home to more than 40 percent of the extreme poor living in the country.

Employment does not appear to have played a significant part in poverty reduction. Better jobs should be central to poverty reduction and shared prosperity moving forward. Quite remarkably, the reduction in poverty took place in Tunisia without large shifts either in employment dynamics or in the already existing gaps between poor and non-poor (or across different population groups defined by gender, skills or location). In fact, the share of unemployment increased between 2008 and 2012 among the most vulnerable population groups but so it did for the least vulnerable. These findings lead to the suggestion that poverty reduction has been detached from the labor market and employment status. Factors that might have driven the poverty

TABLE 2: Tunisia Poverty and Extreme Poverty Rates Show Wide and Persisting Regional Disparities

	Poverty rates			Extreme Poverty rates			Percentage of poor		Percentage of extreme poor	
	2000	2005	2010	2000	2005	2010	2000	2010	2000	2010
Tunisia	32.4	23.3	15.5	12.0	7.6	4.6	100.0	100.0	100.0	100.0
Greater Tunis	21.0	14.6	9.1	4.3	2.3	1.1	14.1	13.6	7.8	5.5
North East	32.1	21.6	10.3	10.5	5.4	1.8	13.5	9.2	12.0	5.4
North West	35.3	26.9	25.7	12.1	8.9	8.8	14.2	19.1	13.2	22.0
Center East	21.4	12.6	8.0	6.4	2.6	1.6	14.4	12.0	11.6	8.1
Center West	49.3	46.5	32.3	25.5	23.2	14.3	22.0	27.7	30.7	41.3
South East	44.3	29.0	17.9	17.5	9.6	4.9	12.9	10.5	13.7	9.7
South West	47.8	33.2	21.5	21.7	12.1	6.4	8.7	7.9	10.7	7.9

Source: INS and authors calculations.[a]

[a] Please note that the percentages of the poor and extreme poor are based on population data from INS adjusted from governorates into the regions– weights from HBS are not applied so there might be slight difference from the final results that will be obtained with the HBS data.

decrease are perhaps to be found in labor income and labor supply dynamics, or the role of public and private transfers and subsidies.

Wide Regional Disparities in Access to and Quality of Basic Infrastructure and Services

Spatial disparities in access to basic services and opportunities constrain growth and the achievement of the twin goals. Despite substantial progress in increasing access to basic services and infrastructure in Tunisia in the decade prior to the revolution, substantial disparities (across space and socio-economic and demographic characteristics) persist in access to, and quality of, basic infrastructure and services provided by local and central governments. Tunisia has one of the largest rural connectivity deficits in MENA: 39 percent rural access compared to a 58 percent average in MENA. Access to public transportation is much lower in the interior regions: 87 percent of households in urban Tunis live within a 15 minute walk to the nearest bus station and in the North-West and Mid-East, the proportion falls to 54 percent and 65 percent respectively. In rural areas, only 55 percent of the population has access to piped water and 52 percent to improved sanitation (compared to near universal access in urban areas) and only 55 percent of women have access to at least four prenatal visits compared to 75 percent in urban areas (MICS 2011–12). Access to education services is also widely unequal between (and within) regions: more than one fourth of students in the interior governorates of Sidi Bouzid, Kasserine, Kairouan, and Siliana are at more than three kilometers from the closest primary school, compared with a national average of 12 percent. Those four governorates have the worst access indicators in almost all fronts including qualification of teachers, multi-grade classes and internet access.[40]

Differential access to opportunities translates into unequal human development and labor market outcomes. While aggregate human development indicators improved, progress was limited in remote regions. In rural areas: (i) children are more than twice as likely to be stunted (10 percent in rural areas versus four percent urban); (ii) fewer women get prenatal services or treatment for high-risk pregnancies; (iii) maternal mortality rates are three times higher (70 versus 20 deaths per 100,000 live births); (iv) pupils face higher levels of repetition and drop-outs (20.1 percent repetition and 12.7 percent drop-outs in Kasserine at the upper

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[40] Ministry of Education – *Indicateurs de performance du système éducatif* – March 2014.

secondary level); and (v) levels of unemployment ranged in 2013 from 20–22 percent in interior regions to around 7–11 percent in coastal areas).

Entrenched Unemployment, Particularly for Youth and Women

The number of jobs created in the past decade was not sufficient to absorb the increasing number of new entrants into the labor market. Despite a job creation rate of 2.5 percent per year—close to the growth rate of the labor force—the Tunisian economy has not been able to absorb new entrants to the labor market, particularly young educated workers. At the same time, the jobs that have been created are mainly in the informal and low productivity sectors, and employed low skilled workers offering low wages and no job security. Indeed, entry rates for young/small firms that create formal sector jobs have been low, and among those created only a few have been able to survive and grow. As of today, slightly more than half of the working age population is out of the labor force, with the vast majority of this group being women. Among those who participate, 18 percent are unemployed and another 41 percent are in low quality jobs, either self-employed (including farmers and un-paid workers),[41] or as wage employees in the informal sector, in jobs that are not covered by labor regulations and that do not provide access to social security. Most of those in informal unemployment live in urban areas.[42] The large majority—close to 90 percent—is represented by people under 35 years old. Those with secondary education or less account for 70 percent.[43]

Women are a great part of the inactive population and, when in the labor force, face higher unemployment rates than men. In 2011, Tunisia was ranked on the lower end of the World Economic Forum's index on gender parity in economic empowerment (126 out of 135 countries). The labor force participation of women in Tunisia is only 28 percent and compares to 74 percent for men (2010). The gender ratio of 0.37 in economic activity is around half of the average ratio found in other U-MICs. This is a very wide gender gap particularly given Tunisia's good performance on education and health indicators as well as the supportive legal framework. Moreover, women account for only 25 percent of waged nonagricultural employment. This is significantly lower than the 39 percent average for other U-MICs and the world average of 37 percent. When in the labor force, women face almost double unemployment rates than men (at 28 percent compared to 15 percent). Women represent an extremely valuable asset while at the same time remaining an untapped pool of resources—willing to work but unable to find suitable jobs. Finding a way to break the barriers to their active participation in the economy would free the country's potential to accelerate growth and move up the income ladder

The tertiary education system is not equipping its graduates with the fundamental skills to perform well in labor markets while vocational training remains subpar and attracts too few students. Even though education achievements are improving markedly and there are growing cohorts with high school degree, the

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[41] About 20 percent of Tunisia's employment is in agriculture. Rural areas contain large pockets of underemployment, a key driver of poverty and vulnerability.

[42] Migration between rural and urban areas where jobs are concentrated, is likely limited to key groups and sectors (an area that warrants additional analysis). Opportunities for international labor migration are currently not fully exploited, which needs to be assessed to determine the optimal strategy for domestic versus international employment.

[43] Workers with higher education represent a higher share of the unemployed; the unemployment rate among workers with post-secondary education was over 25 percent in 2012 and has been increasing over the past years. High jobless rates are coupled with widespread underemployment and inefficient school to work transitions.

lack of a highly qualified labor force is still considered one of the leading constraints to businesses. In addition to the quality of education, the skills and competencies acquired by graduates do not seem to be aligned with those in demand by the private sector. These mismatch results in increasingly high rates of unemployment among young and educated workers (which reached 53 percent in 2011).[44]

Lack of Social Progress Due Mostly to Lack of Opportunities and Exclusion

Tunisia is lagging behind other peer countries[45] in terms of inclusion and social progress. Social progress can be defined in several ways, to include different aspects of the institutional framework which allow human and social development. Only recently, however, it has been possible to "measure" social progress for most countries around the world. The recently established Social Progress Initiative (see Annex VI) defines (and measures) social progress as "the capacity of a society to meet the basic human needs of its citizens, establish the building blocks that allow citizens and communities to enhance and sustain the quality of their lives, and create the conditions for all individuals to reach their full potential." Building on this definition, Tunisia's performance, as measured in the country's scorecard (Annex VI), shows how the sense of social and economic exclusion translates in lack of social progress overall. Progress in terms of social inclusion is definitely linked to but not perfectly correlated with advances in economic development (as measured by GDP per capita). Tunisia is an emblematic example of how economic progress can be detached from advances in social development.

Tunisia's social progress has been hindered by exclusion of large segments of the population from economic opportunities and active participation and engagement in the society. While active social and political participation is a key pillar of active citizenship, very few Tunisians engage in any form of political participation. This is particularly true for the youngest generation (under 30 years old), which also express disillusion on the role of the state and institutions and a very low level of trust and confidence in their ability to engage citizens. Tunisia scores particularly poorly in the dimension of the Social Progress index related to tolerance and inclusion (even after 2011, as the index refer to 2013 and 2014) and in proxies of agency such as progress to higher education, women's average years in school, and tolerance for minorities/religions. The exclusion of large segments of the population from active engagement in the society and in the economy had non-negligible economic consequences, placing the country on a low-growth equilibrium path (Figure 5).[46]

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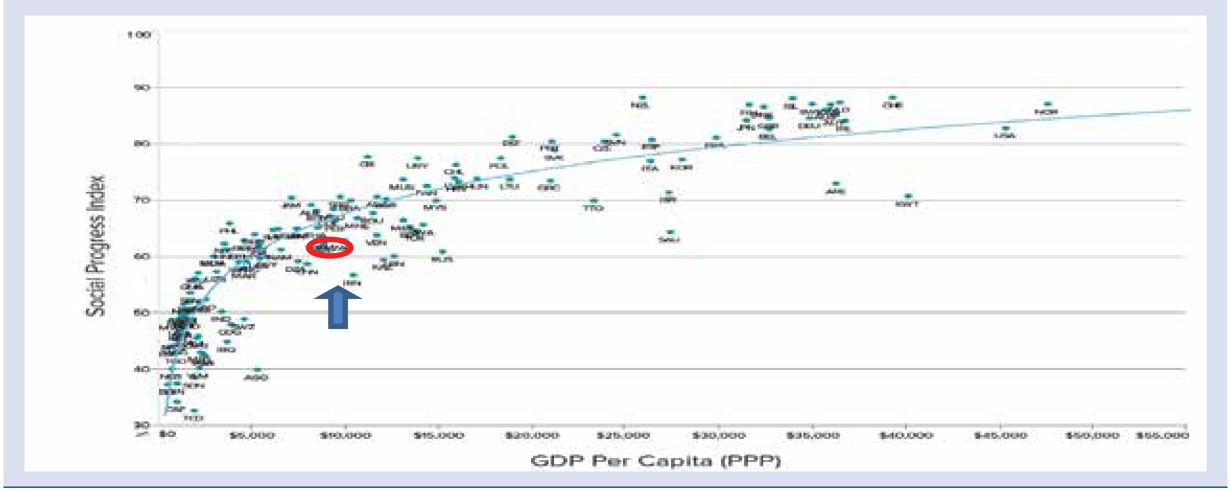
[44] In fact, there is a surplus of skilled labor not rightly adapted to the needs of the labor market and a shortage of unskilled and semi-skilled labor. Not only are there few jobs for the skilled workers, but also a severe discrepancy between the competencies required by the labor market and the fields students are studying in higher education. In fact, findings from the most recent Investment Climate Assessment reports that the level of workers' skills and education are the second leading constraints perceived by employers; 39 percent of sampled firms perceive the available skills of the workforce as a weakness. The rates of underemployment and mismatch are exceptionally high among university graduates. They reach 30 percent for technicians and 36 percent for those with a bachelor's degree in humanities. At the same time, the distribution of skills favors occupations that have less demand in the labor market, to the detriment of occupations such as machine operations, craftsmen, accountants, and salesmen.

[45] Peer countries are defined as countries with comparable level of income and HD indicators.

[46] A recent IMF paper ("Growth slowdowns and the Middle Income trap") links growth slowdowns (the other side of the Middle income trap) to several components, one of which is "institutions" (measured, among other factors, by size of government, rule of law, regulations, etc). It shows how institutions are important in MICs to avoid the "trap." Hence, the "social capital" of a nation, which includes well-established institutions that allow citizens participation and ensure protection of their rights, counts for its economic progress.

FIGURE 5: Social Progress Does Not Necessarily Follow from Economic Development: SPI Vis-à-Vis GDP Per Capita



Source: Social Progress Index (SPI).

Manipulation of Governance Systems Provided a Mechanism for Elite Capture

The institutional system that allowed corruption in the form of elite capture, which in turn negatively impacted economic, social and political participation, has not been completely dismantled. Economic policies aimed at benefitting the elite were implemented through a web of regulatory favoritism that minimized competition, while at the same time restrictions on social and political space stifled criticism and undermined accountability. Restrictions on political and economic participation also furthered social exclusion. The governance system was molded around furthering elite capture while eliminating effective means to challenge official policies and government actions. Institutions needed to further these needs were themselves captured, while others were neglected in terms of building capacity resulting in weak delivery of services to the public. The question is to what extent the system that perpetuated elite capture, to the detriment of the public interest, has been dismantled.

The Government of Tunisia has taken steps to improve the legislative framework covering issues of accountability, transparency, and public participation, which if implemented could address elite capture and improve service delivery. The transition period should be used to correct governance gaps that allowed for elite capture and the resulting economic, political, and social exclusion. The GoT has taken steps to increase transparency and accountability, which if implemented would increase citizen engagement. The new *Constitution* obligates the government to effectively manage public resources (Article 10), serve citizens and the public interest according to rules of transparency, integrity, effectiveness, and accountability (Article 15), and guarantee the right of citizens and civil society organizations to participate in public policy-making at the local level and in implementation of laws (Article 139). The *Freedom of Association Law* was passed in 2011, making it easier to establish civil society (and other types of) organizations. The GoT also joined the Open Government Partnership, committing itself, at least in theory, to timely publishing of budget data, adoption of a freedom of information law, establishment of an income and asset disclosure regime covering elected and senior public officials, and openness to citizen engagement in policymaking and governance. The *Law on Transitional Justice*, adopted in December 2013, establishes a legal and institutional framework to address human rights abuses committed during the Ben Ali regime and providing reparations and restitution to victims as a means toward national reconciliation. It also aims to prevent human rights abuses in the future and guide the transition from authoritarian state to a democratic system that protects citizens' rights.

Assessing implementation and impact of governance reforms is difficult to do at this early stage. With most of these laws and agreements meant to address governance gaps only recently put into place, supporting regulations and adequately resourced institutions are not yet fully in place to ensure efficient implementation. The GoT is in a difficult position given public expectations for quick reforms. In some cases patience is wearing thin, with civil society organizations already questioning commitments to governance reforms.

Emerging Challenges

Macroeconomic Imbalances

Lower growth and greater external imbalances threaten macroeconomic and fiscal sustainability. For the past three years since the revolution, Tunisia has been running down its policy buffers, vanishing any macroeconomic space for expansionary policies that could support a relaunch of the economy. The fiscal deficit increased from one percent of GDP to 6.2 percent between 2010 and 2013 and the public debt from 40.7 percent of GDP to 44.8 percent during the same period. Current account imbalances have risen since 2011, as a widening trade deficit could not be offset by net service imports, notably tourism, due to the uncertain political and security situation. A more flexible stance in the exchange rate policy, together with heavy reliance on external financing from IFIs, helped to preserve an acceptable the level of international reserves.[47] While public and external[48] debt remained at an acceptable level compared to international standards, they are expected to reach unsustainable levels if reforms are not implemented. Recent debt sustainability analysis[49] shows that if fiscal consolidation reforms are not implemented, public debt could reach around 62 percent of GDP by 2019, while a permanent negative growth shock would increase public debt to about 67 percent of GDP by 2019**.**

Since the revolution, the budget has been increasingly centered on the growing current spending rather than investment, undermining growth-enhancing projects. Although the fiscal deficit can still be considered acceptable,[50] the composition of spending remains problematic, as the bulk of the adjustment was borne by lower capital spending combined with improved revenues. Notably the wage bill and subsidies continued to increase until 2013, despite freezes for salaries and hiring of public servants and gradual increase of subsidized fuel prices. In 2013, the wage bill accounted for 12.5 percent of GDP (against 10.6 percent in 2010), and subsidies and transfers represented 7.8 percent of GDP (against 3.6 percent in 2010). Only in 2014 was the expansionary policy has been put to a halt, leading the way to a medium-term fiscal consolidation by slowing down the increase in current spending and progressively improving expenditure composition.

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[47] Reserves stood at around three months of imports. On the positive side, in January 2015 Tunisia launched a US$1 billion sovereign bond without guarantees from international community, for the first time since the revolution. The ten year bond was issued with an interest rate of 5.75 percent, which is lower than that of Greece and Spain. It demonstrated strong international investor confidence in Tunisia and Tunisia's return to the international capital market.

[48] External debt has also increased since the revolution, reflecting the fiscal expansion and the widening of the current account deficit.

[49] IMF Fifth review of SBA (December 2014).

[50] The estimated primary deficit—3.1 percent of GDP—would be well below the target of the IMF program (6.7 percent).

Considerable fiscal risks exist and need to be addressed. Subsidies have become a growing fiscal burden, reaching approximately 24 percent of total spending. Fuel subsidies reached two-thirds of total subsidies budget in 2013, against less than a third in 2009, equivalent to almost 90 percent of the combined expenditures for health and basic education. Fiscal risks and contingent liabilities of SOEs are also increasing, as demonstrated by the rise of external debt from public enterprises guaranteed by the government to 34 percent of the total external government debt (10 percent of GDP) by end 2013, of which the electricity company STEG accounted for 40 percent. Against this backdrop, the government is initiating a more transparent fiscal risk management system through improved monitoring of cross-subsidies, audits, and consolidations of financial situations of the largest companies, and the governance framework of public enterprises. The necessary stabilization of the macro-fiscal situation will require continued action on civil service management and SOE restructuring

The emerging macroeconomic imbalances and challenges represent the major obstacle to accelerate growth and to put Tunisia on a sustainable economic development path. Fiscal consolidation and reforms to enhance productivity and competitiveness are needed to re-balance the macroeconomic imbalances which, although emerging more strongly in recent years, have been underming Tunisia's growth since the last decade. The government's choice in terms of the speed and depth of these interventions will have consequences on the future reduction of poverty and disparities.

Regional Political Instability and Economic Volatility

Social and economic challenges are emerging from the volatile regional context. The power struggle within Libya has brought hundreds of thousands of migrants to Tunisia. The expanded population has meant greater competition for housing and basic commodities such as food, fuel, and social services (health and more recently education). This has driven up prices for ordinary Tunisians, and the need to supply larger amounts of subsidized commodities has played added economic pressure on the government. Tunisia has also lost an important source of remittances as the thousands of Tunisians who relied on Libya for their income have had to return home to bleak economic prospects. Finally, the fear of instability spilling over to Tunisia may have been a deterrent to tourism and foreign investment.

The instability in Libya is putting economic pressure on Tunisia and exacerbating unemployment, particularly in the lagging regions, promoting informality and thereby creating yet another challenge for the government. The official Tunisian policy toward the Libyan power struggle is that of neutrality. That neutrality is strained however by the ongoing smuggling of weapons and fighters across its territory and an agreement with Algeria to combat terrorist threats. The tension is evident in sporadic violence on the borders with both Algeria and Libya. National security was a key issue during the recent elections campaign.

Informal trade has risen considerably between Tunisia and Libya (and also with Algeria), undermining government revenues, the development of formal businesses, and increasing cases of corruption. Although informal trade accounts for only a small proportion of Tunisia's total trade (less than 10 percent of total imports), it plays a significant role in bilateral trade with Libya (where it accounts now for more than half of total trade) and Algeria, and in certain sectors.[51] The main reasons behind this large-scale informal trade are differences in the levels of subsidies on either side of the border as well as the varying tax regimes. The collapse of security and controls following the political and social instability in both countries contributed to

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[51] Source: Ayadi et al. (2015) "An Attempt to Estimating Informal Trade across Tunisia's Land Borders," Journal of Urban Research.

the massive increase in the illicit activities across the borders. The growth in informal trade has a significant impact on several areas of the Tunisian economy. Fuel is cheaper, but government revenues are reduced, not only because goods are not subject to customs duties at the Tunisian border, but also because traders avoid paying value-added tax (VAT) provided they remain within the informal network. This loss of revenues can be significant. Moreover, this type of trade has an important economic and social impact in border regions. In many of these regions, informal trade is one of the most important economic activities—if not the most important—as is the case, for example, in Ben Gardane. Numerous individuals and organizations are involved in informal trade. While some are highly visible, such as transporters carrying the goods across the border, street vendors, and ad hoc traders (known informally as "ants"), others are less so, such as wholesalers, currency changers, and officials in the relevant administrations who are willing to turn a blind eye on the practice. This kind of trade also keeps many goods within budget for Tunisian consumers.

The ongoing exclusion of large segments of Tunisia's youth population from the country's social and economic mainstream has created a breeding ground for radical politics. The Tunisian Ministry of Interior estimates that over 3000 young men and women from Tunisia have traveled to Syria to join jihadist fighting groups. International observers see the failure to address the ongoing exclusion of youth from active participation in the economic and social life as a potential source of radicalization. Unemployment, although a crucial outcome of the youth exclusion, is in fact by no means the only factor contributing to it. Young people appear[52] to have low participation in decisions affecting their lives, limited engagement in associations or structures through which they could articulate their opinions, and a detached attitude toward politics. Absence of opportunities for voice regarding the direction of the country coupled with lack of accountability on the part of public authorities contribute to mounting frustration among this population, which (already a potential source of instability) could be further inflamed once former fighters begin returning home.

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[52] World Bank (2014) Breaking Barriers to youth inclusion.

3 Conceptual Framework

This diagnostic will start from the following thesis:

> *Tunisia's economic performance has been increasingly hindered by economic policies and ad hoc implementation of regulations that served privileged groups and created multiple barriers to the operation of markets, lack of competition, and absence of a level playing field for broad based private sector activity. This in turn has led to a distorted allocation of resources and incentives, insufficient job creation and quality, unequal access to opportunities,*[53] *and ultimately social exclusion. The ongoing political transition, if successful, coupled with a fruitful collective social dialogue, is a crucial step toward unlocking the economic and institutional reforms necessary to place Tunisia on a faster development path.*

The building blocks for the diagnostic will be based on the following objectives/pillar, gateways to a more inclusive society and more widely shared prosperity:

Strengthen Economic Growth

Higher economic growth that translates into better jobs is a necessary condition to increase people's prosperity. Tunisia's growth has been hampered by multiple distortions, which created structural weaknesses to the economy. Such distortions are the result of the past political equilibrium and the direct consequence of capture from selected elite. Economic policies operated in a tightly controlled social and political space, in which public support for the ruling party was highly beneficial, if not an outright requirement for social inclusion, whether it be hiring into jobs in the public sector, access to finance, or engagement in social action, such as the limited space allowed for civil society. Similarly, the private sector has been unable to reach its full potential due to the distortions in the regulatory framework that provided privileged access to politically connected firms. Improved economic governance and transparency is therefore key for any economic reform aimed at accelerating growth and supporting broad based private sector development.

Higher growth requires a minimum level of political stability and security. Ensuring that the political, security and economic environment is stable and conducive to both public and private investment is an

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[53] Including equal access to basic services and infrastructure and widening to full and deep social and economic inclusion, voice, and agency.

essential precondition for fostering economic growth while reducing poverty and enhancing shared prosperity. In parallel, strengthening the social pact which weaves together all Tunisians, a primary challenge of the post-transition period, will include first and foremost rebuilding the broken trust between citizens and state institutions. Within this framework, it will be important to develop an inclusive economic model that strengthens efficiency and competition, along with appropriate social safety nets and mechanisms to create opportunities for the excluded groups and poor. Political and social stability are also essential to the sustainability of any identified reform (section VII).

Promote Inclusive Growth and Redistribution

Growth alone, however, is not sufficient to ensure that the generated prosperity is widely shared. Tunisia failed to create inclusive growth in its most comprehensive sense. Structural weaknesses in the economic model and deep-rooted distortions have prevented the operation of some of the main channels for a more equal and inclusive society: employment, above all, hardly played any role in reducing poverty and increasing sharing prosperity. Unleashing the potential to generate better jobs for all is therefore a crucial step for inclusion and shared prosperity.

Inequality of opportunities, and the exclusion (economic, political, and social) of many Tunisians along spatial, demographic, and income dimensions appears indeed to be one of the main constraints to achieving the twin goals. The extent to which progress toward the twin goals will happen depends on whether or not specific groups can participate in, and benefit from, economic growth. Achieving inclusion means enhancing ability, opportunity and dignity. The extent of real and perceived inclusion can have significant impacts on overall sustainability. Because of the lack of voice and participation, unequal opportunities continued to operate to create circles of exclusion for those who were born as outsiders to the established order.

The ongoing political transition, and its successful conclusion, could unlock the economic and institutional reforms necessary to put Tunisia on a faster development path. The developments of early 2011 in Tunisia offered an opportunity to rebuild the relationship between state institutions and the citizens they are expected to serve. Tunisia sought this opportunity and, despite a prolonged period of political uncertainty and security incidents throughout 2013 and 2014, the country successfully completed the democratic transition process, thanks to the collaboration among all major political parties and key civil society institutions (see Annex VI). The next few years represent an unprecedented window of opportunity for Tunisia to engage in deep structural reforms, which would put the country on a faster development path.[54] Social and political stability (as well as ensuring domestic security) are prerequisites for any reform to happen; and voice, transparency, and accountability in all economic and institutional spheres are preconditions for the sustainability of any reform.

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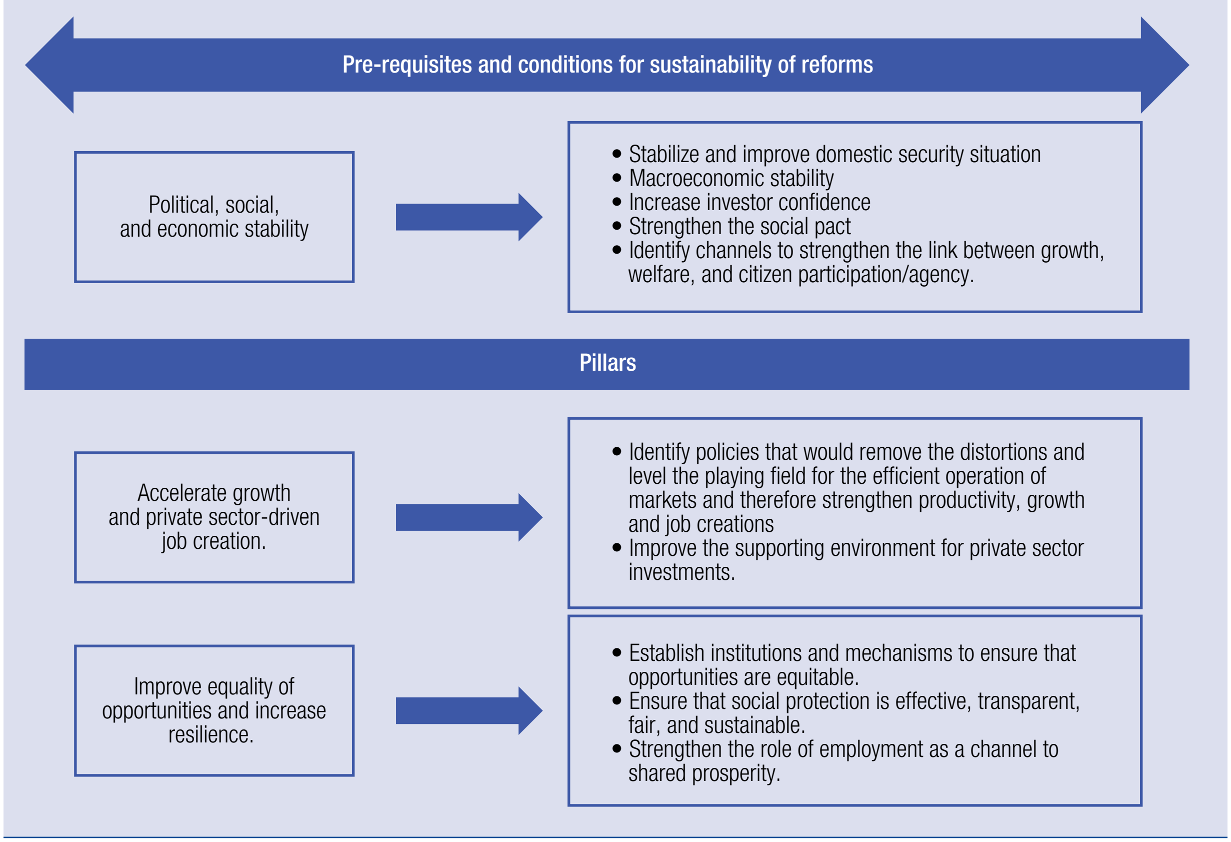
[54] Tunisia's transition toward democracy represents a unique opportunity to tackle structural economic and social reforms. The "implementation challenge" of such reform agenda remains, however, substantial. Tunisia has moved toward a more pluralist society and advanced in terms of institutional and social complexity. This progress is essential to move towards a sustainable reform path, but it also poses a number of organizational challenges that will need to be tackled efficiently and quickly. Key stakeholders will need to progressively adapt to their new functions and develop structured ways of interacting with other components of the society. For instance, the respective role and timing of interactions of the Parliament, Central Government, local governments, legislative authorities, civil society organizations, and private sector organizations will need to be structured and strengthened to facilitate the identification, preparation and strategic monitoring of key reforms ahead. Resolving this "implementing challenge" is a formidable challenge at a time when Tunisia's political system is under pressure to deliver quickly needed social and economic reforms.

FIGURE 6: Pillars to Achieve Higher and Inclusive Growth and Sustainable Shared Prosperity



Pre-requisites and conditions for sustainability of reforms

Political, social, and economic stability

- Stabilize and improve domestic security situation
- Macroeconomic stability
- Increase investor confidence
- Strengthen the social pact
- Identify channels to strengthen the link between growth, welfare, and citizen participation/agency.

Pillars

Accelerate growth and private sector-driven job creation.

- Identify policies that would remove the distortions and level the playing field for the efficient operation of markets and therefore strengthen productivity, growth and job creations
- Improve the supporting environment for private sector investments.

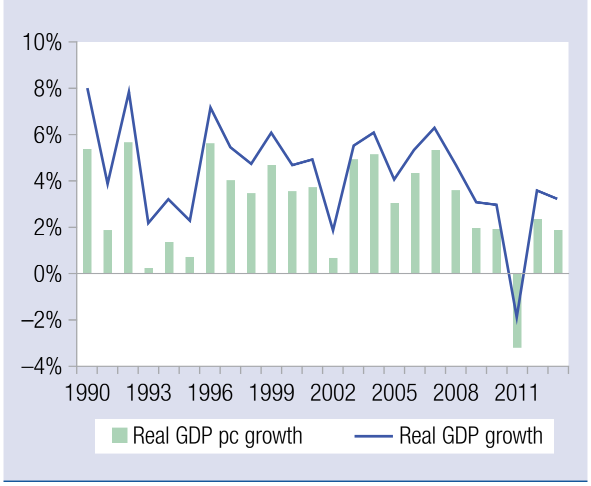
Improve equality of opportunities and increase resilience.

- Establish institutions and mechanisms to ensure that opportunities are equitable.
- Ensure that social protection is effective, transparent, fair, and sustainable.
- Strengthen the role of employment as a channel to shared prosperity.

4 Growth Development and Diagnostic

Despite relatively robust growth rates, Tunisia's macroeconomic dynamics during the past decade have been characterized by low productivity, insufficient investment, fading export performance, and insufficient employment generation. Underpinning this subpar performance, Tunisia suffers from a structurally low investment, especially from the domestic private sector, while foreign direct investment (FDI) has been at times significant but poorly diversified. Although Tunisia has often been perceived as an open and well integrated economy, its export performance has been the second lowest in the region and has lagged far behind the most dynamic U-MICs.

FIGURE 7: Real GDP and Real GDP Per Capita Growth

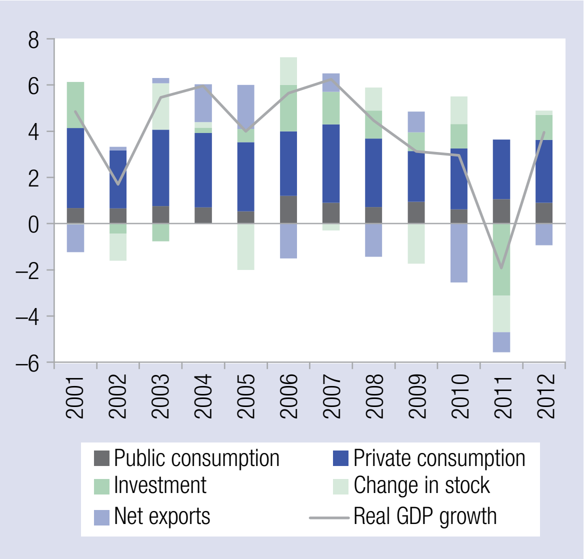


Source: WDI.

Tunisia enjoyed a 4.4 percent average annual growth in GDP during 1980–2010, placing the country among the best performers in the MENA region. However, the growth has been erratic, and the economy has remained vulnerable to exogenous shocks that altered high growth episodes. Despite reforms that helped to reduce the volatility of growth since the late 1990s, the high growth episodes were short-lived. As a result, while Tunisia outperformed U-MICs average during 1980–2000, its growth performance was mitigated during the 2000s, with 4.5 percent average annual GDP growth, well below that of the U-MICs average (5.9 percent), and even slightly below that of MENA average (4.6 percent).

Tunisian economy has been unable to efficiently reallocate resources from low-return to high-return activities, and it has remained trapped into a low-productivity growth. Between 1990 and 2010, accumulation of capital and labor contributed on average 36 percent and 35 percent to growth, respectively (DPR, Chapter I). Only the remaining 28 percent of growth can be attributed on average to improvements in Total Factor Productivity (TFP). This corresponds to an average annual TFP growth rate of approximately 1.3 percent, which, although comparing well with respect to its regional peers, is low when compared to fast growing countries. Further, controlling for human capital, the growth contribution of capital, labor, and

FIGURE 8: Private Consumption as the Main Driver of Growth

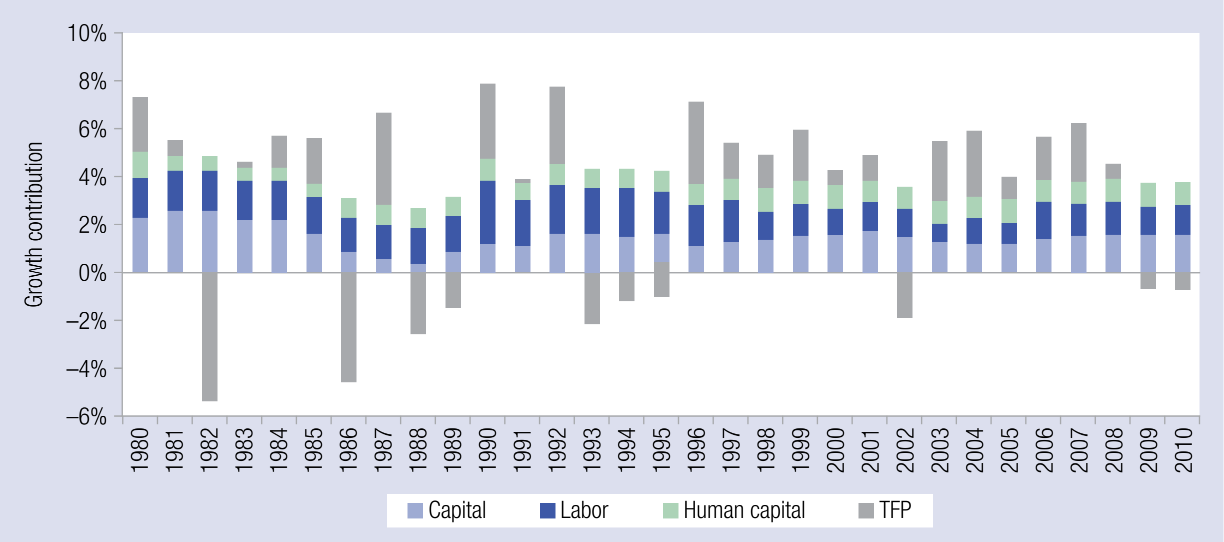


Source: WDI.

human capital becomes 36 percent, 35 percent and 22 percent, respectively, such that contribution of TFP growth shrinks to an average five percent over the last two decades.

Low TFP growth suggests the existence of barriers that prevent a reallocation of resources toward more productive activities and hamper the economy's capacity to generate wealth and jobs. Moreover, in Tunisia the manufacturing sector has a very low productivity, only slightly higher than agriculture, and in fact the textiles sector is even less productive than agriculture. This reflects the fact that most of the manufacturing in Tunisia focuses on simple assembly and other low value added activities, which also explains the low quality of jobs. Labor productivity mirrors this production structure: in 2005, labor productivity in manufacturing in Tunisia was only 1.7 times higher than in agriculture; this is even lower than the 2.3 gap in Sub-Saharan Africa and much below the 2.8 in Latin America and 3.9 in Asia (McMillan and Rodrik 2011). The growth in output per worker (a proxy of labor productivity) was around 2.5 percent on average in Tunisia over the past decade, below most benchmark countries in MENA (such as Jordan and Morocco) and fast growing countries in the EU and Asia.

FIGURE 9: Low TFP Contribution to Growth Suggests Misallocation of Capital



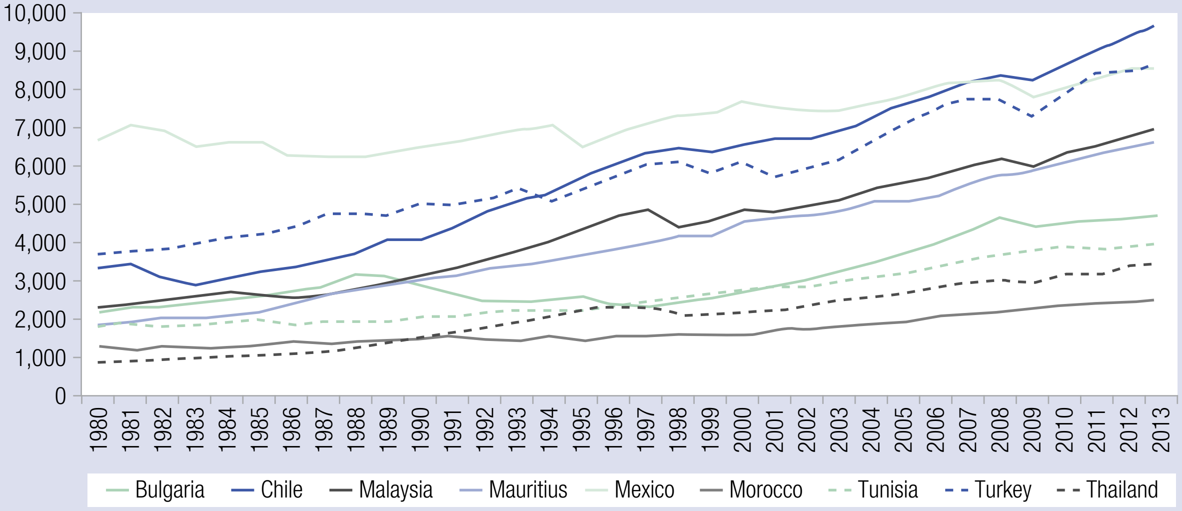
Source: Tunisia DPR 2014.

Box 1: Comparative perspectives of Tunisia's economic performance

Tunisia's economic performance was benchmarked against a set of comparative countries (Chile, Malaysia, Mauritius, Mexico, Morocco, Turkey, Thailand, and Bulgaria) that have been chosen based on similar development experiences and challenges,, type of policies adopted, openness of the economy, and comparable level of development.

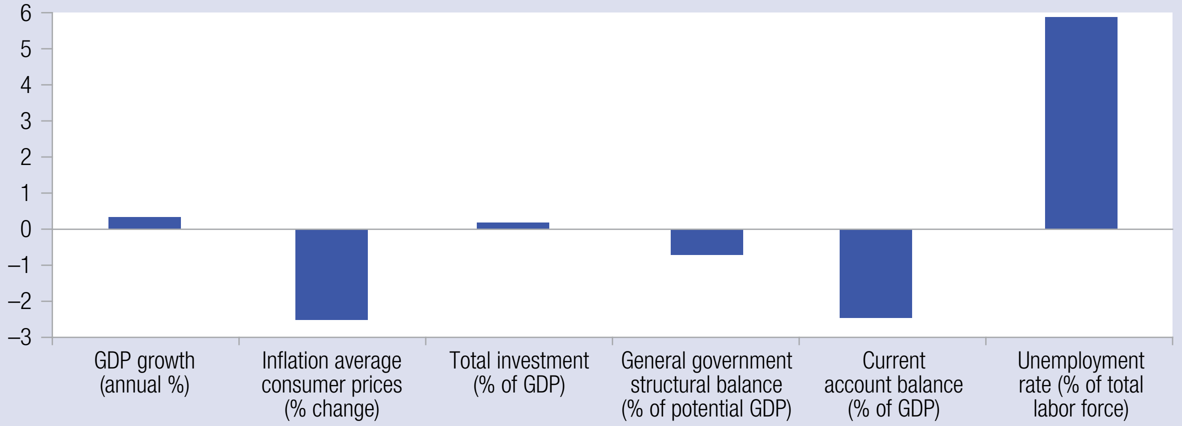
While most macroeconomic indicators are in line with other middle-income countries, Tunisia stands out for the persistently high level of unemployment. Growth and investment were slightly above the average of the comparators, with lower inflation, as well as lower fiscal and current account deficit. However, Tunisia has the highest unemployment rate among this group with 13 percent in 2010, against an average of 7.7 percent for the comparison group (Figure 10).

FIGURE 10: GDP Per Capita (constant 2005 US$)



Source: World Development Indicators.

FIGURE 11: Macroeconomic Indicators (2000–2010 Average): Tunisia and Comparison Group Percentage Point Difference from the Group



Source: World Development Indicators.

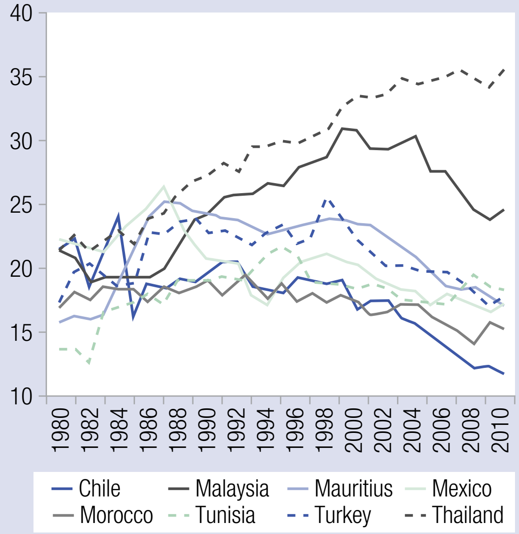
(continued on next page)

Box 1: Comparative perspectives of Tunisia's economic performance *(continued)*

Tunisia did not see a manufacturing export surge like many other countries. Its manufacturing value-added as a share of GDP stagnated after having reached 19 percent in the early 1990. Among the benchmarking countries, East Asian countries have the highest manufacturing share of GDP, with a peak of 31 percent and 36 percent respectively for Malaysia and Thailand during the 2000s, before decreasing to 24 percent and 34 percent respectively in 2012. The share of Tunisia's service sector in the GDP has continuously increased, from 47 percent in 1980 to 60 percent in 2010, which is comparable to Chile and Mexico, but lower than Bulgaria, Mauritius, and Turkey. Tunisia's export performance was mitigated. Tunisian exports growth was positive but slower than in many of the benchmark countries, and its exports as a share of GDP declined from 38 percent to 35 percent over two last decades, with limited increase during the 1990s and a drop over the past decade. There was no strong surge like that of East Asian countries, Bulgaria or Mauritius during the 1990s. Moreover, Tunisia has continued to import more than export reflecting a structural gap in its trade pattern. Further, Tunisia's share of goods exports in world trade fell slightly between 2002 and 2010 while most benchmark countries increased their export share in the world.

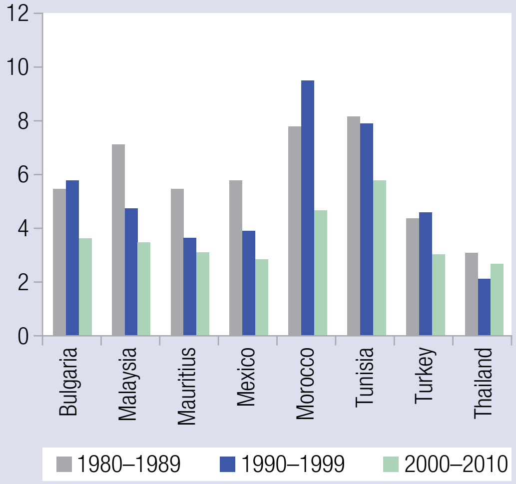
After the structural adjustment period, the privatization process slowed down leaving intact a large public sector in the economy, which increasingly translated in inefficiency, often masked by monopoly-rents, and contributed to weak overall economic performance. SOEs still play a dominant role in key sectors, such as in mining and energy, finance, banking and insurance, transport, and communications. As a result, among this group of benchmark countries, Tunisia has the highest weight of the public sector in the economy. Measured by public and publicly guaranteed debt service as share of GNI, all benchmark countries including Tunisia have continued to reduce the weight of the public sector, but the pace was much slower in Tunisia. Tunisia has the highest share among this group with 4.6 percent in 2010, against an average of two percent in MENA region, 0.8 percent in upper MICs and 0.5 percent in East Asian region (Figure 12).

FIGURE 12: Manufacturing, Value Added (% of GDP)



Source: World Development Indicators.

FIGURE 13: Public and Publicly Guaranteed Debt Service (% of GNI) (average)



Source: World Development Indicators.

Consumption has been the main driver of growth, with private consumption accounting for 66 percent of growth during the 2000s. Investment has remained sluggish and volatile, accounting only for 24 percent of GDP during the same period, which is low compared to other U-MICs. The level of private domestic investment is especially low, at around 15 percent in Tunisia over the period. Further, most of the domestic private investment (54 percent) is concentrated in the services sector, which is highly protected from international competition.

Meanwhile domestic private investment has been constrained by prerevolutionary predatory practices and an underperforming banking sector. Investment hovered around 24 percent since 2000, which is low compared to other U-MICs and take-off countries. The level of private domestic investment is especially low, at around 15 percent in Tunisia over the period. Further, domestic private investment remained focused on real estate (considered safer from predation by the Ben Ali regime). Much of the legislative and administrative framework that allowed for predation, crony capitalism, and elite capture remains in effect,[55] with potential for manipulation by current and future regimes. In terms of sectors, most of the domestic private investment (54 percent) is concentrated in the services sector, which is highly shielded from international competition. Meanwhile, the domestic banking sector has been unable to channel credit to the most productive economic activities and projects.

Tunisia appeared to have attracted relatively more FDI[56] than most of the MENA countries (2.3 percent), but its FDI has remained modest compared to other U-MICs that attracted an averaged 3.4 percent of FDI during the 2000s. Moreover, despite government efforts to promote manufacturing exports, FDI in Tunisia has remained concentrated on the energy sector, which absorbed 60 percent of total FDI during 2007–2010, against 24 percent in manufacturing and 15 percent in services (against Morocco, for instance, where 88 percent of FDI was directed into services sectors).[57] In fact, FDI in manufacturing dropped by half between 2000 and 2006, and has remained focused on low value added industries.

FIGURE 14: Deposit and Credit Growth, Liquidity Refinancing

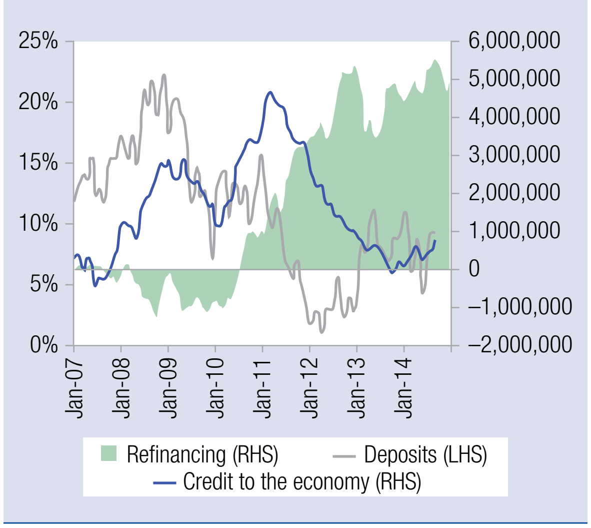
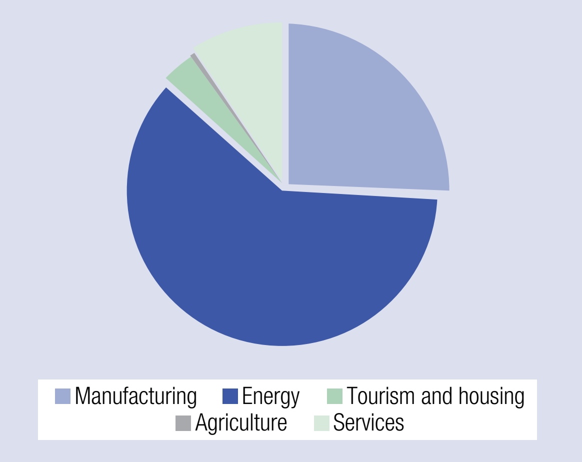


FIGURE 15: FDI by Sector 2006–2012



Source: FIPA.

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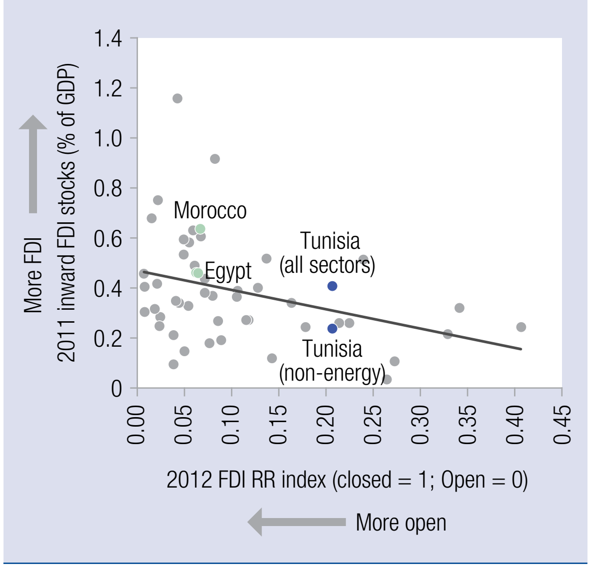
[55] Rijkers, Rob, Freund and Nucifora 'All in the Family: State Capture in Tunisia', Policy Research Working Paper 6810, The World Bank (March, 2014).

[56] FDI has increased from an average of 2 percent of GDP during the 1990s to 3.1 percent during the 2000s.

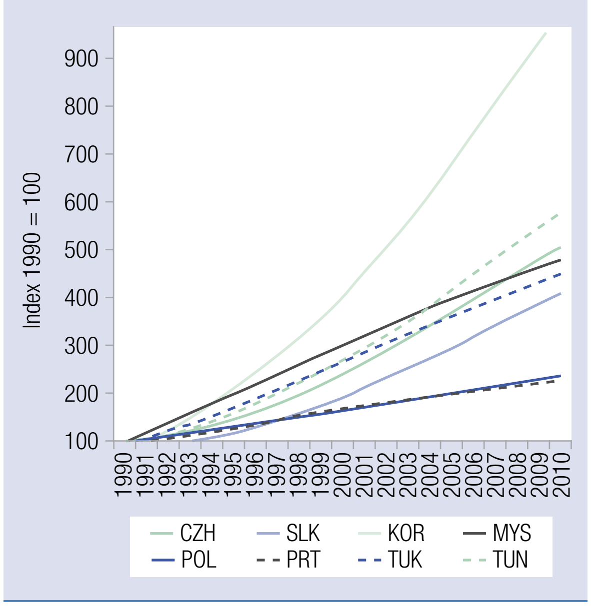
[57] The telecommunications sector has become one of the region's main sources of foreign direct investment (United Nations 2008). Between 2000 and 2009, the sector attracted almost 70 percent of regional investment (around US$42 billion). The prominent trigger of this interregional flow of capital has been the introduction of competition in mobile telecommunications markets since the end of the 1990s, with most cross-regional investment focused on mobile operators. Countries that liberalized first or more aggressively—such as Morocco, Egypt, Jordan, Saudi Arabia, and Iraq—have received the largest FDI inflows from within and outside the region (primarily from Europe and South Africa). By contrast, in countries where there has been no or only timid liberalization—including Lebanon, Syria, and Libya—capital inflows have been limited. However, even in difficult environments where investment carries political risks, such as Iraq, announcements of additional licenses have attracted interest from multiple potential bidders. The opening of mobile markets has attracted intraregional and external flows through greenfield investments in new licenses and cross-border mergers and acquisitions of national operators and regional groups.

FIGURE 16: FDI Remain Concentrated in the Energy Sector, Given the High Restrictiveness on Investing Elsewhere



Source: Data from OECD, FDI Regulatory Restrictiveness Index.

FIGURE 17: Trends in Exports of Goods and Services (nominal) (1990=100)



Tunisia's export performance has remained modest overall, despite an apparently favorable incentives regime. While Tunisia traditionally suffered from structural trade deficit due to its assembly type of exports (which tend to import more than export), and an under-exploitation of its export potential (for instance, food exports, largely geared toward the European market, are merely about 10 percent of total merchandise exports.) In many cases Tunisia is not using its full EU quota.[58] Recent growth in the deficit reflects an increasing share of energy, accounting now for more than a third of the trade deficit. This is exacerbated by a slowdown in export growth,[59] lower tourism receipts, and negative supply shocks in the major productions (such as phosphate and agriculture sectors).

In addition, Tunisia has seen a widening energy trade deficit in the recent years, the result of higher energy bill, lower oil and gas production (which decreases exports and raises imports), and lower gas transiting from

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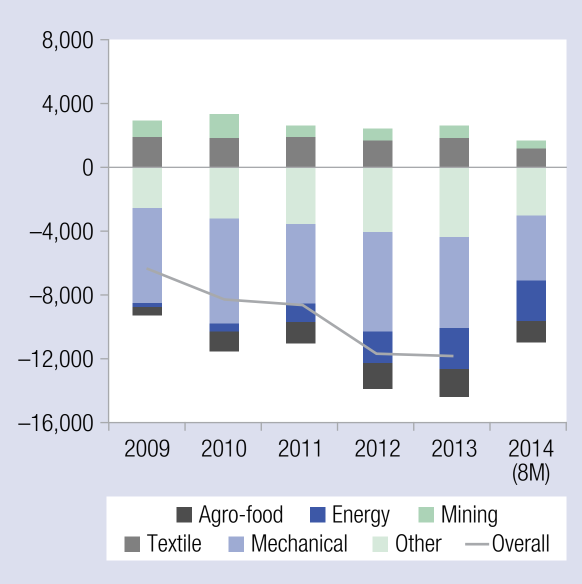
[58] Tunisia's agricultural policy objectives aim to achieve food security for a rather narrow set of commodities such as cereals and livestock production. Overall incentives are geared towards the production of non-competitive commodities in large-scale farms, often located in the coastal areas. Thus, while well intended, the current agricultural policy setting did not manage to support and create job-intensive growth as agriculture is dominated by small and medium-sized family farms. Agricultural policy fundamentally reduces incentives to labor-intensive crop and livestock production.

[59] It is often argued that if Tunisia were to shift production towards several Mediterranean products (arboriculture and horticulture) in which it enjoys a comparative advantage, it could boost the export of labor-intensive agricultural products to the EU market. Such a shift needs to be implemented gradually to ensure that it does not distort national food security objectives. It would require highly sensitive policy prioritization in the area of price support, input subsidies, and the marketing of agricultural products. Importantly, it would need significant hard and soft infrastructure investments in several areas, including irrigation, research and extension, land registry, and agricultural financing. A system of income transfer to mitigate impacts on existing beneficiaries would likely be required.

the Algeria-Italy pipeline (from which Tunisia is paid in gas supplies).[60] The structural trend of growing oil and gas consumption against lower production due to waning domestic resources is reflected in Tunisia's energy import balance, which up until 2000 was positive, and since then turned negative. At the same time investments in the energy sector have been lagging, which could make the system increasingly susceptible to power outages that in turn could also negatively affect Tunisia's export performance. In 2013 the Government began a review process with the aim of addressing these challenges. In 2014 it endorsed a dedicated energy road map and priority measures that focuses on (i) reviewing existing gas resources and consumption patterns; and (ii) diversifying electricity supply away from gas thus strengthening energy security. The implementation of this road map will require making available significant levels of financing to ensure necessary investments can be made to meet electricity demand.

FIGURE 18: Trade Balance by Product Group (in Million TND)



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[60] Lower levels of transiting gas is a direct result of the unfavorable economics combined with a sharp increase in renewable electricity generation in Italy, which has led to a decline of gas demand from Algeria. Given the importance of gas supplies in the electricity mix in Tunisia (about 95 percent), the decline in gas supplied in kind through the Algeria–Tunisia–Italy pipeline weighs heavily on the overall Government budget.

5 Poverty and Shared Prosperity Diagnostic

Poverty incidence in Tunisia halved between 2000 and 2010, from over 32 percent to 15.5. In the past decade Tunisia saw its poverty incidence, officially measured in terms of household per capita consumption, substantially decline. This is true across several dimensions: for absolute and extreme poverty lines, across regions and by strata (Table 3). Furthermore, estimates from the Institute of National Statistics (INS, AfDB, and World Bank 2012) confirm that the depth and severity of consumption-based poverty also improved consistently in the past decade (Figure 20).

TABLE 3: Poverty Incidence and Inequality in Tunisia

	Poverty			Extreme Poverty		
	2000	2005	2010	2000	2005	2010
Tunisia	32.4	23.3	15.5	12.0	7.6	4.6
By region:						
Greater Tunis	21.0	14.6	9.1	4.3	2.3	1.1
Northeast	32.1	21.6	10.3	10.5	5.4	1.8
Northwest	35.3	26.9	25.7	12.1	8.9	8.8
Center-East	21.4	12.6	8.0	6.4	2.6	1.6
Center-West	49.3	46.5	32.2	25.5	23.2	14.3
South-East	44.3	29.0	17.9	17.5	9.6	4.9
South-West	47.8	33.2	21.5	21.7	12.1	6.4
By stratum:						
Cities	21.5	15.4	9.0	4.3	2.2	1.3
Medium-sized towns	32.5	22.1	14.0	10.5	6.5	2.9
Noncommunal areas	40.4	31.5	22.6	19.1	13.4	9.2

Tunisia's poverty reduction process has mostly been linked to its economic growth. About 80 percent of the poverty reduction between 2005 and 2010 has been attributed to growth, and much less, about 18 percent, to redistribution.[61] These findings confirm previous results on the importance of growth compared to redistribution from 1980–2000 (Ayardi et al. 2005). In other words, it is the increase for all, and not the reduction in disparities, that explains the lion's share of overall poverty reduction experienced in Tunisia. Consistently, the evolution of poverty appears to be linked to growth performance. Estimates for post-revolution poverty incidence[62] suggest that poverty increased immediately after the revolution (where growth reached a record –1.9 percent) and then fell again in 2012 to pre-revolution levels (thanks to growth rebound thanks to increased consumption fueled by large public expenditures on wages and social programs). Simulations of the effects of sector-specific changes in growth, prices and employment[63] observed in 2011 and 2012 had on households' consumption[64] show an increase in poverty to

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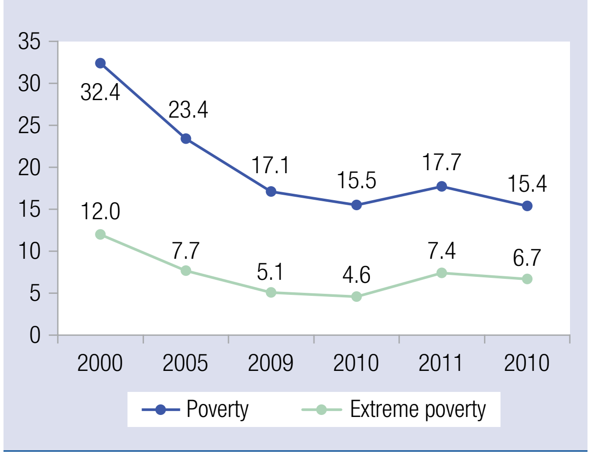
[61] Bank staff calculations from a growth-inequality decomposition methodology developed by Datt and Ravallion (1992).

[62] Forthcoming WB Poverty Assessment for Tunisia.

[63] Gross domestic product (GDP) growth, unemployment rates (by educational attainment category), and Consumer Price Index (CPI) changes.

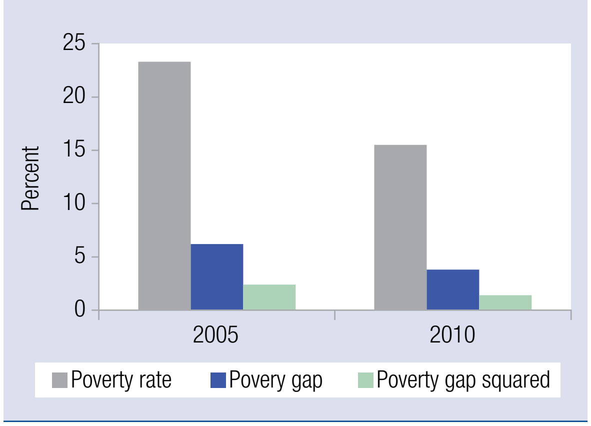
[64] In the latest available 2010 Household Budget and Living Conditions (HBCS) survey.

FIGURE 19: Poverty and Extreme Poverty Trends for 2010–12



Source: World Bank (forthcoming) poverty assessment using HBCS data and INS estimates of unemployment and CPI.
Note: Shadowed areas indicate Bank's estimated rates. Non-shadowed rates report official estimates.

FIGURE 20: Welfare Indicators in Tunisia 2005–2010



Source: Authors' calculations using HBCS data.

17.7 percent in 2011 followed by a reduction to 15.4 percent in 2012. In the case of extreme poverty, incidence increased to 7.4 percent in 2011 and declined to 6.7 percent in 2012, still above the pre-revolution rate of 4.6 percent in 2010 (Figure 19).[65]

Despite a remarkable reduction in poverty incidence, regional disparities persisted and even increased in the past decade. Overall consumption inequality between 2000 and 2010 decreased only slightly: the Gini index went from 0.375 to 0.358. However, inter-regional inequality substantively increased with respect to intra-regional inequality. Inequality between regions explained about 62 percent of total inequality in 2010 compared to 50 percent in 2000. Regional disparities in poverty headcount rates are accompanied by significant regional differences in the concentration of the poor population, which is over-represented in the western regions of the country. In 2010 poverty rates ranged from a low rate of 8–9 percent in the Center East region and Grand Tunis to a high of 26 and 32 percent in the North West and Center West regions respectively. Extreme poverty has become more concentrated than before: the poorest regions of the country, namely the (North, Center, and South) West, were in 2010 home to more than 70 percent of the extreme poor living in the country (and 55 percent of all poor).

Furthermore, poverty incidence in rural areas continued to be nearly twice as high as in urban areas in 2010. It is likely that this pattern has continued without major changes in the post revolution period (at least through 2012). Poverty incidence in cities declined from 21.5 to 9.0 percent, while in non-communal areas, it fell from 40.4 to 22.6 percent (Table 3). Results from survey-to-survey imputation methods suggest that much of the estimated change in poverty between 2010 and 2012 came from reductions in urban poverty rather than reductions in rural households' poverty.[66]

In addition to the modest decline in overall inequality, vulnerability to falling into and/or remaining in poverty modestly improved. However, the probability of falling into poverty for any household in 2010

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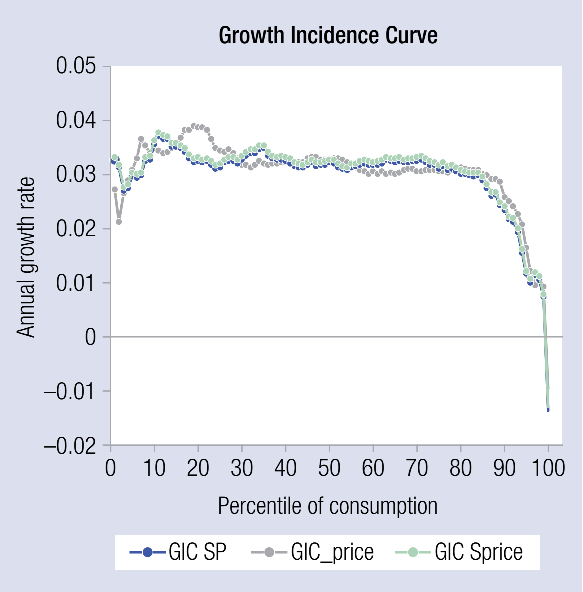
[65] More sophisticated survey-to-survey imputation methods confirm projected post-revolution poverty trends. Poverty is estimated after imputing consumption into the 2012 Labor Force Survey (LFS) using what is known about the key determinants of *observed* consumption reported in the latest available 2010 HBCS survey. Results show that, depending on the assumptions of the imputation method, poverty would have declined between 2.1 and 2.8 percentage points in 2012.

[66] Urban households account for between 65 and 90 percent of the imputed change in total poverty between 2010 and 2012.

remained considerable. This is also true for the bottom 40 percent of the population, which had a one in four chance of falling into poverty, based on the their circumstances, asset ownership, and access to basic services. In 2000, the probability of a household from the bottom 40 percent of falling into poverty was 34 percent.

Despite being "pro-poor," growth did not succeed in reducing disparities. The increase in consumption between 2005 and 2010 was uniform among most of the households groups, in spite of growth being lower for the richer population. This difference led to a pro-poor growth during the period that paradoxically did not come from disproportionate gains of the poor, the bottom 40 percent or the middle class, but from the reduced growth of the rich. After adjusting for inflation between years and for spatial price differences, annual growth rates between 2005 and 2010 were mostly uniform at around three percent for the majority of the distribution (Figure 20). It was only for—roughly—the top 20 percent of the distribution that consumption growth rates were below average (and only the richest top 2–3 percent had an actual negative growth between the two years). In other words, the sustained annual growth rates of consumption are consistent with substantive poverty reduction, but their mostly uniform distribution across many Tunisians explains why monetary inequality improved only modestly.

FIGURE 21: Growth Incidence Curve for Household Per Capita Total Consumption 2005–10



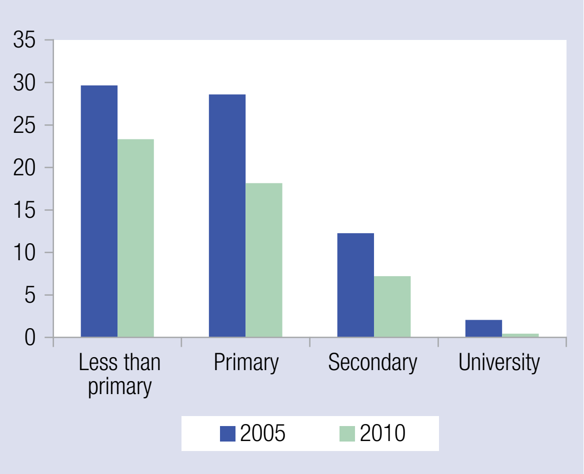
Source: World Bank staff estimates.
Note: "GIC SP" adjusts the distribution of consumption for regional price differences and temporally using the average national poverty line; "GIC Price" adjusts for price variations between 2005 and 2010 without regional price adjustments and using the CPI as deflator; "GIC SPRice" adjusts the distribution of consumption for regional price differences and temporally using the Consumer Price Index. Annual growth rates are expressed in percentage/100.

Profile of the Poor and the Bottom 40 Percent

Poverty status in Tunisia is positively correlated with household size, location, and level of educational attainment of the household head. The poor live in more crowded households, are more likely to reside in western regions, and have less-educated members in their households than the non-poor. Education seems to be a strong correlate of poverty: in 2010, there was a considerable gap in poverty rates between households whose head had less than primary education and others. Specifically, households with uneducated (or less-educated) heads show a poverty rate of around 23 (30) percent, whereas the rate for households whose heads have more than secondary education is just less than 1 (2) percent (Figure 22). The vast majority (around 80 percent) of the poor population live in a household whose head completed only primary or less education (Figure 23). Poor individuals are more likely than non-poor individuals to be unemployed (Figure 24) or work in the agriculture sector (Figure 25). Workers in the public sector are also less likely to be poor compared to the self-employed and those working in the private sector.

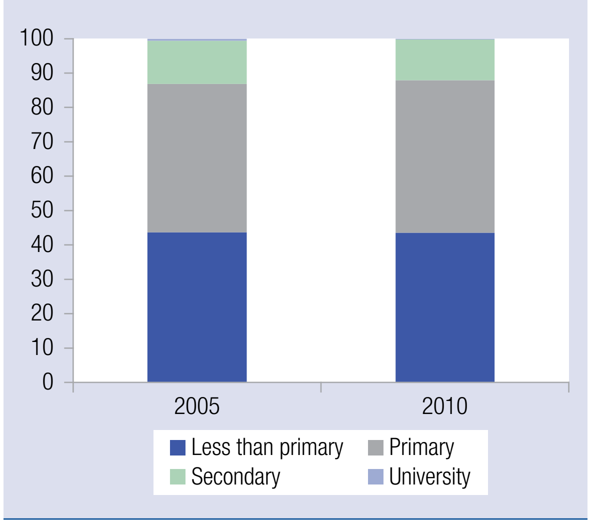
The poor have typically had substantively low access to basic services, notably water and sanitation, and the gaps with respect to the non-poor seem to be an enduring feature. Differences in having a flush toilet or being connected to the sewage network were significant in 2005 and 2010. Moreover, coverage among the

FIGURE 22: Poverty Headcount Rates by Education of the Household Head



Source: World Bank (forthcoming) poverty assessment using HBCS data.

FIGURE 23: Share of the Poor, by Education of the Household Head

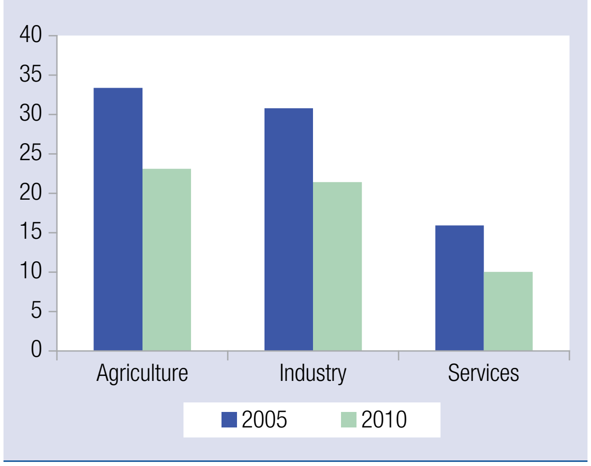


Source: World Bank (forthcoming) poverty assessment using HBCS data.

FIGURE 24: Poverty Headcount Rates by Education of the Household Head

Source: World Bank (forthcoming) poverty assessment using HBCS data.

FIGURE 25: Poverty Headcount Rates by Sector of Employment

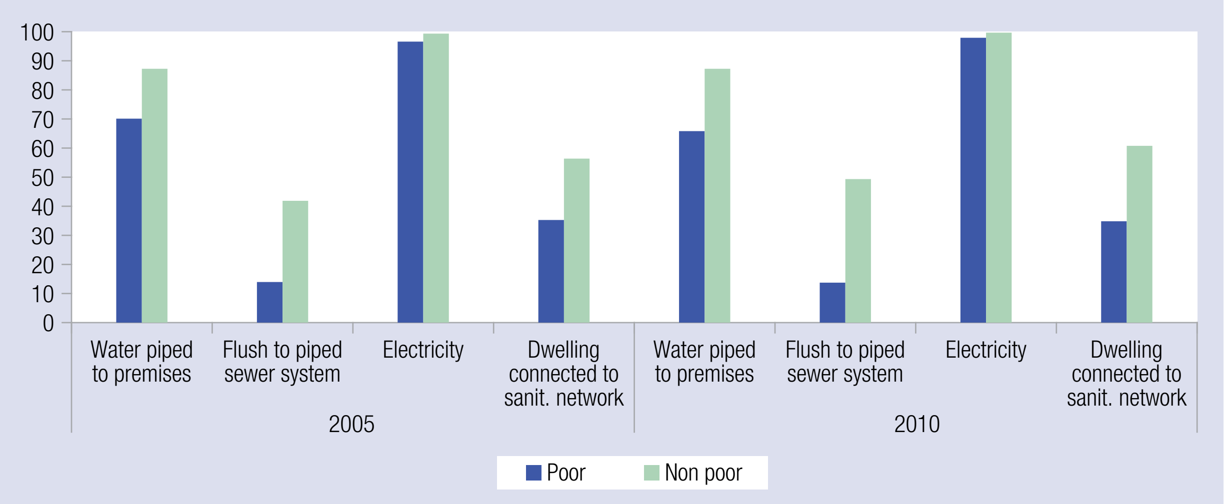


Source: World Bank (forthcoming) poverty assessment using HBCS data.

non-poor increased while that of the poor remained stagnant in more recent years (Figure 26). The poor also have fewer assets than the non-poor, with marked differences in ownership of cars and motorcycles, telephones and cell phones, and computers. In terms of consumption patterns, the poor spend relatively more of their lower consumption expenses on food than the nonpoor. On the positive side, coverage gaps between the poor and the non-poor have narrowed for education services and remain very small for (almost universal) access to electricity.

For virtually all features considered, the profile of the bottom 40 percent falls between that of the poor and the non-poor. Interestingly, for access to services and asset ownership, the profile of the bottom 40 percent aligns closer to the poor than the non-poor. Households in the bottom 40 percent are larger,

FIGURE 26: Access to Services by Poverty Status (in Percent)



Source: World Bank (forthcoming) poverty assessment using HBCS 2005 and 2010.

have more dependents, and are headed by individuals with lower educational attainment than households in the top 60 percent of the distribution. They are also less likely to work in the public sector. Households in the bottom two fifths of the distribution had on average six members—one less than households in the top 60 percent. Dependency rates among households in the bottom 40 percent are higher than those in the top 60 percent, suggesting they face more stringent economic situations to cover their basic needs. The education and economic characteristics of household heads in the bottom 40 percent are similar to the characteristics of heads in poor households and typically worse than those of heads in the non-poor household. For instance, in 2010 over 75 of the households in the bottom 40 percent were headed by an illiterate individual (over 80 percent for the poor), whereas half of household heads among the non-poor were. In addition, almost 37 of household heads in the bottom 40 percent had a household head working in a salaried private job while only about 27 percent of the head of non-poor households did.

Individuals and households in the bottom 40 percent are spatially concentrated in the Center West and North West regions of Tunisia. In 2010, over 55 percent of households, who belong to the bottom 40 percent of the consumption distribution, were located in rural areas of Tunisia. The regions with the largest concentration were the Center West and North West regions hosting over 40 percent of the population belonging to the bottom two fifths of the distribution (Figure 27). The same regions are home to almost 48 percent of the poor (Figure 28).

The similarity in demographic, economic characteristics and spatial distribution of the poor and the bottom 40 percent population reassures that the poverty reduction and share prosperity boosting targets are totally coherent. As shown, poverty status of a household seems to have been related, both in 2005 and 2010, to a similar set of characteristics as those from households in the bottom 40 percent.[67] These results may hint that shifting policies benefitting the entire populations for others that more specifically focus on the bottom 40 percent would have substantive benefits for the poor as well.

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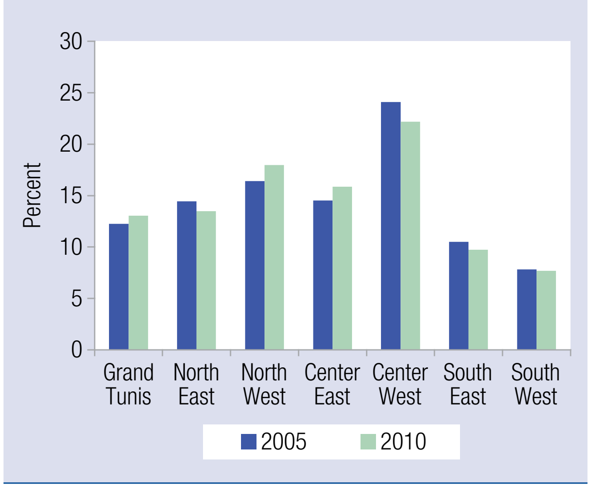
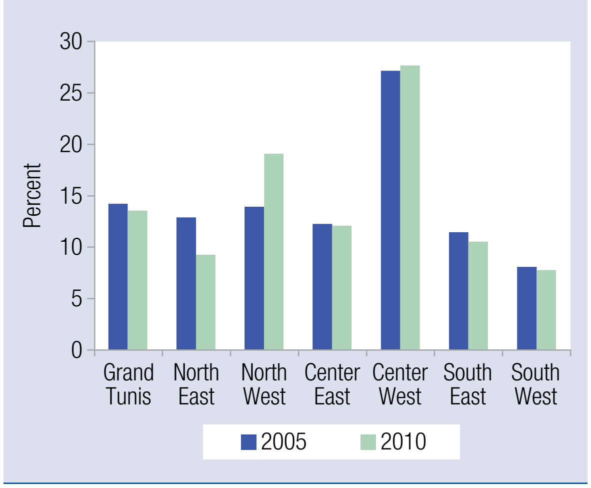
[67] For instance, poor households—as well as households in the bottom 40—percent tend to be larger and concentrated in the western and rural regions of the country. Also, non-poor households tend to have heads who have higher education levels or who are more likely to be employed in the public sector, as well as much better access to services, particularly water and sanitation.

FIGURE 27: Distribution of the Bottom 40 Percent Across Tunisian Regions



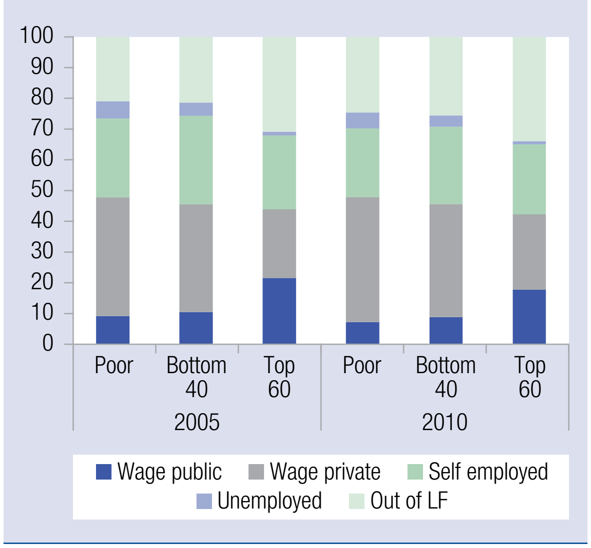
Source: World Bank (forthcoming) poverty assessment using HBCS 2005 and 2010.

FIGURE 28: Distribution of the Poor Across Tunisian Regions



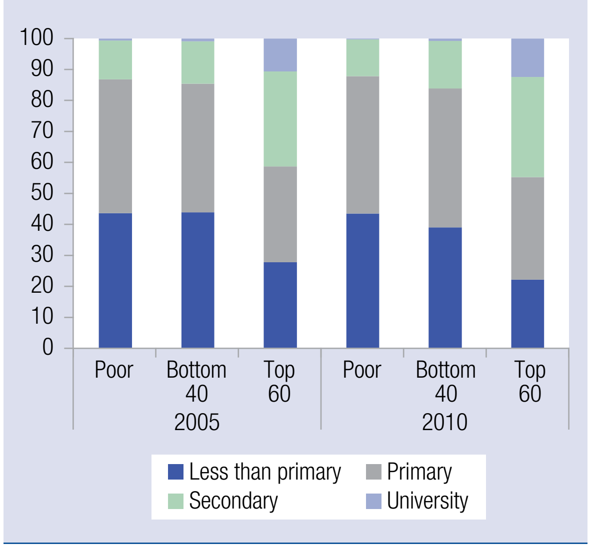
Source: World Bank (forthcoming) poverty assessment using HBCS 2005 and 2010.

FIGURE 29: Distribution of Labor Force Status of Household Head by Group of Consumption Distribution



Source: World Bank (forthcoming) poverty assessment using HBCS 2005 and 2010.

FIGURE 30: Distribution of Highest Educational Level Attained by Household Head by Group of Consumption Distribution



Source: World Bank (forthcoming) poverty assessment using HBCS 2005 and 2010.

Employment and the Poor

In Tunisia, employment rates among the bottom 40 percent of the population are lower than in other Middle Income Countries.[68] Participation rates are comparable across consumption deciles (see Figure 31). There are, however, marked differences in the unemployment rate. Among workers living in households in the poorest decile, for instance, the average unemployment rate is more than 30 percent, more than double the rate for workers living in the richest households (which is below 15 percent). An important implication is that, contrary to other countries where most of the poor work—albeit in low quality jobs—in Tunisia standards of living can still be improved by connecting the poor to jobs.

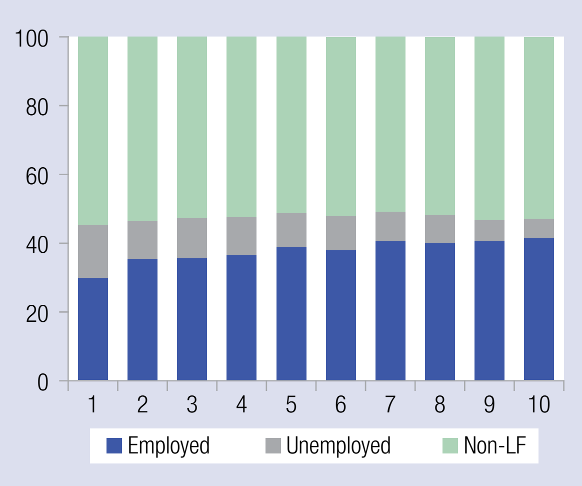
Workers living in poor households are often employed in low quality jobs. In the poorest households, less than 20 percent of workers are in formal wage employment in the private or public sectors. The majority are in irregular wage employment (40 percent), or self-employed in agricultural or non-agricultural activities. In the richest households, close to 75 percent of workers are in formal wage employment. The share of those who are self-employed in agriculture or in irregular wage employment is negligible (see Figure 32).

Workers in the bottom 40 percent are often in lagging regions, especially in the North-West, Center-West, and South-West. Individuals living in these regions are also more likely to be inactive or unemployed (see Figure 33 to Figure 36). Improving labor market opportunities for them might require targeted multi-sector policies that go beyond reforms at the macro level and the overall business environment, and focus on the regions where they live and sub-sectors linked to the economic activities they engage in.

Unequal Opportunities

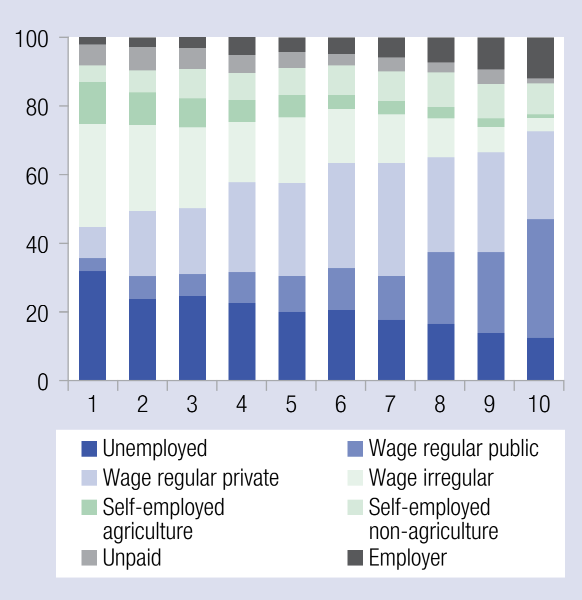
Shared prosperity has many different dimensions. This includes an equal access to

FIGURE 31: Labor Force by Consumption Decile – Age 15+



Source: Authors' calculations using ENB 2010.

FIGURE 32: Active Labor Force by Consumption Deciles



Source: Authors' calculations using ENB 2010.

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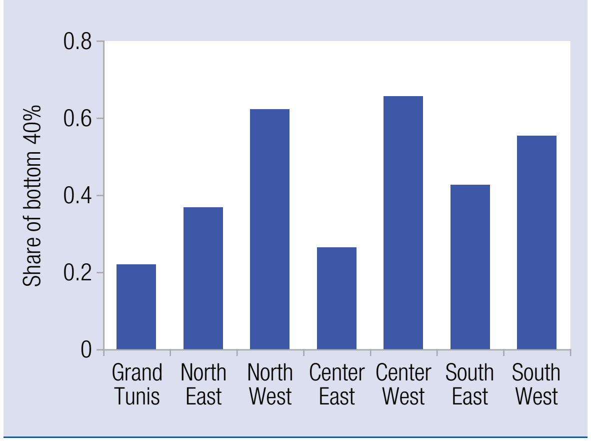
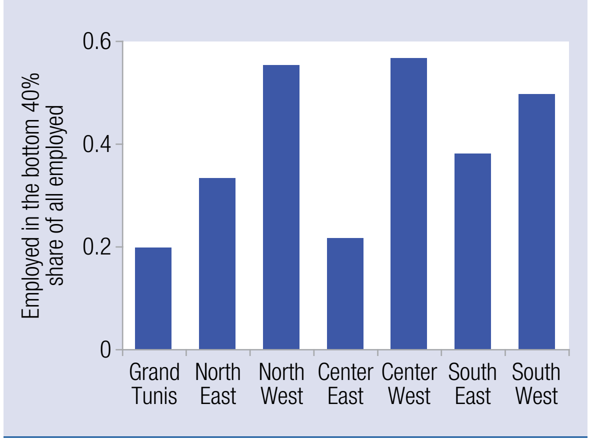
[68] At the individual level, youth, women and workers living among the bottom 40 percent of the population have much worse labor market outcomes. Among youth in the bottom decile, for instance, only less than 20 percent are employed, 40 percent do not participate in the labor market, and over 20 percent are unemployed. The share of inactivity increases across deciles and reaches 80 percent amongst the richest. Inactivity and unemployment among youth are worse than among the overall working age population, across all deciles. In fact, youth are 2.5–3 times more likely than adults to be unemployed; this rate is higher among men than women. At the regional level youth are 2–5 times more likely than adults to be unemployed. In addition, 2 out of 3 youth with tertiary education are unemployed. In terms of the type of job held, youth and workers in the bottom deciles are more likely to be irregular wage employees or unpaid workers and are less likely to be employed in the public sector relative to all workers.

FIGURE 33: Bottom 40% Share by Region



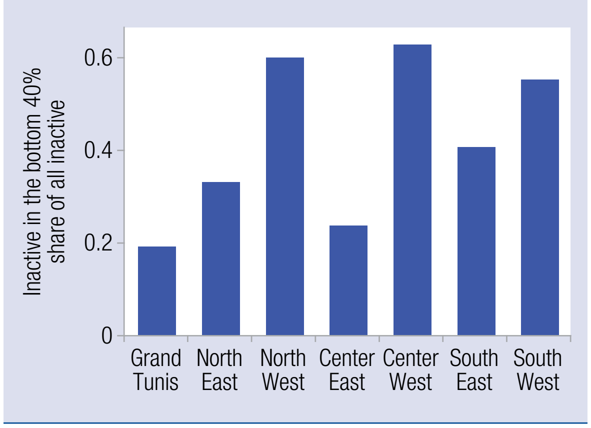
Source: Authors' calculations using ENB 2010.

FIGURE 34: Bottom 40% Share of Employed by Region



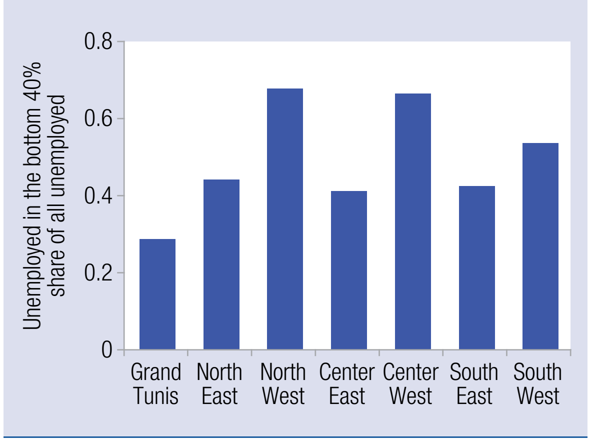
Source: Authors' calculations using ENB 2010.

FIGURE 35: Bottom 40% Share of Inactive by Region



Source: Authors' calculations using ENB 2010.

FIGURE 36: Bottom 40% Share of Unemployed by Region



Source: Authors' calculations using ENB 2010.

"opportunities."[69] **In Tunisia, uneven access to basic services is preventing progress to achieve shared prosperity.** Equal opportunities occur when access to basic services, employment and, ultimately, welfare does not depend on factors for which an individual bears no responsibility, such as the gender, location, or the family's socioeconomic background he or she is born into. To the extent to which those factors play an increasing role in such dimensions, a society is said to have unequal opportunities. In Tunisia, unequal opportunities determine, in addition to the poverty status, the extent of the disparities in access to services among Tunisians.

In Tunisia, access to basic services, with the exception of some educational opportunities, remains low and unevenly distributed. In effect, only some educational opportunities, such as attending school and starting school on time, are almost universal in Tunisia. In contrast, the likelihood of finishing basic primary education

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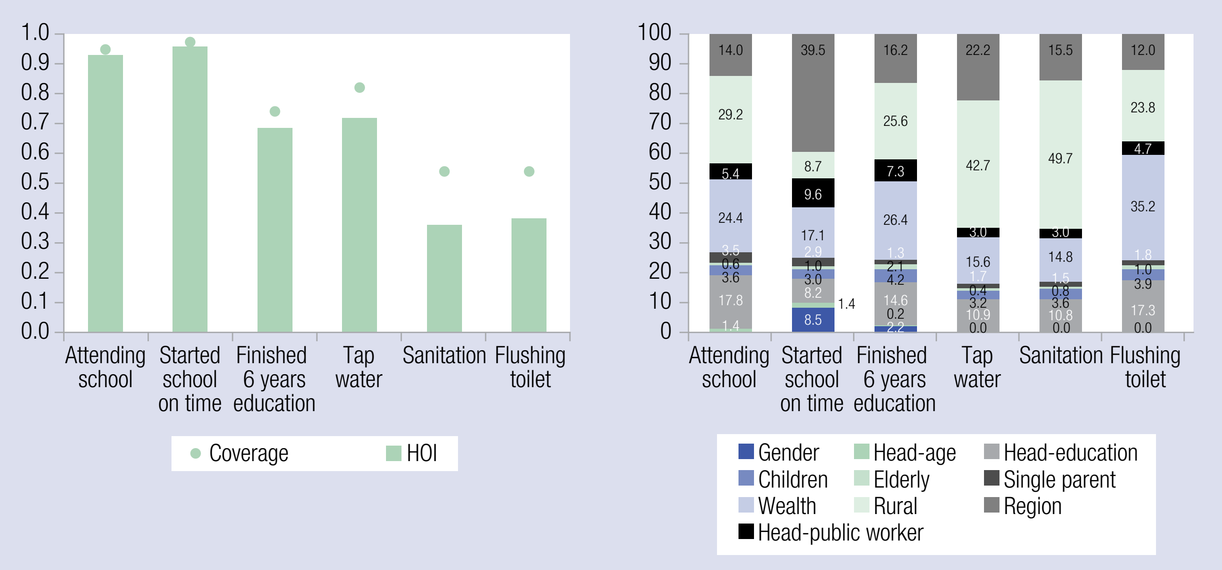
[69] Opportunities are often used in this diagnostic in a wider sense than what is reported here. In this specific case, we refer to quality access to basic services.

FIGURE 37: Coverage, Human Opportunities Index, and Shapley Decomposition for Education, Water, and Sanitation Opportunities in Tunisia, 2010



Source: World Bank staff estimates from ENBC 2010.

Note: Circumstances include gender of child; age, education, and working condition of household head; demographics of the household; presence of spouse of household head in the household; consumption of household; type of village; and region of residence. Relative weights are calculated from a Shapley decomposition methodology. This methodology measures the contribution of each variable to the total intergroup inequality of coverage of a given opportunity.

on time or having access to other basic services, such as tap water or sanitation, are both low and systematically leave out certain groups of the population. Figure 37 presents the coverage rate and HOI[70] for education-, water-, and sanitation-related opportunities for children in Tunisia.[71] Completing six years of education (basic primary education) on time and having access to tap water have coverage rates between 75 and 80 percent. But the access to these opportunities is not uniformly distributed across different population groups. Their HOI is about five to ten percentage points below their respective coverage rates. Access to sanitation and presence of a flushing toilet in the dwelling yield the lowest coverage and the largest inequality of access across population groups, with gaps between coverage and HOI well exceeding 10 percent points. In other words, not only do fewer Tunisian children have access to such services, but there are large inequalities in coverage across different population groups. The type of households a Tunisian child is born into still bears a lot of weight in the basic services he and she will enjoy early in life. Education of the household head, urban/rural location and regional residence, and wealth are systematically the most relevant circumstances to explain unequal opportunities in Tunisia. Combined, they account for between 75 and 90 percent of the observed inequality among those with access.

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[70] The Human Opportunity Index (HOI; Paes de Barros et al. 2008) is one of the analytical tools that have been developed to measure equality of opportunities. The HOI synthesizes in a single indicator how close a society is to universal coverage of a given opportunity *and* how equitably coverage of that opportunity is distributed. The HOI "penalizes" the extent to which different circumstance groups—that is, population groups defined by certain circumstances, or attributes of an individual environment—have different coverage rates. When coverage rates among multiple circumstance groups are equal, the penalty is zero and the HOI is equal to the opportunity's overall coverage rate. As coverage rates differ among circumstance groups, the penalty increases and the HOI decreases. Higher inequality in coverage rates leads to lower HOI.

[71] The HOI index "corrects" the observed coverage rate of a given service by "penalizing" the extent that coverage varies across different population groups. The lower the HOI, the higher the differences in coverage of that given service across different population groups (based on their circumstances).

Box 2: Unequal access to (and quality of) water and sanitation

Despite large coverage in water supply,[a] great disparities persist in Tunisia in access to water between poor and non-poor households, with only 73.3 percent of the poor having access (in 2005) to an improved water source, while the nonpoor had 88.3 percent access rate. In 2010, the gap between poor and nonpoor had increased, with only 68 percent of the poor having improved access, while the nonpoor had an access rate 20 percentage points higher (88.3 percent). Households in the first quintile of the consumption distribution showed access rates of 63.5 percent in 2005 and 61.7 percent in 2010. In contrast, households in the richest quintile had almost universal access, in both 2005 (97.2 percent) and in 2010 (98.1 percent).[b] For sanitation, while there was significant increase in access to a flush toilet connected to the sewer system between 2005 and 2010 (35.4 percent in 2005 to 43.8 percent in 2010), the largest expansions occurred among the privileged segment of the population. Nonpoor access rates reached 49.3 percent in 2010 (from 41.9 percent in 2005), whereas among the poor, access hovered around 14 percent.

Important geographic disparities exist in access to water sources and sanitation services While urban households have close to universal access to an improved water source, only 6 of every 10 rural households had an improved source in both 2005 and 2010. Similarly, Grand Tunis had access rates above 97 percent in 2005 and close to universal coverage in 2010, whereas the western regions (central and north) had coverage rates below 70 percent in both years. Geographical disparities for sanitation access seem to have been exacerbated between 2005 and 2010. Urban households' sanitation coverage at the highest level reached 64.2 percent—an increase of over 11 percentage points. In contrast, rural households' coverage at the highest level barely budged, increasing just 2.4 percentage points in the five-year period. Also, while access rates increased across all regions in Tunisia, eastern regions experienced the largest increases. The Center-West access rate improved by 3.1 percentage points, but was the lowest of all regions in 2010 at 15.5 percent.

The quality of services is also far from ideal, as also reflected in citizens' perception. When using the definition of adequate access to water and sanitation, following the United Nations Children's Fund's (UNICEF) conceptual framework, the results show a different water, sanitation profile on access of water and sanitation services: less than two percent of Tunisian households in 2012 had access to adequate improved water and sanitation; did not share toilets with other households; and safely disposed of child feces. When combining several criteria defining adequate water and sanitation services, only 76.5 percent of Tunisian households are considered to have adequate services and most of the households with inadequate services are poor (46.5 percent adequacy) or rural (54.5 percent adequacy). Further evidence exists of in relation to the quality of services received by citizens. A survey of beneficiaries of 80 rural water supply systems[c] shows that a majority of beneficiaries complain about the frequency and length of water supply interruptions. In a previous WHO-supported survey covering 1,468 households (2004), the quality of potable water was perceived as bad by 12 percent of households (9.8 percent in urban areas, and 15.1 in rural areas).

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[a] UNICEF/WHO. (2014). Progress on drinking-water and sanitation: 2014 update, Report of the WHO/UNICEF Joint Monitoring Programme on Water Supply and Sanitation.New York, Geneva: United Nations Children's Fund and World.

[b] In terms of socioeconomic and labor characteristics, a typical pattern emerges: characteristics associated with higher socioeconomic status (e.g. higher numbers of rooms per capita, household head working in the public/services sector, heads or other members having higher levels of educational attainment, ownership of certain assets such as air conditioner unit or a car) are correlated with higher rates of access to an improved water source and lower rates of access to an unimproved source.

[c] SONEDE, SCET Tunisie. Juin 2014. *Etude stratégique de l'AEP en milieu rural – Mission 1: Evaluation rétrospective du secteur de l'alimentation en eau potable en milieu rural.*

Addressing unequal opportunities is a key component for poverty reduction and to increase shared prosperity. Circumstances do also affect the vulnerability of Tunisians to fall into poverty, not only access to services. This is important because today in Tunisia, factors other than talent and effort determine to a large extent the chances of Tunisians to become and remain poor. If we define the top 10 most (least) vulnerable groups as those for which poverty incidence in 2005 was highest (lowest) among a series of demographic characteristics, we observe marked and persistent differentials in terms of poverty incidence. The 10 least vulnerable groups do not exceed an 11 percent incidence of poverty. In contrast, the incidence of poverty among the top 10 most vulnerable groups ranges between 35 and 60 percent. The most vulnerable group in 2005 is composed of female individuals, younger than 18 years of age, who belong to households in peri-urban areas located in West regions and where no member of her household has at least primary education (see table in Annex IV). Individuals in this group had in 2005 an average poverty incidence of 57 percent. The least vulnerable group, in contrast, refers to males over 60 years of age, with primary education residing in Grand Tunis. Their observed poverty incidence was just above three percent. A cursory assessment indicates that most vulnerable groups are found among young individuals residing in Western regions. Moreover, while the most vulnerable groups have typically reduced their poverty incidence between 2005 and 2010, their incidence still remains substantially apart from the least vulnerable.

6 Key Constraints to Growth and Inclusion

The most recent analysis on constraints to inclusive growth in Tunisia highlights how policies designed in the absence of effective institutions to ensure public sector accountability have acted as binding constraints to growth. The 2014 World Bank Development Policy Review (DPR)[72]—whose conceptual framework informs this diagnostic—argues that Tunisian prosperity has been held back by policies that have reduced the country's overall economic performance. These policies created multiple barriers and deep distortions to the operation of markets that are behind the poor growth performance vis-à-vis comparator countries. Specifically, the DPR argues that a protected regulatory environment resulting in lack of competition and large bureaucratic burden, a financial sector hampered by governance failures, labor rules that paradoxically promote job insecurity, and industrial, agricultural, and natural resources management policies that introduce distortions and deepen regional disparities are at the core of Tunisia's economic and social impasse fueling discontent that led to the revolution. Similarly, two recent studies[73] identified strong state regulations that create an environment of low appropriability on returns and low social returns as a binding constraint to growth and inclusion. Below, we present the channels through which we believe the institutional and economic set-up is preventing higher growth and wider inclusion.

Business Climate

Weak Contestability and Competition

Government regulations and actions in Tunisia are distortive of market development and generate unintended barriers to competition. Contestability of markets is weak given significant barriers to entry (especially legal and administrative measures), widespread pricing policies and restrictive practices. Pervasive restrictions to the number of firms allowed to operate in the market are coupled with many legal (public) monopolies and undue regulatory constraints in network sectors, severely limiting competition. In fact, sectors in which investment faces restrictions account for over 50 percent of the Tunisian economy, whether

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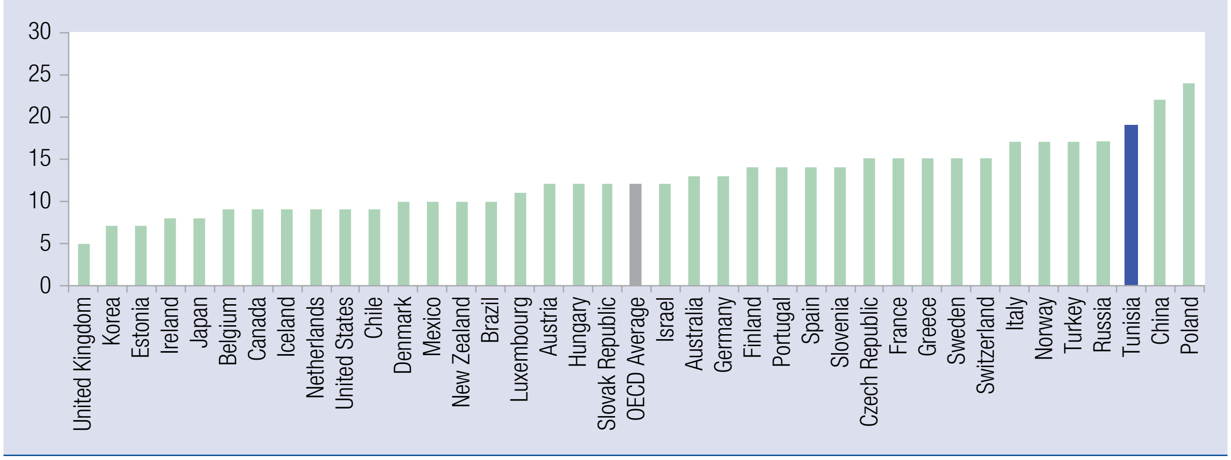
[72] "Bringing Opportunity, Good jobs and Greater Wealth to All Tunisians," 2014.

[73] "Towards a New Economic Model for Tunisia—Identifying Tunisia's Binding Constraints to Broad-Based Growth," 2013 and Overcoming the Binding Constraint to Economic Growth in Post-Revolution Tunisia," 2012, D. Pickard & T. Schweitzer, John F. Kennedy School of Government, Harvard University. The 2013 study finds (in addition to a lack of checks on executive power, which results in predation and protective policies) the high fiscal and regulatory cost of hiring workers to be a binding constraint to growth and a leading cause of low worker productivity, a lack of employment opportunities, and therefore to shared prosperity.

FIGURE 38: Number of Sectors with at Least One SOE in Tunisia Compared to OECD, Non-OECD and Central and Eastern Europe (CEE) Countries



Source: Tunisia DPR.

through the Investment Incentives Code, the Competition Law or specific sectoral legislation. Many of these sectors at present remain de facto closed to competition. In addition, there are legal constraints on the sale of the stakes held by the government in publicly controlled firms in some of these sectors. Network sectors such as gas and electricity; water mobilization, treatment, and distribution; and rail transport (infrastructure operation, passenger and freight transport) as well as other sectors such as the tobacco supply chain are legal/state monopolies. In these same sectors, regulatory barriers to international telecommunications and air transport entail de facto monopolies or oligopolies. Even segments of markets in gas, transport, and telecoms where private sector participation is feasible are closed in Tunisia compared to comparator countries.

The widespread lack of competition has far reaching implications for the performance of the economy. Firms in these sectors de facto benefit from rents that arise because they face limited competition. These firms remain profitable largely thanks to the protection they enjoy in the domestic market—at the expense of the consumers who are forced to buy more expensive and lower quality goods produced by the uncompetitive onshore firms—further reducing investment and productivity. The Competition Law does not in fact support competition and the weak governance of SOEs further undermines the operations of markets.

Political Connection, Economic Performance, and Unequal Opportunity

Heavily regulated market access has become a smokescreen for rents extraction by politically connected firms who receive privileged access to certain lucrative activities. Tunisia's industrial policy increasingly was used as a vehicle for rent creation for the ousted president and his cronies (DPR). Regulatory capture, stemming from authorization requirements, investment restrictions or fiscal advantages would allow firms owned by Ben Ali's clan to record spectacularly higher levels of output, profits, and growth than their competitors.[74] Thus it appears that capture was a major conduit for rent appropriation. The heavy cost of bureaucracy

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[74] The analysis presented in the Tunisia DPR (2014) suggests that the superior performance of Ben Ali-owned firms to a large extent results from regulatory capture. In the absence of these regulations, performance differences between Ben Ali and other firms were much smaller, absent altogether, or even negative.

represents a burden especially for the small entrepreneurs that do not have the means to outsource the handling of administrative requirements, and induce small companies to remain informal. The results of the World Bank 2012 Enterprise Survey highlight that overall the bureaucratic burden imposes a huge "tax" on firms' competitiveness (further discussion follows).

There is significant evidence of tariffs and tax evasion, which hampers competition and gives a strong unfair advantage to the (larger and) better connected firms. Beyond the measurable direct and indirect costs that the heavy regulatory and bureaucratic burden imposes on firms, there is a significant issue related to how policies and regulations are applied today. This problem appears to be most prevalent in the administration of both customs and tax, suggesting these services require significant regulatory simplification reform (aiming to reduce the room for discretion). Discretionary implementation of customs regulations and tariff evasion results in an estimated annual revenue loss of at least US$100 million (approximately 0.15 percent of GDP). Moreover, import-monopolists (i.e. firms that are the only firms that import particular products) on average underreport in the magnitude of 131 percent relative to firms that are not. Corruption in customs has received considerable media attention and has also been identified as one of the key mechanisms by which cronies were able to reap rents.

The Regulatory Environment for Private Sector Investment

Excessive regulatory burden holds back private sector investment and business, as shown in the high management compliance time and the large estimated losses resulting from administrative interaction. The 2012 Enterprise survey shows that close to 25 percent of managers' time is spent on meeting regulatory and bureaucratic burden, confirming the multiplicity of interactions with the different agencies. This figure is relatively high by international standards. Field interviews show that firms have dedicated personnel whose sole responsibility is to ensure that their firms fulfill all its administrative and bureaucratic requirements. Also, the ICA estimates that close to 13 percent of firm annual sales is spent to deal with regulations, covering the cumulative cost resulting from administrative interaction (direct and indirect costs including compliance time), a high percentage relative even to its regional peers. The weak regulatory environment pertaining to private businesses creates distortive incentives for firms, thwarts firm growth, and imposes high costs for businesses. A few examples of these regulatory constraints are presented in Box 4. Similarly, when compared with other countries in the region, Tunisia incurs almost as much losses in terms of sales due to investment climate issues as FCS countries like Yemen and Iraq, while the proportion of time spent by senior managers dealing with regulation is much higher than comparator countries (Figures 39 and 40).

Trade and Integration in the Global Economy Held Back by Weak Regulatory Framework and Business Environment

The integration into the global economy, despite being an engine of growth in the past decade, is now holding growth below potential by remaining limited in scope and depth. Tunisia's integration with the global economy remains superficial, both in quantities and sophistication of exports. In a sense, Tunisia does not "produce" its manufacturing exports. It is mostly serving as a re-exporting hub for products originated and sold elsewhere, mainly France and Italy.[75] This highly skewed trade pattern reflects the duality of the

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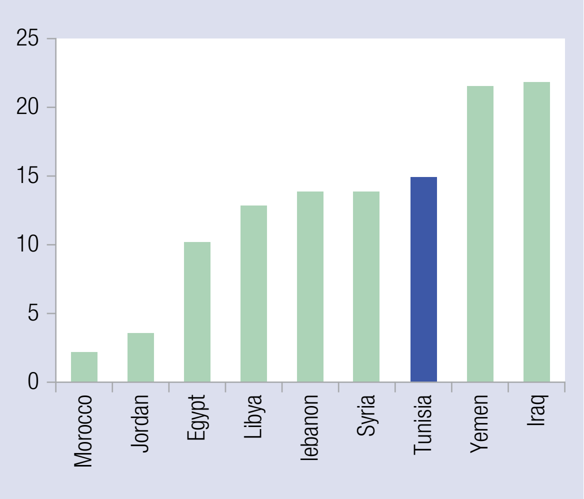
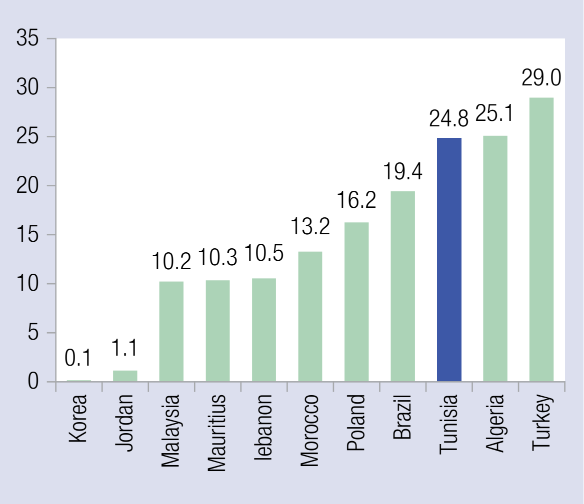
[75] Tunisia DPR, WB 2014. Integration is also limited in terms of destination markets: while Tunisia appears integrated with the EU, in fact exports are concentrated almost only on France and Italy, linking in this way the performance of exports to a narrow demand set and raising the risk of fluctuations.

FIGURE 39: Losses Due to Investment Climate Weaknesses (in Percent of Sales)



Source: World Bank (2013), Investment Climate Assessment in 2013 (based on the World Bank's Enterprise Survey in Tunisia in 2012).

FIGURE 40: Percentage of Senior Management's Time Spent Dealing with Regulations



Source: World Bank (2013), Investment Climate Assessment in 2013 (based on the World Bank's Enterprise Survey in Tunisia in 2012).

Box 3: How regulations affect businesses and distort incentives

Dealing with construction permits. Tunisia ranks 122 out of 189 countries in the Doing Business indicators for dealing with construction permits, mainly due to (a) the large number of procedures required (19); (b) the long duration needed (average 94 days); and (c) the excessive cost (equivalent to 255 percent of income per capita), especially in the review of the building plans and the inspection stages. Multiple actions are required to improve the process, including adopting clearer legislation, streamlining the procedures and establishing official time limits, digitization, online approvals, rationalization of costs when possible, and putting in place one stop shops to deal with construction permits.

Simplifying the incentives regime. The Investment Incentives Code has so far had limited results in terms of attracting additional investment and jobs creation, despite its cost, and has exacerbated regional disparities. By allowing different tax regimes[a] for exporting and domestic firms, the Investment Incentives Code has segmented the economy between the "offshore" and "onshore" sectors, limiting the interaction between firms and thereby restricting competition to the detriment of performance in both sectors. This dichotomy has translated into limited back-forward linkages and productivity spillovers between the export-oriented and more productive offshore sector, and the highly inefficient onshore firms. Moreover, the Code has exacerbated regional disparities. Over 85 percent of projects and jobs benefiting from the incentives were in fact created in the coastal regions. The analysis of the costs and benefits of the Code has shown that the total cost of incentives is approximately 2.2 percent of GDP (in 2009) and that 79 percent of this amount is wasted, in that it benefits companies that would have invested even in the absence of incentives. In fact, the cost of each additional job created is extremely high for Tunisia, at approximately $20,000 per additional job. Further, the Code has attracted mainly: footloose" investment focused on assembly and other low value added activities. In addition, the incentives system is extremely complex and there appears to be an opportunity to drastically simplify it by removing incentives of little or no use (which however are expensive in terms of readability and administration). In fact the first four types of incentives (out of the list of 68 different types) account for nearly 85 percent of incentives, as many incentives schemes are redundant and remain unused.

Simplifying the tax regime. Taxpayers in Tunisia face a complex and unclear tax system, increasing the risk of evasion and reducing compliance. Tax compliance is costly for businesses that frequently need to interact with tax officials in order to meet the different requirements set by the *Direction Générale des Impôts "DGI."* The small business tax regime (*forfaitaire*), has multiple thresholds and levels of segmentation which can be challenging for small businesses who want to comply but are unable to do so due to the complexity. The Ministry of Finance has initiated a process of simplification reforms over the past three years, however further more in depth process streamlining and simplification is necessary in order to address the compliance costs faced by taxpayers. In particular, VAT refund, appeals, and business cessation procedures mechanisms pose a significant burden to taxpayers and consume limited DGI resources to administer. The lack of clarity in tax legal text coupled with the dichotomy between the onshore and offshore tax rates creates opportunities for tax avoidance through transfer pricing, both locally and internationally.

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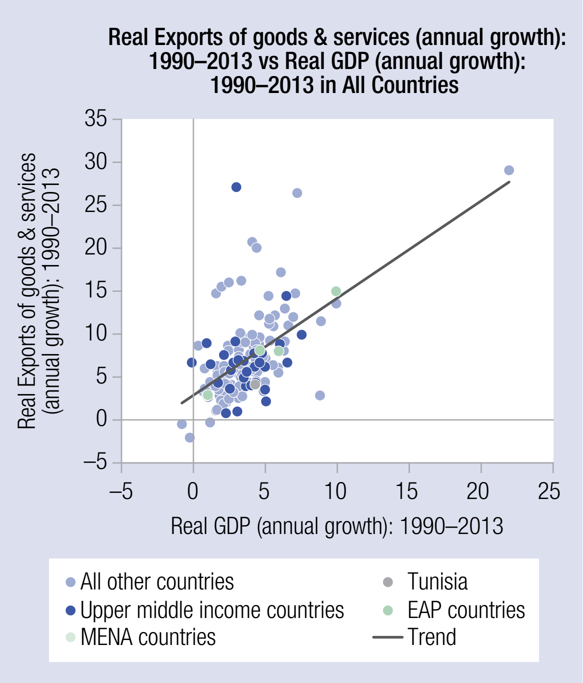
[a] The Investment Incentives Code allows tax-free imports of intermediate inputs and grants 10 years of corporate tax holiday for firms producing for export, the "offshore sector." These firms are also largely spared from the suffocating layers of red-tape and bureaucracy which afflict (mainly) the firms producing for the domestic market, the "onshore sector." In theory the offshore firms could buy tax-free from the onshore, and could also sell a share of their production in the domestic market. However, very few offshore firms take up these options, since this would expose them to a heavy administrative burden.

Tunisian economy, which has become increasingly concentrated toward low value added activities.[76] The performance of exports remains therefore below potential and limited, with the second lowest exports growth (in volume) over the past 20 years in the region—and compared to other benchmark countries. The performance weakens further if we consider the low value added of exports: beside the low export sophistication compared to benchmark countries—and its slow and only slight increase over the past decade—Tunisia's "share" of value added in exports has been estimated around 33 percent (Tunisia DPR) versus an average of 70–80 percent for G7 countries and 50 percent for countries heavily engaged in processing trade (like China). See Figure 41.

FIGURE 41: Exports' Performance Remains Limited



Source: Find my Friends tool using Macro_and_Fiscal_WEO.

The low contribution of trade to GDP with respect to peer countries is linked to the absence of broad institutional and structural reforms that included domestic deregulation, reforms of the regulatory framework and overall business climate. Despite the trade reforms since the mid-1990s,[77] Tunisia's tariff structure and degree of openness vis-à-vis non EU countries remains relatively restrictive. This is mostly due (beside the persistent high logistic costs) to the prevalence of trade regulations or Non-Tariff Measures (NTMs) to manage trade flows.[78] Tunisia has relatively low non-tariff measures (NTMs) frequency and coverage ratios, but it has highly bureaucratic and potentially discretionary procedures. While technical measures and standards (TBTs and SPS) are legitimate and increasingly used worldwide, they may be used for protectionist reasons and in a non-transparent way.[79] Firms have repeatedly complained about the lack of transparency in the application of rules giving room to procedural inefficiencies, obstructions, and arbitrary conduct hampering the country's overall competitiveness.

The contribution to the economy of the agricultural sector, which plays a key role in terms of job creation, especially in poor areas of the interior regions, has not reached its full potential. In trade,

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[76] Companies from Europe have outsourced the assembly tasks and other low value added tasks to Tunisia, taking advantage of the very favorable offshore tax regime, the availability of cheap low-skilled human resources, and the subsidized energy. This has made it extremely difficult to move beyond assembly tasks and low value added processes.

[77] Tariff reforms gradually reduced the average "most favored nation" (MFN) tariff (calculated as the simple mean of MFN duties level at the HS 6-digits level) from 30 percent in 2002 to 16 percent in 2011.

[78] Non-tariff measures (NTMs), generally defined as non-price, typically reduce international trade in goods, changing quantities traded, or prices or both (UNCTAD, 2010).

[79] Augier (2011), Feki (2013, background paper for this report, Basu et al. (2012) report the results from questionnaires administered to 395 Tunisian firms. The large majority (74 percent) reported Technical Barriers to Trade (TBTs)s followed by SPS measures (four percent). The majority of TBTs were reported by importing firms while for SPS, the majority was for exporting firms with five partners (France, Libya, Italy, Algeria, and Germany). Firms reported important procedural inefficiencies, obstructions, arbitrary conduct, and charges that were considered abnormally high, show disparity in frequency rates and coverage ratios.

agricultural products do not even meet Tunisia's EU quota in exports. Agriculture accounts for about 10 percent of GDP and total exports and it employs, directly and indirectly, about 20 percent of Tunisia's labor force. Although output fluctuates with rainfall, the contribution of the agricultural sector to gross domestic product has remained relatively flat over the past decade. Food exports, largely geared toward the European market, are merely about 10 percent of total merchandise exports. Yet in many cases Tunisia is not using its full EU quota. The current agricultural policy setting did not manage to support job-intensive growth as small and medium-sized family farms dominate agriculture. Agricultural policy fundamentally reduces incentives to labor-intensive crop and livestock production. As a consequence, agricultural policy does not contribute effectively to help reduce unemployment and regional disparities.[80]

Agriculture in Tunisia has significant potential that could be unleashed through a combination of policy reforms, trade facilitation, and infrastructure investments. A crucial aspect would be the reform and prioritization of the current agricultural policy framework. It is often argued that if Tunisia were to shift production toward several Mediterranean products (arboriculture and horticulture) in which it enjoys a comparative advantage, it could boost the export of labor-intensive agricultural products to the EU market. Such a shift needs to be implemented gradually to ensure that it does not distort national food security objectives. It would require highly sensitive policy prioritization in the area of price support, input subsidies, standards and regulations and the marketing of agricultural products.[81] Importantly, it would need significant hard and soft infrastructure investments including in irrigation, research and extension, land registry, and agricultural financing.[82]

Services sectors underperform and undermine the competitiveness of the entire Tunisian economy. The relatively high contribution of services trade to Tunisia's GDP (21 percent compared to 12 percent for OECD countries) would suggest both some openness and success on the trade front. However, a closer analysis of the country's services exports reveals a high dependence on transport and travel (tourism). Travel alone represents close to 50 percent of Tunisia's services exports, compared to 25 percent or less, on average, for the rest of the world and the OECD (Figure 42). Cumulatively, travel and transport represent almost three quarters of Tunisia's services exports. As a result, the share in total exports of other types of services such as financial and insurance and communications and computer services remains well below the world average. The high dependence of sectors like travel and transport (i.e. tourism) makes the contribution of services trade to growth highly susceptible to political and security shocks. The deteriorating security and political situations has negatively and severely impacted these sectors and disrupted economic activity since 2011.

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[80] Tunisia's agricultural policy objectives aim to achieve food security for a rather narrow set of commodities such as cereals and livestock production. Overall incentives are geared towards the production of non-competitive commodities in large-scale farms, often located in the coastal areas.

[81] In terms of public expenditure efficiency, the current policy focus on achieving food security; partial self-sufficiency is costly. Estimates indicate that the budgetary costs may amount to about one percent of GDP. Yet there are also significant costs for (largely urban) consumers because of the need to pay higher prices for food products. These costs are estimated at up to four percent of consumption expenditures. Most importantly, there are significant distortions of production and international trade. While there may be uncertainties regarding the true quantitative costs in household welfare and GDP, it is likely that the current policy produces a net overall net welfare loss, and contributes to major inequities to the Tunisian urban and rural population. Also, similar to other countries in the region, Government agriculture services lack responsiveness to producers' priorities, which further reduces expenditure efficiency.

[82] A system of income transfer to mitigate impacts on existing beneficiaries would likely be required.

FIGURE 42: Transport and Travel are the Majority of Services Exports

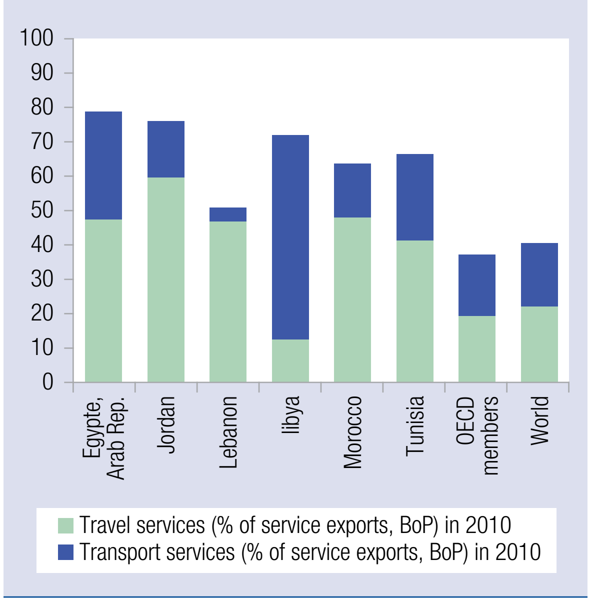
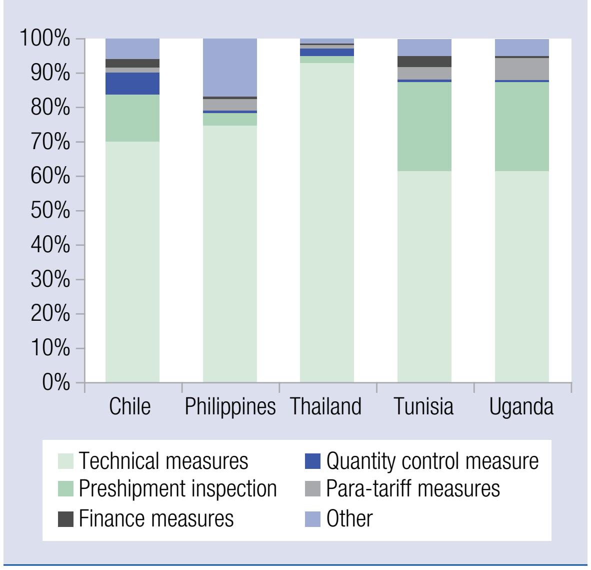


FIGURE 43: NTMs Experienced by Exporting Firms as % of NTBs



Financing Growth

Limited access to finance among MSMEs and households, low levels of financial intermediation, and weak financial sector regulation have prevented Tunisia's financial sector from efficiently allocating resources toward the most productive projects, often to the advantage of politically connected firms. Similarly, the financial sector has not been an engine of inclusion through promoting access to finance and economic opportunity for large segments of the population, including low and middle income households and women and youth.

Access to finance remains underdeveloped at both household and firms levels in Tunisia. According to Findex data,[83] fewer than five percent of adults save at a formal financial institution although 25 percent save informally and 32 percent report has access to an account at a bank or the post. The non-salaried population, despite being very large (1/3 of non-farm employment, est. 430,000 households and including creditworthy segments (average estimated household income: 2.5*minimum wage), is not served by financial institutions. The reliance on informal financial services also suggests that the supply of financial services targeted to the

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[83] According to Findex 2011, about 32 percent of adults in Tunisia have access to an account (39 percent among men and 25 percent among women; and 26 percent among young adults). This level of financial inclusion is higher than regional 18 percent level (13 percent for women and 13 percent for young adults), however it is lower than the average H-MIC level of 57 percent (53 percent for women and 49 percent for young adults). The access to accounts is significantly lower among women, young adults, rural population and population with primary or less education; the access to account among these groups are 25–26 percent in Tunisia. It compares favorably to MENA benchmarks for these categories; however, in the other U-MICs these indicators are at about 50 percent or more on average. Only 16 percent of those in the bottom 40 percent of income have access to accounts, which is worse than any other groups (youth, women, rural, etc.) taken separately. The benchmark for U-MICs is 42 percent for this category, and it shows that the access to accounts for bottom 40 percent is very non-inclusive.

Box 4: First steps toward a more inclusive financial system

Micro finance. There have recently been important judicial and regulatory reforms that promote expansion of the Tunisian microfinance sector. In March 2011, microfinance was presented as a primary pillar in the Ministry of Finance's post-revolution economic and social development program. The Ministry of Finance put in place a working group composed of donors, microfinance institutions (MFIs), government representatives, and outside specialists in order to develop a coordinated strategy for expansion and management of the sector. In conjunction with this strategy, the authorities have established a microfinance regulator and have adopted a new microfinance law in 2011. This new law allows for the creation of MFIs and allows foreign MFI networks to enter the country. New MFI entrants are critical to expand outreach and geographic coverage of microfinance services to the poor. Similarly, new entrants promote competition, which can lead to greater product diversification offered at more competitive terms and conditions. Further development of the regulatory framework and financial infrastructure is required in order to ensure responsible growth and innovation in the sector.

Restructuring of State-Owned Banks. In August 2014, the GoT approved the restructuring plans of two large SOBs. These restructuring plans aim at restoring banking sector stability, increasing banking sector competition and innovation, and improving access to finance.

Banking Sector regulation. After the revolution, the CBT has started implementing stricter banking sector regulation. The 2011 circular improved the corporate government practices while the 2013 circular on provisioning rules has forced the banks to significantly increase the level of their provision. In some cases, this sudden provisioning caused some banks to display Capital Adequacy Ratios (CADs) below the regulatory requirement (9 percent by December 2013 and 10 percent by December 2014).

Housing finance. The Tunisian government is currently reviewing its housing finance sector as part a new housing strategy effort, with a view of increasing outreach to middle- and low-income households and enhancing affordability. Key elements of the strategy include provision of better incentives for lenders to further expand down-market including to informal sector households, and improving the targeting of credit linked public subsidies to ensure that they are provided to the lowest income households.[a] Furthermore, the Central Bank of Tunisia is considering steps to allow variable rate mortgage lending beyond 15 years, under conditions that preserve stability, and facilitate medium term housing loans that are well suited for self-construction.

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[a] Successful targeting along those lines will significantly reduce the need for future subsidies and enable coverage of a larger number of beneficiaries.

poor is not adapted to financial needs, leaving a significant market gap. Access to finance was indicated as a major constraint by 34 percent of Tunisian firms, the second highest leaving aside concerns about political and macro uncertainty (which are exacerbated in the post-revolution transition phase). A 2014 IFC survey found that only 14 percent of MSMEs in Tunisia are served by bank financing, despite contributing 40 percent of the overall GDP.

The banking sector suffers from a severe lack of competition, despite a large number of banks. The Tunisian financial sector is small and dominated by banks, with assets equal to about 115 percent of GDP. The Tunisian banking system is characterized by limited profitability, inefficiency, low credit intermediation, and significant vulnerabilities. The absence of long term refinancing resources for banks mainly through capital markets limits long-term domestic lending and impacts credit affordability. As a result, financial deepening has been limited over the past decade and remains well below potential, the performance of the loan portfolio is very weak and increasingly poses a risk to the stability of the financial system, and progress in product innovation and quality service has generally been low. The low level of competition in the banking sector appears due to an environment fraught with weak regulatory practices, and substantial failures in the corporate governance of, in particular, state owned banks (SOBs). In addition, inadequate bankruptcy procedures enable inefficient firms to survive (instead of having to restructure or exit), therefore (and to the advantage of the less productive units) slowing down the success of productive firms and the rechanneling of resources toward more productive uses.

Nonbank financial institutions could play an important role in providing credit, savings, and insurance services (among other financial services) to segments of households and firms not traditionally served by banks but development has so far been limited. The non-bank financial sector accounts for around 20 percent of financial systems assets in Tunisia. Tunisia has a small insurance sector, with 19 companies primarily

Box 5: A comprehensive and integrated job strategy for Tunisia

Considerable work has been done to date to understand the key jobs challenges facing Tunisia: low labor force participation and insufficient job creation mostly in low productivity sectors. Even before the revolution and with a growing economy, the country was not creating enough jobs to absorb new entrants to the labor force. There were important job deficits affecting, in particular, higher education graduates. Today the unemployment rate is high (18 percent overall), particularly among youth (30 percent) and women (20 percent). At the same time, close to 80 percent of women and 30 percent of youth (who are not studying) do not participate in the labor market.[a] Those who have a job, on the other hand, are mainly in informal activities in low productivity sectors. Regions in the South and West face particularly difficult conditions and overall there are wide regional disparities. This also extends to inequalities between the bottom 40 percent, who often live in lagging regions, to the upper 60 percent of the population. *(See also Development Policy Review,* 2014, and *Labor Policy to Promote Good Jobs in Tunisia,* 2014*).*

A jobs agenda for Tunisia should focus on three main components: (i) facilitating the creation of new jobs through private sector investments, (ii) increasing the productivity of jobs and upgrading production technologies, and (iii) connecting people to jobs. There is evidence that new (young) and productive firms create the majority of jobs in Tunisia. Yet, the rate of creation of new firms is low by international standards—half of that of other middle income countries such as Brazil or Chile. The business environment suffers from high barriers to entry, lack of competition, and a culture of entrepreneurship that thrives on rents rather than innovation. At the same time, current active labor market programs are dysfunctional and unable to effectively facilitate labor market transitions and connect individuals to jobs. Labor regulation and social insurance policies reach only a minority of workers and yet might be reducing incentives to create formal sector jobs.

Changing current jobs dynamics, however, requires a comprehensive jobs strategy. Such a strategy needs to go beyond improving the investment climate (e.g., financial system reforms, competitiveness law) and the reform of labor policies (e.g. regulations, tax wedge, active labor market programs). These reforms are essential to promote investments and growth at the aggregate level, but they do not necessarily ensure the creation of the jobs needed to address the current issues. Such interventions do not directly support job creation and reduce unemployment in the most disadvantaged regions in Tunisia. Therefore, there is a need for greater detail in the identification of potential sources for jobs in specific sectors and occupations. They should target different segments of the labor force across regions and involve an assessment of multi-sector, short-term, interventions to be implemented in partnership between the public and private sectors.

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[a] Up to 80 percent of the unemployed have low education and have not finished secondary education, many of which have problem reading and writing.

focused on nonlife activities (85 percent of premiums) and annual premiums to GDP of about 2 percent. The equity and fixed-income markets are still small, with a market capitalization equal to 24 percent of GDP, lower than in regional peer countries such as Jordan (112 percent) and Morocco (76 percent). Private equity remains small and the leasing sector, accounted for 15.5 percent of private gross fixed capital formation in 2010.[84] Flaws in the institutional, legal, and regulatory framework prevent greater growth of NBFIs, instruments, and markets. Similarly, bankers and venture capital players in Tunisia point to a scarcity of patient funding products[85] as one of the major impediments for SMEs growth, and one of the causes of firms' bankruptcy. Even though Tunisia has one of the most developed housing finance sector in the MENA region (the mortgage debt to GDP ratio is 17 percent), the level of market outreach is very low (around 4 percent of households access housing related credit), leaving large fringes to friends and family finance or informality.

The Role of Employment and Social Policy

Employment did not act as a channel for poverty reduction in the past decade. A comprehensive and integrated jobs strategy is therefore key to poverty reduction and shared prosperity moving forward. The reduction in poverty took place in Tunisia without large shifts either in employment dynamics or in the already existing gaps between poor and non-poor (or across different population groups defined by gender, skills, or location). In fact, the share of unemployment increased between 2005 and 2010 (or 2012, based on WB estimates) among the most vulnerable population groups but it also increased for the least vulnerable.

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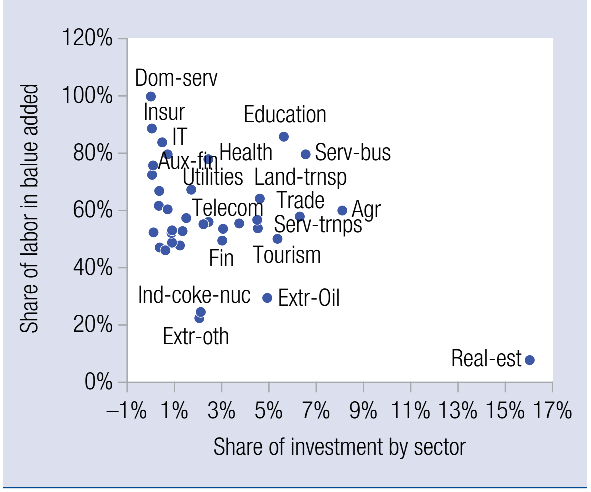
[84] Source: Tunisia Financial Sector Stability Assessment, International Monetary Fund, August 2012.

[85] Patient loans are long terms loans (12 to 15 years) with a grace period of 4 to 6 years.

FIGURE 44: Investments in Tunisia have been Directed Toward Lower Productivity and More Capital Intensive Sectors



Source: Tunisia CGE model simulation.

Unemployment rates also increased, although to a limited extent, among males and females, skilled and unskilled youths, or among urban and rural age-working individuals. It increased among the bottom 40 percent and the poor. While some population groups saw their self-employment rates go up slightly,[86] others, such as skilled youths saw their public sector salaried employment, the most coveted jobs in Tunisia, go down slightly. These findings lead to the suggestion that poverty reduction has been detached from the labor market and employment status.

The Challenge of Job Creation

Tunisia faces a considerable job challenge if economic growth is not translated into adequate job creation. Even during periods of relatively rapid economic growth, Tunisia experienced weak private sector job creation (five percent GDP growth was associated with a two percent increase in employment[87]). Insufficient job creation is one of the main causes of persistently high unemployment rates and may well remain so in the future if business continues as usual. Even under the assumption that participation rates remain at current levels (which is around 50 percent of the working age population[88]), demographic growth alone will push around 47,000 new entrants into the labor market on average per year.[89] While higher growth rates are a necessary pre-requisite to increase job creation,[90] they will need to be coupled with specific policies targeting constraints at the micro level, affecting firms and investment. Targeted sectorial policies that aim to promote jobs for specific population groups or regions are also an important complement to macro reforms aimed to improve macro-economic management, governance and political stability, and micro reforms tackling inefficiencies and bias in the business environment.

A substantial part of investments in Tunisia are directed into lower productivity sectors with lower share of labor in total value added (i.e. sectors that are more capital intensive, see Figure 44**).** Investments in labor intensive sectors, such as health and education services, financial services, IT, and insurance are relatively low.

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[86] In the case of females, rural residents, the unskilled youth and bottom 40 percent, increases in unemployment rates were also accompanied by increases in self-employment work.

[87] Tunisia's employment growth elasticity of only 0.4 is considerably lower than what is observed in other countries in the region.

[88] Around 50 percent of the working age population participated in the labor market in 2014; close to 4 million people. This low rate is explained essentially by the very low participation rate of women (under 26 percent compared to 71 percent for men). The participation rate of women is expected to increase gradually, approaching 30 percent by 2020. But even if it remains at current levels, the total labor force is expected to increase to 4.5 million people in 2020, implying that the economy would need to create around 50,000 jobs on average per year over the next five years, without taking into account the stock of unemployed and potential transitions of individuals in or out of inactivity.

[89] ILO, Economically Active Population, Estimates and Projections (6th edition, October 2011).

[90] Under the status-quo, assuming that the economy grows at only four percent per year, the unemployment rate would decline by only one percentage point over the next five years.

This outcome is the result, among other factors, of distortive incentives introduced by the current investment code, which subsidizes mostly capital intensive sectors, coupled with the high tax wedge imposed by the social insurance system (more than 35 percent of wages, see section E below) which renders labor-intensive sectors relatively unattractive.[91] In the absence of structural reforms that affect the allocation of investments, most jobs would continue to be created in sectors with low value added per worker, hindering the potential for structural transformation[92] and with a negligible change in the rate of unemployment, particularly for highly skilled workers[93] (see Box 6).

Jobs Dynamics at Firms Level

Younger, smaller and more productive firms have been the main engines of formal job creation in Tunisia. However, their contribution to job creation remains well below potential pointing to the presence of substantial constraints to startup growth. Recent evidence on the firm-level determinants of job creation shows that in Tunisia—as in most countries in the region as well as in high-growth economies—it is younger firms and more productive firms that create more jobs (World Bank, 2014). Figure 49 illustrates this finding in the case of firm age. It shows that, while older firms tended to shed workers, net job creation was positive for firms in their startup period (first four years). Micro-startups—firms between 0 to 4 years of activity and with less than 4 workers—generated about 580,000 jobs in Tunisia between 1997 and 2010, accounting for the almost totality (92 percent) of aggregate net job creation. However, small firms did not grow. Micro firms with less than ten employees almost never enter larger size categories. Figure 50 summarizes the probabilities that firms transitioned among different size categories (or exited them) in 2007–2011. For instance, of all one-person firms in Tunisia in 2007, 22 percent exited by 2011, 76 percent remained one-person firms, and only two percent hired at least one more worker. The probability of all non-farm micro firms to grow beyond ten employees 4–5 years later is strikingly low at three percent in Tunisia (compared for instance to 12 percent in Lebanon). This is a clear symptom of the country's difficult business environment that prevents firm entry (or exit) and hence distorts the process of creative destruction, which would lead to faster productivity growth, investment, and jobs creation. A majority of Tunisian firms identify policy "uncertainty," resulting from discriminatory policy implementation, as a "severe" or "major" obstacle to growth.

Access to Jobs

There are important variations in labor market outcomes and access to jobs across regions and between population groups. Labor force participation rates, unemployment, and type of employment (wage/

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[91] It is estimated that a 10 percentage point increase in the tax wedge can reduce formal employment by between one and five percentage points, with the effects being larger among low skilled workers (Lehmann and Muravyev 2014). This occurs as firms substitute labor with capital in the formal sector (that is, they reduce hiring) and as lower-productivity firms and jobs move into the informal sector. Many employers and workers could avoid heavy taxation by creating or taking informal jobs, but for larger formal sector firms this is more difficult—or potentially expensive—which would lead to strategies to save on labor.

[92] As an illustration a four percentage-point increase in the investment rate in Tunisia financed by an increase in local savings, could add around 76,000 net jobs to the economy, but their distribution across sectors would vary greatly. The largest increases would be in sectors such as construction trade, non-metal industries, and transportation services. In some sectors there would not be significant changes in the number of jobs, but in others there could be net reductions, for instance, in agriculture, textiles, and tourism, in part due to a lower propensity to consume.

[93] And only slight decrease in unemployment among semi-skilled workers, particularly youth (–3.5 percentage points).

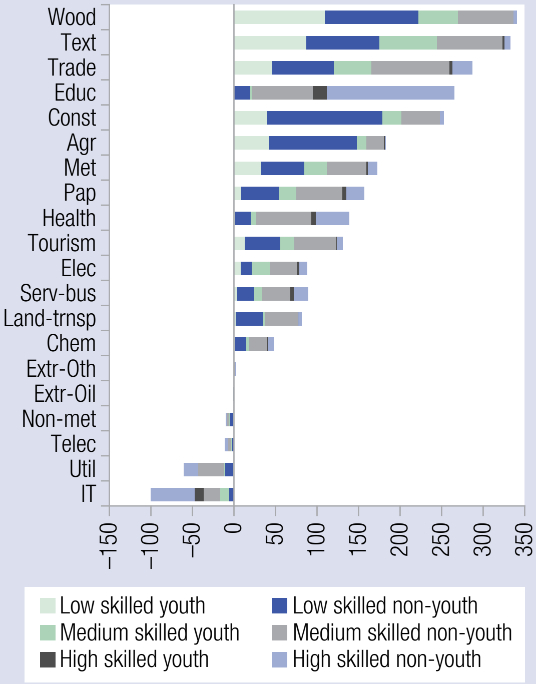
Box 6: The complex relations between investment and job creation

New jobs in Tunisia need to come from higher investments in the private sector. However, the links between investments and jobs are complex and not unequivocal. The proportion between the stock of capital and labor in the economy or at the sectoral level is not constant; job creation therefore does often not have a linear relationship with new investments. Reallocating a given amount of capital to a specific sector can have very different consequences in terms of the number and composition of jobs created. These effects operate through two main channels: i) a substitution between capital and labor (as more capital reduces its rate of return, capital becomes cheaper relative to labor); and ii) the reduction of investments in other sectors, which reduces intermediate consumption from the sector in question.

Labor-intensive sectors might not necessarily be the ones with the highest job potential but could help address unemployment for disadvantaged groups and areas. Analytical work done as background to this diagnostic (CGE model simulation) shows how, contrary to what is usually assumed, that certain sectors such as agriculture might not necessarily be the sector with the highest potential for job creation (Figure 44). Given substitution effects (capital vs. labor) and the need to finance investments by reducing investments in other sectors (which can reduce the demand for intermediate inputs produced in agriculture), the net effect can be less important than what is estimated from input/output tables. However, the jobs created in some of the labor-intensive sectors (including agriculture, but also textile and wood processing) can be very important for unskilled workers both adults and youth (which continue to remain the bulk of unemployed).[a] Moreover, depending on the sector chosen, specific investments entail varying levels of indirect job creation (Figures 45–48). Even if a sector does not create a high number of direct jobs, demands of intermediate consumption from others sectors can indirectly create jobs. For example, investments in food or IT sectors would lead to a reduction in jobs in those respective sectors but would indirectly create a disproportionately high number of jobs in other sectors.

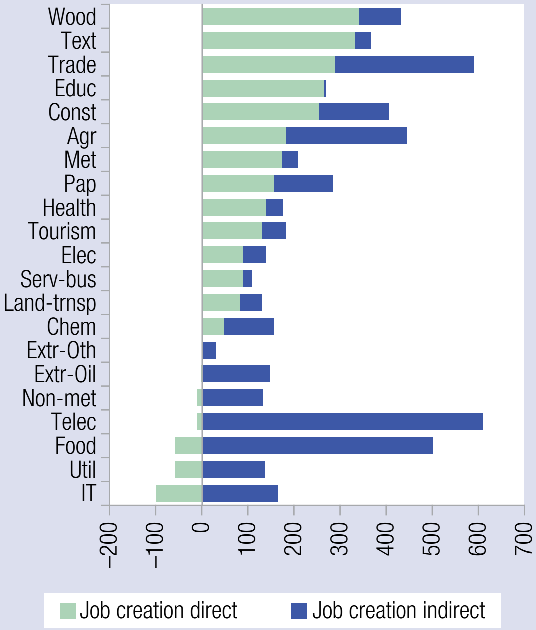
It is crucial to ensure that investments are targeted at sectors with potential to support the structural transformation of the economy and to increase productivity at the macro level. Given the current economy, without structural reforms that affect the allocation of investments, most jobs would be created in sectors with low value added per worker (Figure 45). The largest increases would be in sectors such as construction, trade, textile, and wood. Jobs in different sectors require diverse profiles in terms of skills both for adults and youth and therefore have heterogeneous impact on various groups of the active population. It is crucial to ensure that the currently untapped human capital is

FIGURE 45: Number of Jobs Created by Age and Skills Level Following a US$10 Million Sectoral Investment



Source: Tunisia CGE model simulation.

FIGURE 46: Number of Direct and Indirect Jobs Created Following a US$10 Million Sectoral Investment

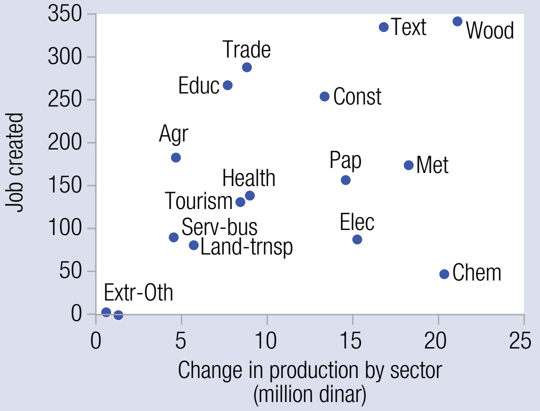


Source: Tunisia CGE model simulation.

(continued on next page)

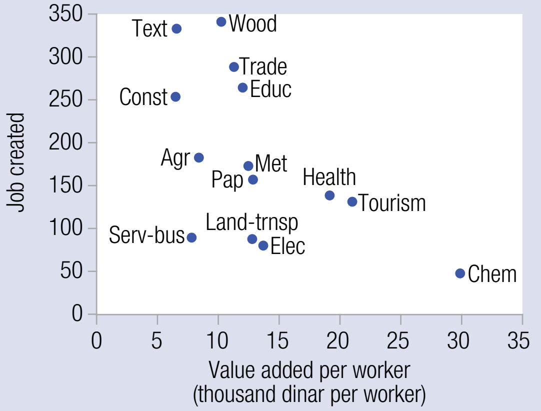
Box 6: The complex relations between investment and job creation *(continued)*

FIGURE 47: Jobs Created by Changes in Production Following a US$10 Million Sectoral Investment



Source: Tunisia CGE model simulation.

FIGURE 48: Jobs Created by Value Added Per Worker Following a US$10 Million Sectoral Investment



Source: Tunisia CGE model simulation.

allowed to fully contribute to the progress of the economy and that jobs would be the main channel trough which economic development operates. Creating a level playing field and nurturing specific sectors via non-distortive policies will encourage investment in new products and enable the growth of sectors in which Tunisia appears to have a strong comparative advantage. Tunisia's high potential in services sectors could bolster the process of structural transformation and become a source of dynamic growth and jobs creation, notably for university graduates. Soft policies cover capacity-building policies such as investments in infrastructure (transport, telecoms, and energy), fostering technical and scientific skills, and promoting research; they also include horizontal incentivizing measures such as macroeconomic policies (openness to trade, exchange rate policy, and fiscal and financial incentives), promoting human capital and research, supporting business development, harnessing foreign capital and knowledge, and labor market policies.

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[a] Reallocating US$10 million dollars to agriculture in Tunisia could generate around 140 new jobs. Other sectors in the economy can have larger impacts in terms of job creation For instance, for the same level of reallocation trade and education can create about 305 and 237 jobs, respectively. Investment in sectors that are high tech might even result in net job destruction in the short term (but would be a first step towards moving up the value ladder).

self-employment, formal/informal) vary markedly across population groups (youth, women) and regions. More disadvantaged regions tend to have lower participation rates and higher unemployment. Living in rural areas decreases the probability of finding a formal job. Women, youth, and the poor are, as discussed, more likely to be inactive or in low quality jobs. Education increases the probability of joining the labor force,[94] but its effects on employment status are mixed, with higher educated people facing higher probability of being unemployed. This signals the presence of a skill mismatch combined with a gap between supply and demand. Overall, these outcomes reveal barriers to access to jobs that are linked to poor labor market conditions.

The Tunisian labor market is characterized by deep dysfunctions: rules and institutions have failed to protect either workers or jobs and exacerbated the bias toward low-value added activities. The growing

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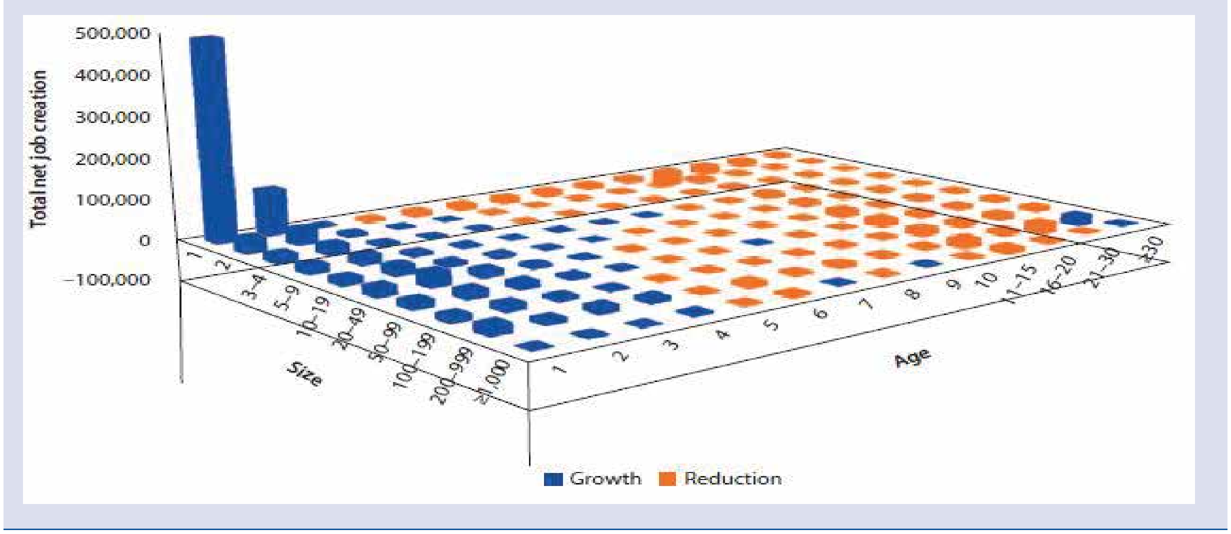
[94] Educational attainments increase women probability to join the labor force (a woman with a university degree is 64 percent more likely to participate in the labor force than a woman who completed only primary education.

FIGURE 49: Net Job Creation in Tunisia by Firm Size and Age, 1997–2010



Source: The World Bank (2015) Jobs or Privileges.

FIGURE 50: Employment Transitions Matrix 2007–2011 %

	Status in 20011				
Status in 2007	**Exited**	**1-person**	**Micro**	**SME**	**Large**
1-person	22%	76%	2%	0%	0%
Micro	9%	21%	67%	3%	0%
SME	6%	11%	16%	64%	4%
Large	6%	11%	3%	15%	65%

Source: The World Bank (2015), "Jobs or Privileges: Unleashing the Employment Potential of the Middle East and North Africa." MENA Development Report.

graduate unemployment over the past decade reflects the structural mismatch between the increasingly educated labor force and an economy that has remained stuck in low productive activities. As much as 77 percent of Tunisia's workforce is employed in low-productivity sectors. High-productivity service sectors absorbed only 7.7 percent of total employment. Available jobs have been of low quality, both in terms of value added and also in terms of low job security. Jobs have increasingly been informal or in fixed-term contracts, which entail no workers' protection, and have translated into an overly high level of turnover: 45 percent of workers do not have an employment contract, 64 percent of jobs are either informal or self-employment. The public sector remains the main source of formal employment in Tunisia, with 22 percent of employment while only 14 percent of all employed individuals are in the private formal sector.

Tunisia's labor policies and regulations tend to lower wages and discourage job creation particularly for educated youth. Half of the companies perceive the labor code as a constraint (ITCEQ firm's survey). Despite a competitive minimum wage relative to the value-added per worker, Tunisia's labor tax and contribution as percentage of wage are among the highest in the world, much higher than MENA or other MICs' averages, and even higher than that of OECD. In Tunisia payroll taxes and social security contributions reach almost 29 percent of wages. The average tax-wedge in Tunisia could be as high as 38 percent. These high tax and contribution rates inflate the actual labor costs for the firms, and they impact Tunisia's labor factor competitiveness. They are also at the expense of the labor force, which obtains a lower share of actual labor costs and a lower job creation level. Moreover, firing rules in Tunisia are among the most restrictive in the world. The rigidity associated with terminating contracts limits turnover in the labor market by increasing informal jobs and by reducing job opportunities for the new entrants. Elasticity of employment to economic growth

Box 7: Female labor force participation and access to jobs

At 27 percent, Tunisia has one of the lowest female labor force participation in the world. If things remain the same, it would take Tunisia about 150 years to attain the current world average. Both economic and social factors explain such low participation: low market wages coupled with high reservation wages (that could arise because of the high cost of and low access to child care and domestic work), transportation constraints, and/or low employment quality or safety of available jobs are, among others, important economic factors that undermine women's decisions to join the labor force. These factors are likely to be important in a country like Tunisia, where about half of all wage earners work without a contract and in low-pay/low-productivity jobs, conditions that appear particularly binding for women.

Demographic factors, combined with social norms and economic factors, play an important role in determining women decision to work: recent analysis shows that marriage decreases a woman's likelihood of participating in the labor force by 31 percent compared to single women (other things being equal). Corroborating this statement, data from the 2010 labor force survey reveal that family reasons are the most often cited reason for women being out of the labor force. Female role models can influence a woman's decision to look for work, especially in societies driven by different cultural preferences and values. Women look at the behavior of other women in the household as role models, thus influencing their preferences. For instance, the education of the spouse of the household is positively associated with female labor force participation. Women living in households where the head's spouse has a university degree are 12 percent more likely to participate in the labor force compared to women who live in a household with a spouse who attained primary education at most.

Local labor market conditions (such as the prevalence of unemployment in the region/area of residence) also influence female labor force participation. Women appear to be less motivated to enter the labor force if they feel there are limited employment opportunities (that is, discouragement). For instance, women living in localities where female unemployment rates are higher are less likely to participate in the labor force (an increase of the regional female unemployment rate of one percent decreases the probability of a woman participating by almost one percent). On the contrary, in regions where unemployment rates among men are higher, women tend to display higher rates of participation. This is explained because women's reservation wages decrease if men in the household are idle, thus making it necessary for the household to get additional sources of income (an increase in the regional male unemployment rate of one percent increases the probability of a woman participating by almost one percent)

Box 8: The mechanisms of social exclusion – youth inactivity in Tunisia

The lack of jobs opportunities for young (and educated) Tunisians has long-term consequences as it further discourages them to engage in education or job search. Young people who are not in education, employment, or training (NEETs) comprise a substantial proportion of the potential youth labor force in Tunisia, with one in three young men in rural Tunisia (33.4 percent) and one in five in urban Tunisia. Rates are even higher for young women, where half of the young women living in rural areas are NEET (and one third in urban areas). Young people without work, who are no longer attending any school or training program, spend on average more than three years searching before finding a job, making increasingly less likely for them to find formal employment.

The severity and regional incidence of NEET reflect the extent of regional disparities. NEET affects more than one-quarter in the coastal region (23.6 percent urban, 37.3 percent rural), more than one-third in the south (35.9 percent urban, 47.9 percent rural), and about one-third of youth in the interior region These young people, excluded from the labor market for years, are referred to as "Generation Jobless".[a] Youth in the interior face an especially unproductive abyss of years transitioning between their school and work lives. As focus groups revealed, youth have little faith in their skills or qualifications as they attempt to navigate a system they perceive to be rife with corruption.

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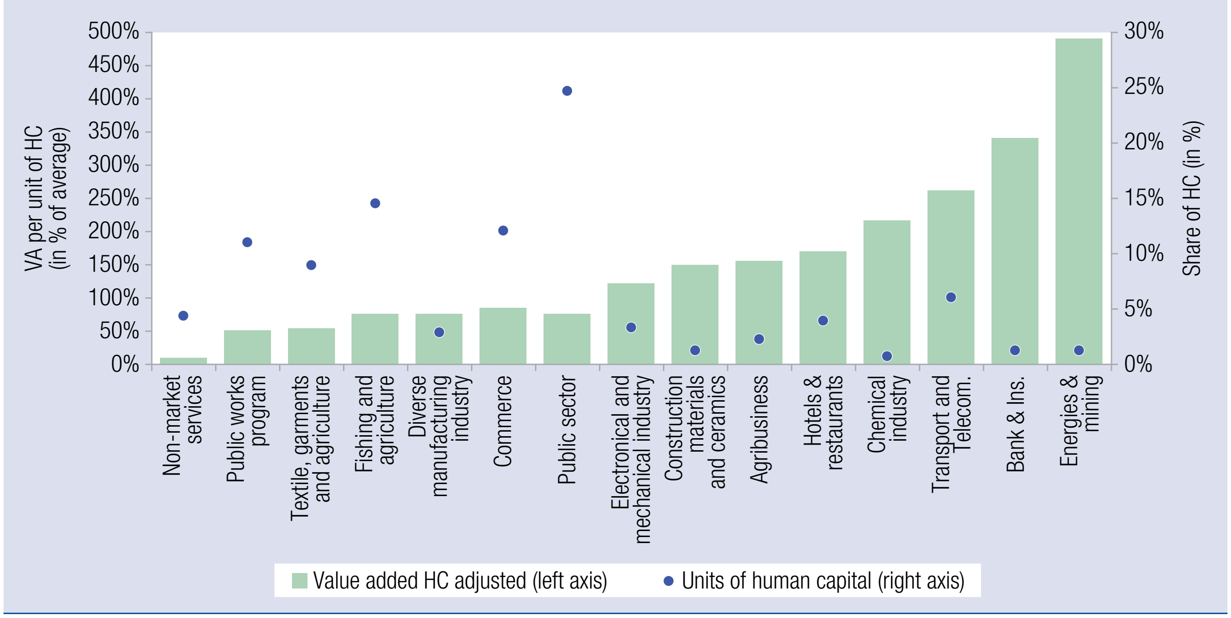
[a] The Economist 2013

is among the lowest in the region, less than 0.5 during 2000 to 2009, compared to the 0.8 MENA average. Limited labor mobility also reduces the economy's capacity to respond to the new opportunities and to shift toward higher value-added activities. While Tunisia needs to increase job creation for (educated) youth, its employment elasticity to the knowledge investment is among the lowest in the region, at only 0.4, against the MENA average of 0.7 (World Bank, 2013).

Social Protection, Equity, and Resilience

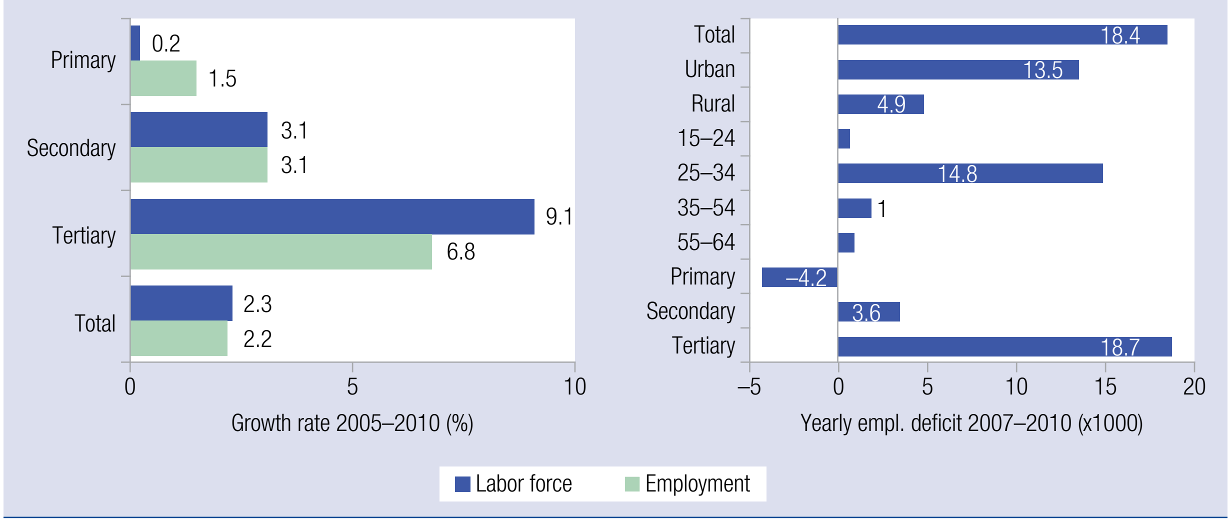
An extensive system of subsidies/transfers and social protection contributed, despite great inefficiencies, to keep the cost of basic necessities affordable for the poor and protect them from shocks. As a legacy of the old socio-economic model, Tunisia continues to spend today about 25 percent of GDP on social sectors

FIGURE 51: Significant Misallocation of Human Capital in the Tunisian Economy



Source: DPR. Output per worker controlling for HK. Year 2009.

FIGURE 52: Employment Growth and Yearly Employment Deficit



Source: Urdinola (2013) based on LFS 2007–2010.

(including social protection, health, and education).[95] This includes an array of programs, such as universal food and energy consumption price subsidies, social security (pensions and health insurance), unconditional

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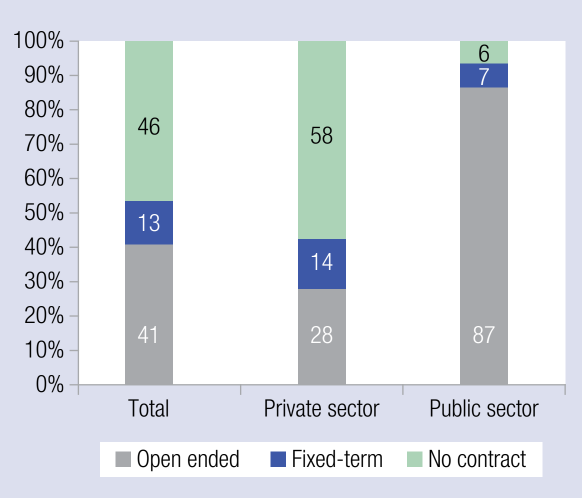
[95] Tunisia´s social expenditure mainly comprises education (accounting for 20 percent of total public expenditure), followed by consumption subsidies (12.9 percent), health (8.3 percent), direct cash transfers and in-kind social assistance (1.3 percent, of which direct cash transfers accounts for nearly 0.5 percent) and active labor market programs (3.9 percent). Nearly 3000 million Tunisian dinars (TND) were spent on fuel, food, and transport subsidies, accounting for five percent of GDP as of 2012. Of this spending, fuel subsidies account for 1500 million TND and 1200 million TND goes towards subsidizing food and basic products.

cash transfers, and subsidized health care cards intended for low-income and poor groups. In addition, in principle the government's provision of basic services such as water, education and health services are meant to ensure equitable access to basic necessities (see Box AV.1 in Annex V). While improving Tunisians' welfare, social policy was first and foremost designed to compensate for the lack of civil and political liberties. Social policies thus were not targeted according to efficiency, fairness, or effectiveness but rather served to discourage any perception from citizens to be excluded by the increased welfare of the country.

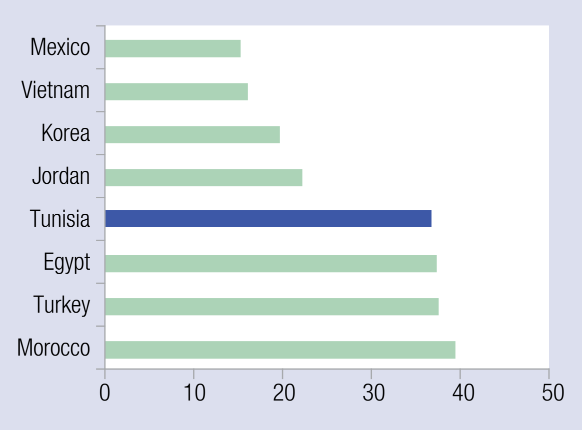
Consumption subsidies (particularly subsidies to diesel, gasoline, electricity, and liquid petroleum gas (LPG) consumption) **are the most regressive of these policies.** Expenditures on basic food, energy and transport subsidies paid through the budget represent today about seven percent of GDP (of which about two-thirds is spent on energy products). This is today over 10 times that spent on direct social transfers to lower-income groups in the form of cash (pension, employment, and social assistance, see Figure 55). This expenditure benefits both vulnerable and higher-income households, with nearly half of energy subsidies consumed by the top 40 percent of the income distribution. For diesel and gasoline, nearly 60 percent and 70 percent of subsidies accrue to the richest 20 percent alone. While food subsidies are relatively less regressively distributed, the expenditure on subsidies that accrues to the top 60 percent of the income distribution is expenditure that may be better invested in policies to mitigate shocks, boost purchasing power, and enhance employability more effectively for the bottom 40 percent.

FIGURE 53: Employment by Type of Contract and Private/Public Sector



Source: World Bank, DPR, Chap. 5.

FIGURE 54: Taw Wedge in Selected Countries and by Education Level in Tunisia



Source: DPR Background paper on the Labor market.

A generous (although not very large), nominally targeted cash transfer scheme for the poor and vulnerable represents about 21 percent of total consumption for the lowest quintile.[96] Tunisia's national cash transfer program, though inefficiently targeted, accounted for nearly 420 million dinars as of 2013, or just under 0.4 percent of GDP (Figure 55). However, nearly 60 percent of the benefits do not go to the poorest 20 percent for whom the program ought to be targeted. Due to inefficiencies with the pension system and

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[96] Social assistance programs cover about 13 percent of the population within the first consumption quintile. The Program of Support to the Needy Families (PNAFN), operated by the Ministry of Social Affairs, is the main non-contributory system of social protection in Tunisia. It is mostly composed (about 70 percent) of unconditional cash transfers and it also includes cards for health services.

FIGURE 55: Tunisia Spends as Much in Social Protection as it Does in Subsidies, with Mixed Benefits for the Poor

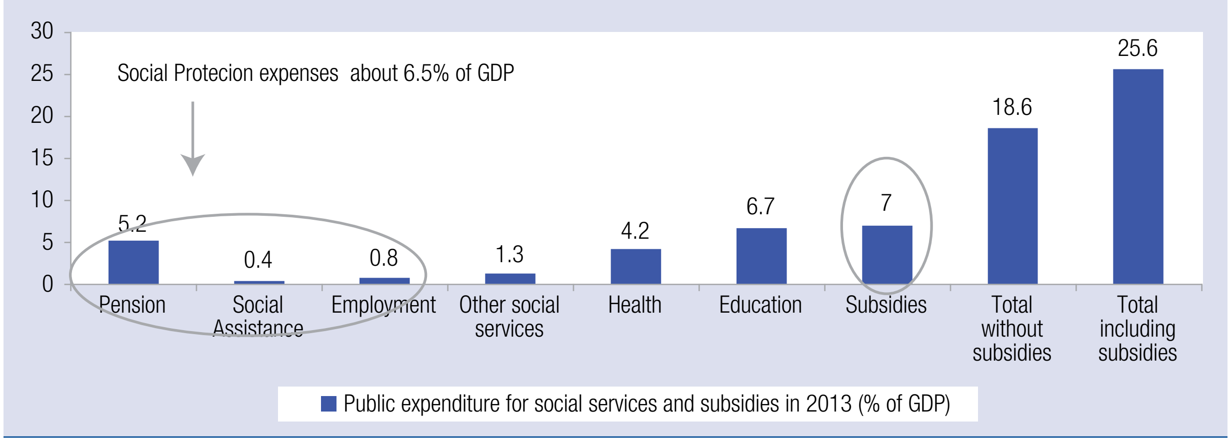
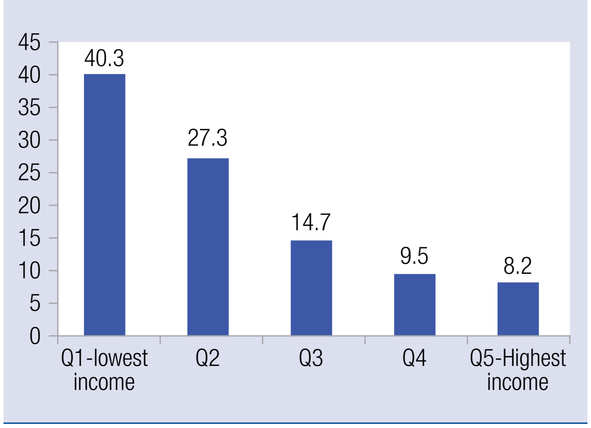
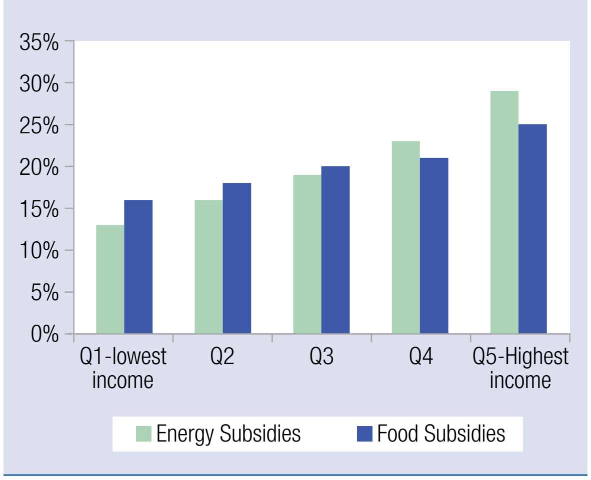


FIGURE 56: Beneficiaries of Social Assistance (PNAFN – Mostly Cash Transfers) According to Income Level



Source: WB 2013 "Vers une meilleure equite'…".

FIGURE 57: Distribution of Benefits from Energy and Fuel Subsidies Per Income Level



high informality, many older persons benefit from the cash transfer program despite not being poor (based on $2 per day). Nearly 60 percent of beneficiaries of the cash transfer program are over the age of 65, suggesting that this program is acting as both a poverty-mitigating measure as well as a social pension by default. Overall, nearly 235,000 households benefit from cash transfers, or nine percent of the population, as of 2014. The cash transfers come with health care cards that, in principle, entitle beneficiaries to exemptions from co-pay at public hospitals for largely preventative health care services and basic pharmaceuticals. In effect, due to limited or low-quality supply, most beneficiaries forego care or pay out of pocket for pharmaceuticals. In addition, 550,000 low-income individuals benefit from a subsidized health care card also managed under the social safety net framework, which entitles beneficiaries to preferential co-payment rates for health care services.

Box 9: A fragmented system that does not provide adequate coverage

Given lagging economic growth, an informality rate estimated at 50 percent, Tunisia's social security system, which should be a key pillar of poverty mitigation and equity, currently faces significant deficits and inadequate coverage. In terms of pensions, as of 2014 the system is projected to face a deficit of approximately two percent of GDP by 2018, with the burden of inadequate coverage falling on the low-skilled and poorer groups. Tunisia's modern social security system dates from 1898 with the creation of a pay-as-you-go (PAYG) system for civil servants. Today, the system is fragmented into two different funds and spans different public pension schemes for various categories of workers, with nearly 70 percent of the labor force enrolled. Social insurance and pensions are administered by two main national insurance funds. Pensions for civil servants and contractual workers and emergency family loans are administered by the Caisse Nationale de Retraite et de Prévoyance Sociale (CNRPS), while pensions for private sector workers are administered by Caisse Nationale de Sécurité Sociale (CNSS). The number of contributors as of 2012 is approximately 1.5 million for CNRPS and 646,000 for CNSS. Similarly, health care in Tunisia is financed through a combination of social health insurance (Caisse Nationale de l'Assurance Médicale or CNAM), general government revenues, and private spending, with health insurance accounting for an increasingly greater share (see section E below on health services). **A more coordinated approach is needed to enhance coverage and sustainability of both pensions and health insurance.** By pooling resources and contributions, particularly from non-poor informal sector workers, the sustainability of various social protection schemes becomes more viable

In total, the social safety net programs benefit nearly 23 percent of the population, many of whom are middle- or upper middle-income who ought to be enrolled in contributory programs, as benefits and the quality of services are stretched as it is. However, despite great inefficiencies in targeting and allocation, these programs still remain relatively more efficiently targeted than universal subsidies and can be improved further to protect the neediest households (and those that may become so in the future) from income shocks.

Growing fiscal pressure is leading to a revision of some of the structured social assistance—direct and indirect—to ensure fiscal sustainability. The slowdown in economic growth and revenue projections will require the Government to increase the efficiency of public expenditure, some of which might directly impact the poor. For instance, energy subsidy expenditures[97] are undergoing revision with the objective of lowering the fiscal burden.[98] The impact on consumption for the most vulnerable groups[99] might be relevant if these reforms are not accompanied by a system to protect them.

Shielding the most vulnerable from the impact of fiscal consolidation and structural reforms should therefore be a key priority when considering sustainability of any progress toward the twin goals.

Governance and Institutions

Governance in Tunisia had been characterized by a strong executive with limited checks and balances, allowing for elite capture to flourish through administrative favoritism, repression of dissent, and

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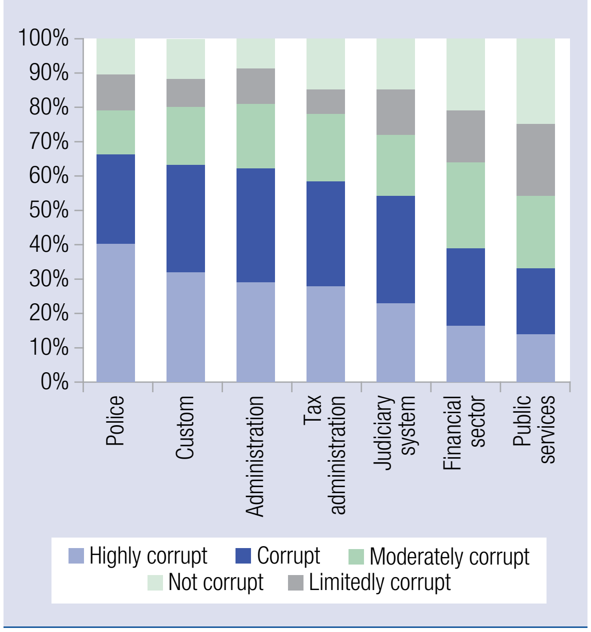
[97] As for food subsidy reform, given the importance of food subsidies for poorer households and despite existing leakages (e.g., to hotels or industry), the government will assess at a later stage how to reform these, and may be able to use lessons from the energy subsidy reform to design compensatory measures.

[98] The government's medium-term objective is to replace generalized price subsidies with a well-targeted social safety net, starting explicitly with the most regressive energy subsidies. As a first step, it increased fuel and electricity prices by around 14 percent between September 2012 and March 2013, which has generated one percent of GDP in annual budgetary savings. the government also plans to revise and reinstate an automatic price setting mechanism (at least for petroleum and diesel products) by 2014 or when retail prices are close to international prices. These increases should be accompanied by a new household compensation (and targeting) strategy for selected products. (IMF program note 2013).

[99] Recent analysis (Verme 2013) reports negligible direct effects of the increase in prices of fuels and electricity on the households' expenses (as they are highly regressive). However, for fuels, the indirect effects might be larger. In addition, food subsidies are an important component of household income.

FIGURE 58: Corruption Perception Among Tunisian Firms (2010)



economic and political exclusion of the vast majority of the population. The Ben Ali regime was characterized by the dominance of the executive branch over both the legislature and judiciary, the latter two being unable to provide proper checks and balances on executive abuses. During this period Tunisia fared poorly on a number of governance indicators in terms of core governance empirics. In 2008 Global Integrity rated it as "very weak" in terms of executive accountability, due primarily to limited checks and balances, and "very weak" on election integrity. The press was rated as "not free" by Freedom House. A single party dominated the legislature, and the judiciary lacked independence. Elections were neither free nor fair. Political opposition was met with considerable repression, including imprisonment and banishment. These gaps were both developed and exploited to further elite capture by the Ben Ali regime and its supporters, while at the same time minimizing space for criticism and opposition. In addition, both high and low level corruption were considerable. Global Financial Integrity estimated that the amount of illegal money lost from Tunisia due to corruption, bribery, kickbacks, trade mispricing, and criminal activity between 2000 and 2008 was, on average, approximately two percent of GDP per year (approximately US$1.2 billion per annum). With a population of approximately 10.6 million that means a loss of almost $110 per person per year in the unrecorded transfers of illegal capital (Global Financial Integrity 2011).[100]

Some of the key governance failures were not adequately captured in the rankings. Tunisia had strong governance ratings pertaining to business licensing and regulation as well as taxes and customs (though the enforcement of tax laws has often been criticized as being discriminatory). The Anti- Corruption Law was seen as of very good quality, although the implementation of this law was considered very weak. Indeed, there were important shortcomings and failures not captured by these rankings, most notably related to poor progress made on voice and accountability, the highly centralized decision making process which undermined the system of checks and balances (which largely existed on paper only), and more generally the substantial discretion in the application of the laws.

Since the 2011 Revolution new governments introduced some reforms to address governance gaps, particularly in relation to enhancing civil and political rights. Successive regimes have undertaken a number

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[100] Further, in the aftermath of the Tunisian revolution, assets of the Ben Ali clan were confiscated. The confiscation process involved the 114 individuals, including Ben Ali himself, his relatives, and his in-laws, and concerned the period from 1987 until the outbreak of the revolution. The confiscation commission estimates that the total value of these assets combines is approximately US$13 billion, or more than one quarter of Tunisian GDP in 2011 (which would correspond to a one-off transfer per person of approximately US$1,230 per person in Tunisia, i.e. about one quarter of average income). Among the assets that were seized were over 300 enterprises (some of which were abroad), 550 properties, 48 boats and yachts, 40 stock portfolios, and 367 bank accounts.

of steps to address the serious governance gaps plaguing Tunisia. New elections regulations were passed, allowing for greater public engagement in the election process and enhancing accountability of elected officials. The right to access to information was enhanced by the *Constitution* and other legislation requiring disclosure of public documents, and the establishment of an open data website offering access to public data (data.gov.tn) that enables citizens to make direct requests for information. Compliance is to be monitored by an independent commission. A number of civil rights enjoy constitutional protection, including: academic freedom; rights to peaceful assembly and demonstration; freedom to establish political parties, unions, and associations; the right of workers to strike; and freedoms of expression, opinion, thought, and publication. Citizen engagement has been enhanced by government decisions allowing citizen participation in the public service assessment process, delivery of public services and legislative drafting; a public consultation website was created to promote participation in policy-making.[101]

The extent to which citizens can adequately exercise these rights will impact social and political exclusion. Exercise of these rights could also help promote greater transparency in public administration and accountability of government officials. In part due to these reforms, Tunisia's ranking by Freedom House was raised to "free," and political rights were given the highest score possible. Some backlash has taken place against exercise of civil and political rights, usually justified by security concerns. While instances of arrest and conviction of journalists on grounds of defamation have been fewer, independent reporting has been punished on security grounds. Cases have been brought against bloggers and union activists on grounds of defaming the army or criticizing the GoT on security measures.[102] The use of military courts, which lack fair trial safeguards, to try civilians is particularly problematic. Criminal cases have been brought against internet users based on content they posted online. Civil society organizations have been closed by the government, without following established procedures, based on antiterrorism and security justifications.

Steps have been taken to address elite capture and other forms of corruption, but progress remains limited and legislative gaps remain. An anti-corruption commission was established in 2012 and later converted to the Good Governance and Anti-Corruption Commission in 2014 per the Constitution. More than five hundred cases have been investigated, with over one hundred forwarded for further investigation and prosecution. However, very few prosecutions have taken place, with the notable exception of trails in absentia for members of the Ben Ali and Trabelsi families. Given that the Commission is a relatively new institution its performance would need to be tracked over time. Allegations of public sector corruption can also be made online via a corruption reporting website.[103] The frameworks covering financial disclosure by public officials is weak, especially in regards to higher-level executive officials. The framework covering conflict of interest is even weaker, with very few restrictions applicable to the President, members of parliament, ministers or civil servants. Given the history of elite capture in Tunisia, there is a particularly urgent need for stronger frameworks governing both of these issues.

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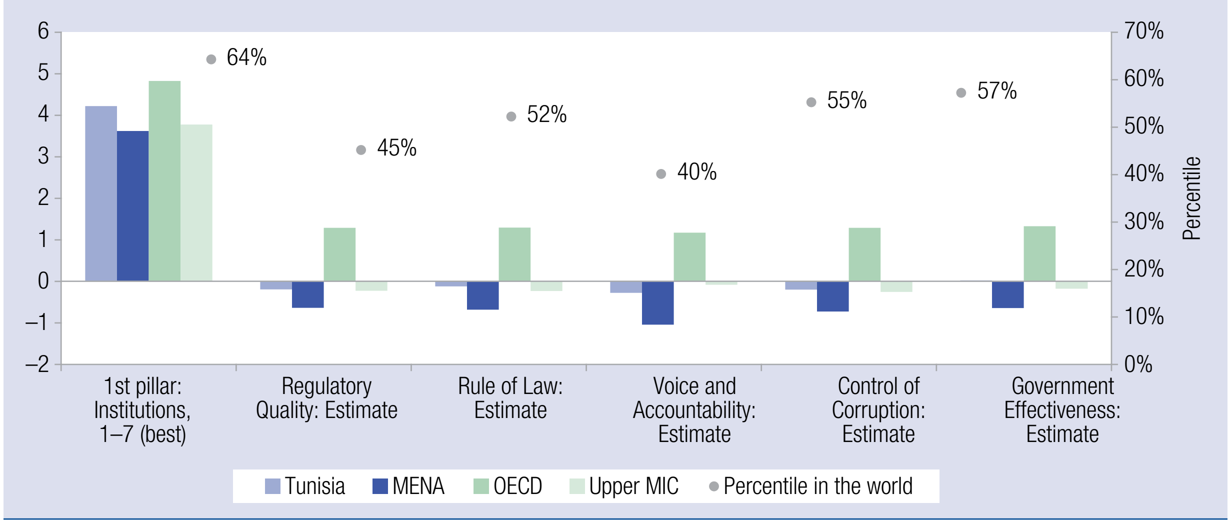
[101] www.consultations-publiques.tn. The site was used to promote participation in legislative drafting, assessment of public sector performance, establishment of a civil service code of conduct and improvement of the business climate through administrative reform.

[102] Blogger Yassine Ayari was tried for "defaming the army" on Facebook for criticizing Defense Minister Ghazi Jeribi and other military leaders, and sentenced in absentia to a three-year prison term by a military court. Upon return to Tunisia he was retried by a military court and given a one year sentence. Sahbi Jouini, a union representative, was also tried by a military court and given a two-year sentence in absentia for criticizing the government's handling of antiterrorism operations. Freedom House at https://freedomhouse.org/report/freedom-world/2015/tunisia.

[103] www.anticorruption-idara.gov.tn.

FIGURE 59: Tunisia with Respect to Comparators Groups on Quality of Institutions



A framework exists for addressing human rights abuses under former regimes and vetting institutions that had been involved in corruption. Tunisia is one of the three countries in the MENA region, along with Libya and Yemen. to have passed legislation on transitional justice. The *Law on Transitional Justice* was adopted in December 2013. Its primary aims are: addressing past human rights abuses through truth-telling and by holding perpetrators accountable; providing restitution and reparations to victims of human rights abuses to promote national reconciliation; guaranteeing non-repetition of human rights abuses; and guiding transition from an authoritarian state to a democratic system that guarantees protection of rights. Specialized courts are to be established to prosecute perpetrators of gross human rights abuses.[104] A Truth and Dignity Commission is responsible for conducting hearings involving political, economic, and social crimes abuses since July of 1955. Addressing past abuses is a regular component of transitional justice regimes. Tunisia's framework goes further, by mandating the Truth and Dignity Commission to undertake institutional reforms aimed at dismantling and rectifying the system of corruption and repression conducted under previous regimes in order to guarantee non-repetition and establishment of the rule of law. These reforms are to be instituted through revision of legislation and vetting of public sector entities previously involved in corruption to address vulnerabilities. While the latter could potentially be instrumental in addressing corruption and elite capture, it would require considerable institutional capacity that may not yet be present in the Commission. Civil society has been particularly active in promoting transitional justice initiatives, for example the establishment of a Transitional Justice Academy and training of judges and other officials on transitional justice issues.

Governance shortcomings affect the quality of service delivery. Responsibilities for delivery of services and planning remain very centralized. Tunisia is facing an important mismatch between institutional mandates and the accompanying fiscal assignments. Despite embarking on ambitious decentralization, the provision of basic services such as health and education, as well as basic infrastructure (e.g., water, sanitation, electricity, and solid waste management) remains highly centralized. These services continue to be provided by line ministries, their de-concentrated regional offices, and affiliated state-owned enterprises. Additionally,

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[104] As defined by the law, gross human rights abuses include: murder; rape and sexual violence; torture; enforced disappearance; and execution without fair trial guarantees.

Box 10: Strengthening the role of public procurement and Public Financial Management in fighting corruption

Tunisia scored relatively well on Public Financial Management (PFM) compared to its income group average in the PEFA assessment from 2010.However, according to a recent assessment,[a] the PFM system has not aged well and is no longer entirely suited to the demands of modern management. Specifically, the system does not permit precise detection of waste and corruption, and has been identified as one of the area's most vulnerable to corruption. Since 2011 the pace of reform has been slowing down. There are major weaknesses in terms of lack of multi-year fiscal planning, credible expenditure policy, investments planning and management and in the area of accounting and reporting. The area of controls and audits has a solid base in terms of quality of staffing but is hampered by organizational inefficiencies and an approach to audit that is insufficiently risk-based and geared toward performance. The country is quite advanced in terms of Performance-Based Budgeting (PBB) but critical steps still have to be made to have a measurable impact on public sector performance.

Public procurement accounts for close to 18 percent of the Tunisian GDP and 40 percent of the State budget. Until 2011, it was highly inefficient, lacking transparency and prone to corruption. In 2011 the Interim Government started to take some short-term actions in particular thanks to the 2011 Governance and Opportunities DPL. In 2012, Tunisia conducted a holistic diagnostic of the public procurement system using OECD-DAC self-assessment method, with the active support of the World Bank and the African Development Bank. As a result, the government adopted a new procurement decree, effective since June 1, 2014, that established new procurement institutions and the foundation of a more transparent procurement system (e.g., e-procurement). In parallel, the Bank provided support in various areas, in particular through: (i) the mobilization of an IDF Grant for the modernization of the Tunisian public procurement system with a focus on the design of a capacity building strategy; (ii) the implementation of a regional program to support SMEs access to public procurement activities and (iii) the establishment of a MENA network of public procurement experts to foster integration and knowledge sharing within the region. However, these actions are limited in scope and any substantial improvement of the procurement system in Tunisia will require much larger involvement and sustainable assistance from the Bank which should include the following reform priorities: (i) strengthening procurement institutions in particular by establishing an independent and functioning complaint review mechanism; (ii) professionalization of the procurement function at the central and local level; (iii) improving efficiency in procurement processes by removing unnecessary bottlenecks, strengthening the audit function and supporting the decentralization of procurement decisions; and (iv) modernization of the procurement system by dissemination of e-procurement and development of data and performance management tools. These actions have to be conducted both at the central and local level to serve the purpose of delivering better services to the population.

[a] Conducted jointly by the OECD and the interim Tunisian government

investments at the local level are highly centralized: municipal investments account for only 10 percent of all investments at the local level while the remaining 90 percent is financed and implemented by line ministries. This centralized system has done little to involve municipalities in managing urban development within their jurisdictions. For the framework of planning, connecting, and financing to work, a good governance structure is a prerequisite. Coordination across levels of government and between neighboring jurisdictions will become particularly important as Tunisia moves toward greater decentralization and subsidiarity to ensure the coherence and alignment of investments in ways that maximize their value at the local, regional, and national levels.

Recent results from service delivery surveys at the national and local levels show that poorer and less educated groups are less likely to rank services positively, and redress mechanisms are weak. Until 2011, this weak performance has not been monitored or assessed and citizens' engagement, needed to help build accountability and performance, has been non-existent. Recently, reforms and measures have been taken to begin enhancing transparency and voice in ensuring services meet the needs of the most vulnerable in particular. The wide majority of respondents from a household survey find services in Tunisia to be of poor quality, but more importantly, grievance redress mechanisms are weak.[105] Health and education are perceived to be of relatively better quality (with 33 and 36 percent, respectively, of respondents rating services as "poor") than social and employment services (56 and 76 percent, respectively). Despite the relatively low perception of the quality of services in Tunisia, only between 10–20 percent of respondents admitted they had specific complaints about the services rendered. Less than half of the respondents who had complaints about the services actually issued the complaints formally. Rural respondents formally complained more than urban especially regarding

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[105] World Bank, *Building citizen engagement in service delivery in Tunisia* (forthcoming).

Box 11: Building citizen engagement for service delivery in Tunisia

Following the 2011 revolution, a participatory process for systematically monitoring the performance of public services by civil society, citizens, and service providers is being progressively instituted. The first national scorecard launched by the Prime Ministry sought public feedback on over ten public services from April 19 to May 4, 2012. Approximately 8,500 citizens provided feedback and results were published online (http://www.consultations-publiques.tn). A second national scorecard on services from the National Health Insurance Fund was launched in 2012. In 2012, the government launched consultations with the Tunisian civil society (citizens, patients, HR, experts) to build a consensual sector diagnosis and a shared vision of the Tunisian health system. A community health project that includes participatory service delivery planning is piloted with the Bank's support in Jendouba, Tataouine and Kasserine.

As of September 2013 participatory monitoring has been gradually implemented but it remains limited, in part due to a lack of clear institutional linkages between participatory monitoring, budgeting, and policy formulation. The reform nevertheless institutionalizes mechanisms for participatory evaluation of public service performance improvement, as overseen by the National Controllers Body for Public Services (Contrôle Général des Services Publics, CGSP) in coordination with the Prime Ministry's Department of Public Administration Reforms (Direction Générale de la Réforme Administrative, DGRA) and concerned line ministries. The overall aim of the participatory monitoring policy is to strengthen citizen voice and accountability in the evaluation and planning of public service delivery. Given that the reform instituted a systematic participatory process among government, citizens and civil society for evaluating and reforming services within a supreme audit institution such as the CGSP, a more direct link between accountability and access to services can be developed for enhancing opportunity for the bottom 40 percent and the poorest groups

The Government is currently introducing an annual performance assessment system for local governments that will offer another supply-side tool for enabling citizen engagement in service delivery. The system comprises an annual assessment of each Tunisian local government's performance on a set of indicators measuring the local government's performance in governance, management, and sustainability. The results of the assessment will be made public, will inform citizens as they participate in annual municipal investment planning, and they will be used by the central government to allocate capital block grants to local governments. The system was designed in 2015, will be piloted in 2016 and in full effect in 2017.

employment services and education. In the vast majority of cases when citizens provided feedback, they stated that their complaint went unaddressed. These trends, and similar work undertaken by the government, further highlight major gaps between citizens' real needs and what services are offered in the public sector.

The framework for strengthening accountability adopted in Tunisia has therefore aimed, as an initial step, to introduce the tracking of service delivery performance in a highly transparent, participatory way. Prior to the revolution, performance targets with which citizens could hold providers accountable were absent in Tunisia. Agency and voice of service users and beneficiaries had not been a part of public sector reforms. Public financial management and civil service policies generally do not explicitly incorporate incentives for achieving agreed-upon results. For transparency and participation in service delivery to realize their full potential in Tunisia, a stronger policy commitment to both demand- and supply-side reforms is needed. Reinforcing demand-side governance in service delivery should be supported through greater public disclosure, participatory budgeting and citizen and civil society involvement. These mechanisms however, will be inadequate in the absence of structural reforms such as greater autonomy and decentralization, reforms to introduce performance incentives into civil service management, and budgetary and public financial management reforms.

SOEs and Autonomous Government Agencies (AGA) play an important role in the governance of sectors. These entities have not been achieving the required performance and are generally poorly managed and poorly monitored by the government. These agencies are often major actors in key sectors such as banking, transport, energy, and industry, where they play an important economic and social role. In the agriculture and agro-industry sector for instance, various SOEs are controlling production, distribution, and commercialization of products, and are enjoying monopoly positions. SOEs and AGAs have been criticized for weak management of public resources and for suffering from lack of accountability at the managerial level. The fact that the central government is not adequately equipped to play its role as shareholder is further adding to the problem. Box 12 below presents an illustration of the variety of governance issues found in sectors where substantial governance challenges have been identified (and, in the case of telecom, started to be addressed).

Box 12: Sector-specific governance challenges

Water and Sanitation: A recent OECD study[a] showed that some of the issues faced by Tunisia in the water sector, like the aging of infrastructures, weak service delivery performance, and financing difficulties are the direct consequence of weak governance. Governance of the water sector is characterized by strong centralization of responsibilities and decision–making, and by an institutional inertia that is an impediment to reform. In addition, the political instability of the transition period has impaired the capacity to build a coherent strategy for the sector and has led, in the face of social demands, to a management in crisis mode. The sector would need to reflect on how to best involve the private sector and on the implications of this move in terms of institutional and regulatory needs, as well as in terms of administrative culture. Such solutions and an effective engagement of communities and in the design and operation of rural water supply services to meet the pressing needs of a growing population (private household connections), coupled with a revision of the current water pricing policy (including subsidies) to increase the financial sustainability of utilities and pro-poor benefits are key priorities. Development partners including WBG are engaged with the government to identify sustainable means of supporting the water sector including through PPPs for sanitation and rural water supply, although some of the related institutional reforms may take time.

Energy and Natural resources Management: The January 2014 Constitution ensures that the state “strives for proper management of natural resources” (Article 12), that “natural resources belong to the Tunisian people” (Article 13), and that natural resource contracts need to be ratified by the NCA, the constituent assembly (Article 13). Article 136 also allows for the possibility of allocating a percentage of natural resources to advancing regional development and regional management of resources. This is a significant step forward for Tunisia, where the initial protests, leading to the 2011 unrest, were linked to poor governance in the phosphate industry, national parks, and forest areas. A year-and-a-half after the fall of the Ben Ali regime, Prime Minister Hamadi Jebali announced his government’s commitment to joining the Extractive Industries Transparency Initiative (EITI), though this has yet to happen. This is an important part of the transparency agenda that will involve regulatory bodies, auditors, relevant administrations and SOEs, CSOs and Parliamentarians.

Telecommunications: The Bank has identified the telecommunication sector as being particularly crucial for growth in the Tunisian context and has imbedded a reform program in its Governance, Opportunity, and Jobs DPL series. The objective of the reforms is to substantially increase competition, and encourage market entry, similarly to the experiences in the EU and Turkey. To strengthen competition in international communications, the National Telecommunication Authority (Instance Nationale des Télécommunications, INT) issued a first decision to open up access to the landing stations of international telecommunications cables (controlled by SOE Tunisie Telecom) to other operators in September 2012 and the requirement to route all their data communications through Agence Tunisienne de l’Internet (ATI) was removed from the Tunisian operator’s licenses. The opening of the landing stations of the state-owned operator represented an important decision in the overall telecommunications regulatory framework, as it creates the conditions for an increased competition and reduction in the price of international communications. In parallel, the Government has also been working to increase competition in the market for backbone connectivity. The substantial fiber optic infrastructure owned by various SOEs (notably the electricity utility STEG, the railway corporation SNCFT, and the highway operator Tunisie Autoroutes) mainly served their own corporate needs, with large unused capacity. To enable the use of such alternative backbone infrastructure, the Telecommunications Code (Code des Télécommunications) was revised by Law No 2013–10 dated April 12, 2013 and the INT has subsequently approved and published technical and price offers by the two main holders of alternative fiber optic backbone infrastructure (STEG and SNCFT) to lease capacity to licensed operators on a non-discriminatory basis (prior action GOJ-2). The package of measures currently considered expands the reform process in the sector by (i) tackling the issue of the restructuring of the state-owned historical operator, Tunisie Telecom, which cannot any longer be isolated from regulatory reforms; and (ii) broadening the liberalization process through service based competition for internet service and voice services (Internet Service Providers and Virtual Network Operators), coupled with improved access to fixed backbone/backhaul/local loop infrastructure for data transmission and the internet (unbundling and bitstream wholesale offer by Tunisie Telecom).

Financial Sector: The Tunisian financial sector is in need of structural reforms in order to facilitate the country’s economic modernization. The banking sector suffers from a high degree of fragmentation and under-capitalization. Political interference and weak governance has severely undermined its performance and led to a high number of non-performing loans. To address these problems, the Central Bank has announced reform measures including stricter prudential regulations for micro-finance to large state-owned banks.

Transport: **(a) Governance of SOE and sustainability**: The Tunisian transport sector is characterized by the involvement of several state-owned companies (SOE) that are currently in weak financial situation, characterized by a high level of borrowing and poor operational performance. Often these companies are not even able to maintain their fleet and honor their financial commitments. This is the case of most transportation companies, including TRANSTU (urban transport), SNCFT (railways), STAM (port operator), and TunisAir (airline). Existing transportation institutions, such as the Ministry of Equipment, need to significantly improve their planning capacity to better respond to the economy’s needs with limited resources. Investment may be necessary to improve delivery of services and increase the financial sustainability due to lack of maintenance of assets.

(b) Decentralization/Deconcentration of responsibilities: Responsibilities for delivery of services and planning remains very centralized. In the road sector, despite the creation of regional administrations, the decision making, financial and human resources remain very central. At the city level, (although the 2004 Transport Law provided for the establishment of urban transport management authorities within governorates, the funding of transport services by users and other beneficiaries, and the compensation of public service obligations by the State budget) the lack of decentralization, strong resistances of several ministries under previous governments to transfer responsibilities, and MOF’s past reluctance to revise the tax system of car usage have stalled implementation.

Role for the private sector: As delivery of services has traditionally been provided by SOE, the private sector role in the transport sector is sub-optimal. While perception of the private sector during the Ben Ali area, and recent pressure on SOE to increase employment following the revolution, there is a need to rethink the role of the private sector. Even when SOE will remain in place a competitive environment

(continued on next page)

Box 12: Sector-specific governance challenges *(continued)*

and appropriate governance structure should be encouraged to improve the quality, efficiency and sustainability of transport services and infrastructure.

Health Sector. Governance challenges in the health sector undermine equal access to services and their quality. In particular, roles and responsibilities are not well delineated, which has led to overlapping functions, conflicts of interest and inefficiencies in the four functions of the health system (provision of health care services, resource generation, financing, and stewardship). For example, the MoH, the main health care provider, is also responsible for managing the resources allocated to non-contributory health coverage for the poor and vulnerable population. Ill-equipped for this function, it manages these resources inadequately, allocating them to public facilities without taking into account their activity. Second, although the MoH is supposed to ensure the stewardship of the system, its limited capacities are mainly allocated to service provision and financing functions, which do not allow for an effective regulation and control of the private providers. This results in important inequities in access to health services and their quality.

Education Sector. The Tunisian education system is characterized by high levels of centralization for all sub-sectors (general, vocational, and higher education) and subject to the overall burden of heavy prior controls and other bureaucratic processes with no real check and balance mechanisms in place. As a result, education institutions at all levels have little room to manage their inputs and adjust to the needs of the students and their families; and there are no incentives for performance or innovation. Another effect is the near absence of involvement or even representation of key stakeholders (parents, students, employers, civil society) in the governing bodies and decision-making processes of educational institutions. This could explain the disconnect between education outcomes and labor market needs as employers have little say in the determination of priority areas and the design of vocational training and higher education programs. Teacher policies have been characterized by a succession of inconsistent and ineffective reforms of pre-service teacher training; lack of accountability mechanism; highly centralized recruitment systems and related risks of corruption and cronyism; and inefficient distribution of resources disadvantaging the interior/lagging regions. Private sector contribution is still very limited (four percent of total students in general education and 6.5 percent in higher education). Private providers are subject to tight regulations and relatively severe criteria for investment and operation

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[a] OECD (2014), *La gouvernance des services de l'eau en Tunisie: Surmonter les défis de la participation du secteur privé,* Etudes de l'OCDE sur l'eau, OECD publishing *http://dx.doi.org/10.1787/9789264213807-fr*

Implementing governance reforms and improving delivery of public sector services is dependent on the performance of a public sector long characterized by inefficiency. While the skills of civil servants have traditionally been relatively high in Tunisia, corruption, nepotism, and the lack of performance monitoring and evaluation have undermined performance. Hiring and promotion in the civil service has not normally been based on merit. Much of the focus of the civil service was on serving the elite, the party, or themselves as opposed to serving the public. GoT plans to incorporate citizen engagement in evaluating performance of the civil servants and delivery of services, and implementation of a civil servant code of conduct, may have positive impacts. But changing the culture of the civil service is a longer term proposition. Tunisia's civil service was relatively large and expensive prior to the transition. In the current political climate, with job creation a priority, it is unlikely the civil service will be downsized, but instead is likely to grow further.

Human Capital[106]

Quality of Education and Skills Mismatch

Tunisia rapidly expanded access to education over the past 20 years, particularly to higher education. However, the quality of education has become a challenge and acts as a constraint to growth. From 1990 to 2010, Tunisia rapidly expanded access to education, particularly to higher levels of education (see

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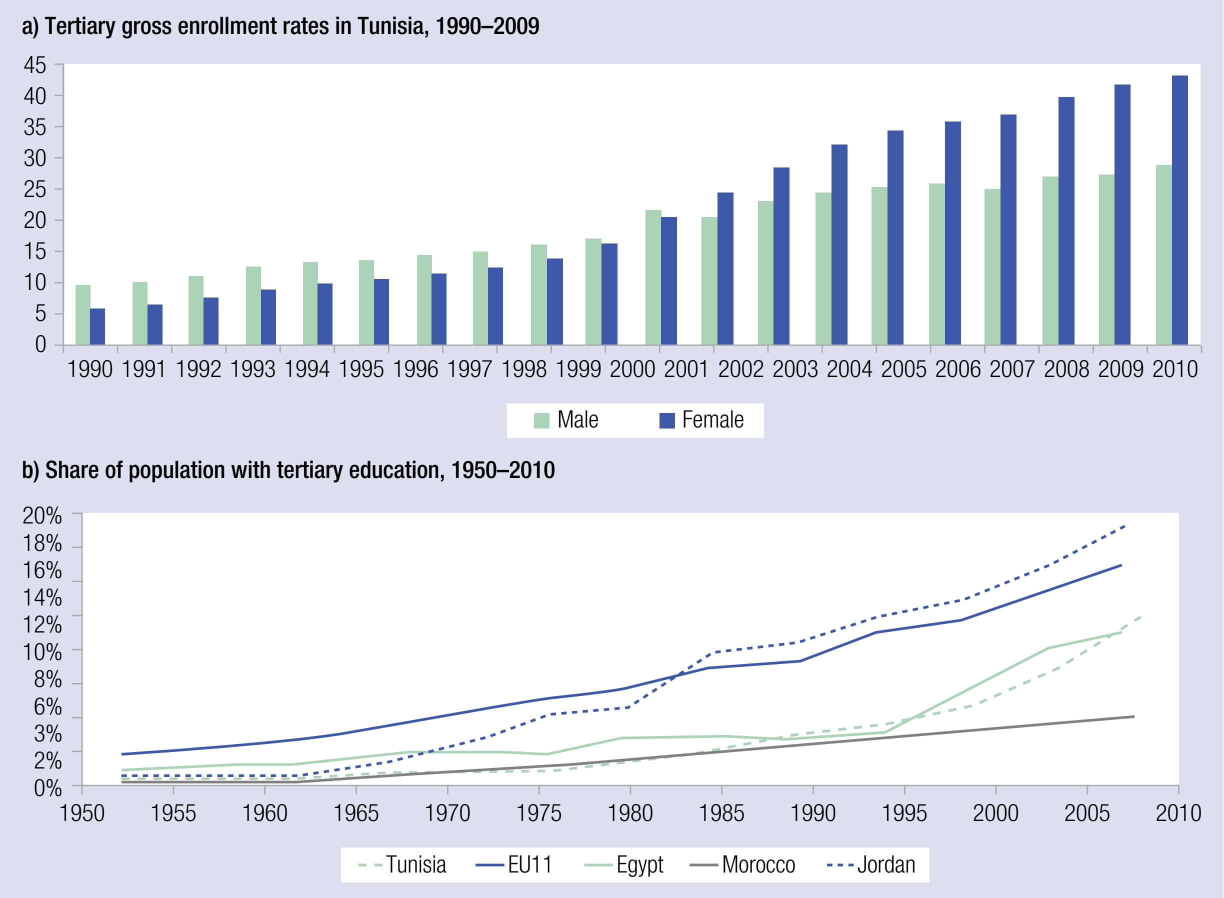
[106] The World Bank defines social capital as, "the institutions, relationships, and norms that shape the quality and quantity of a society's social interactions. Social cohesion is critical for societies to prosper economically and for development to be sustainable."

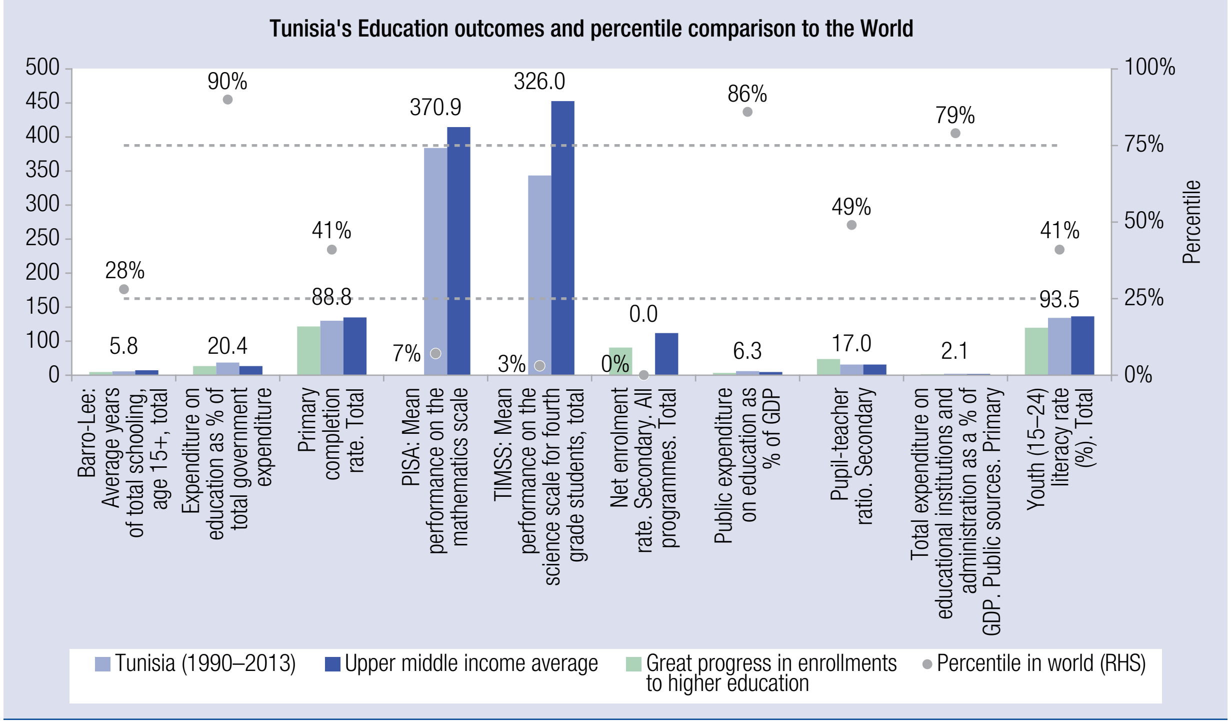
FIGURE 60: Great Progress in Enrollments to Higher Education...



a) Tertiary gross enrollment rates in Tunisia, 1990–2009

b) Share of population with tertiary education, 1950–2010

...but quality of education remains a challenge



Tunisia's Education outcomes and percentile comparison to the World

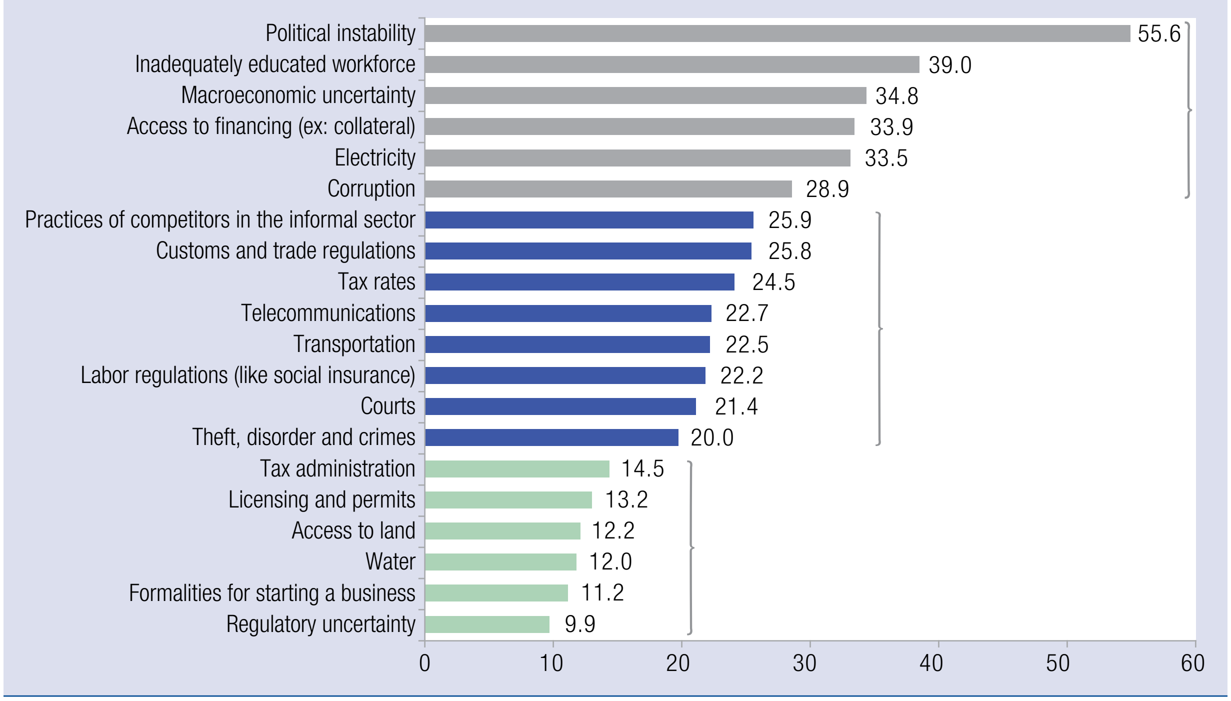
Figure 60a and 60b). As a result, impressive progress has been made in enrollment and completion rates in both secondary and tertiary education. In particular, gross secondary enrollment rates increased from 52 percent in the early 1990s to 89 percent in 2009, and gross tertiary enrollment rates increased from eight percent in the early 1990s to 34 percent in 2009. These increases have made possible a sharp reduction in gender gaps in education and for some education outcomes—such as access to tertiary education—a gender-reversed gap is observed. However, challenges remain in ensuring the quality of education in Tunisia. Evidence on learning outcomes—as measured by Trends in International Mathematics and Science Studies (TIMSS) among 8th graders and by the Program for International Student Assessment (PISA) among 15 year olds—points to a relatively low quality of education (see Figure 60, bottom pane). The 2011 TIMSS indicates that 75 percent of 8th graders in Tunisia displayed "low" and "below low" performance in mathematics, suggesting that secondary school students may not have even basic mathematical knowledge. Similarly, data from the 2012 PISA suggests that Tunisian pupils' performance in sciences and mathematics is low (given the country's level of development). While these data look only at performance in secondary education, nevertheless they signal that the education system is not producing a critical mass of students who have the fundamental quantitative skills to perform well in labor markets.

A serious skills mismatch, together with low quality of educational outcomes, prevents a full utilization of the human capital. **Lack of adequate skills is the second leading constraint for firms in the private sector**. The skills and competencies acquired by graduates do not seem aligned with those in demand by the private sector. In addition to the quality of education, the relevance of graduates' skills is crucial for employability. Ideally, the skills and competencies available among job seekers and those required by available jobs in the labor markets should match in order to make graduates employable. About 63 percent of all students enrolled in tertiary education institutions in the academic year 2010/11 were in the fields of humanities and social sciences. Such skills, however, are not very attractive in private sectors where employment demand for graduates is highest, such as health, ICT, agro/industrial, financial services and telecommunications. Other factors affecting negatively the quality and relevance of higher education outcomes include the difficult transition to the newly implemented Bologna LMD model, the limited autonomy of universities and lack of employers' involvement in university programs design. This is reflected in the findings of the most recent ICA (2012) where the level of workers' skills and education are the second leading perceived constraint to firm operations, immediately after political uncertainty (see Figure 61). Thirty nine percent of sampled firms in the recent ICA (2012) perceive the available skills of the workforce as a weakness. Many firms have responded that candidates do not meet their required qualification expectations. For instance, 70 percent of respondents stated that the types of engineers and/or professionals available on the job market do not possess adequate skills required for the position.

Health Services

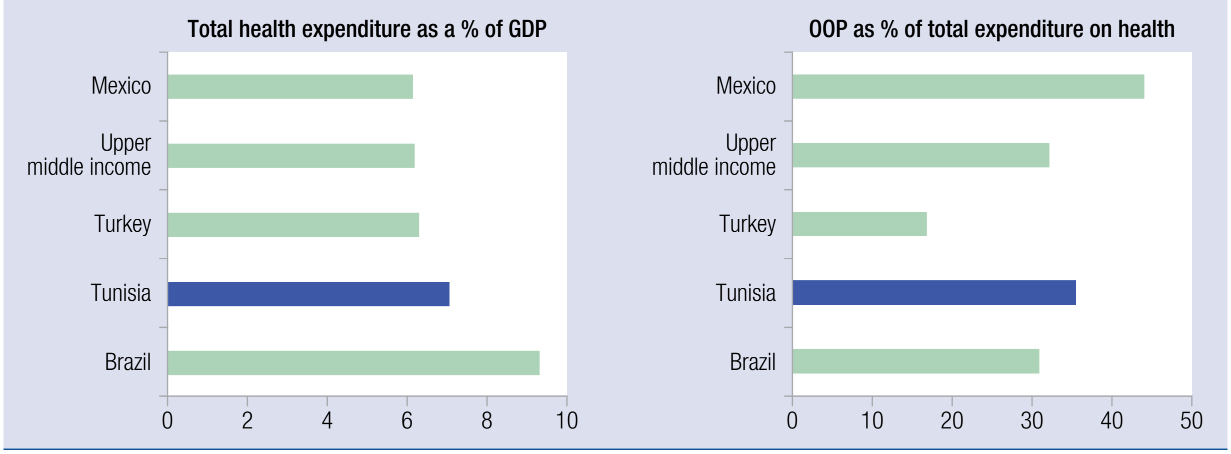
While health facilities are relatively well distributed, the main challenges facing the system emanate from a lack of adequate financial protection and a poor delivery of public health services, particularly in interior regions. Between 2000 and 2013, total health expenditure grew from 5.5 percent to 7.1 percent of GDP, which looks adequate for an upper middle income country. However household out-of-pocket (OOP) expenditure are persistently high. Health care in Tunisia is financed through a combination of general government revenues (27.1 percent of total health spending), social health insurance (Caisse Nationale de l'Assurance Medicale or CNAM, which account for 34.9 percent of total health expenditure), private insurance (0.4 percent) and household OOP payments (37.5 percent). CNAM covers nearly 66 percent of the Tunisian population but services are not adequate, driving many patients to OOP payments on private providers that are not covered

FIGURE 61: Inadequate Skills is the Second Leading Constraint to Businesses



Source: ICA 2012.

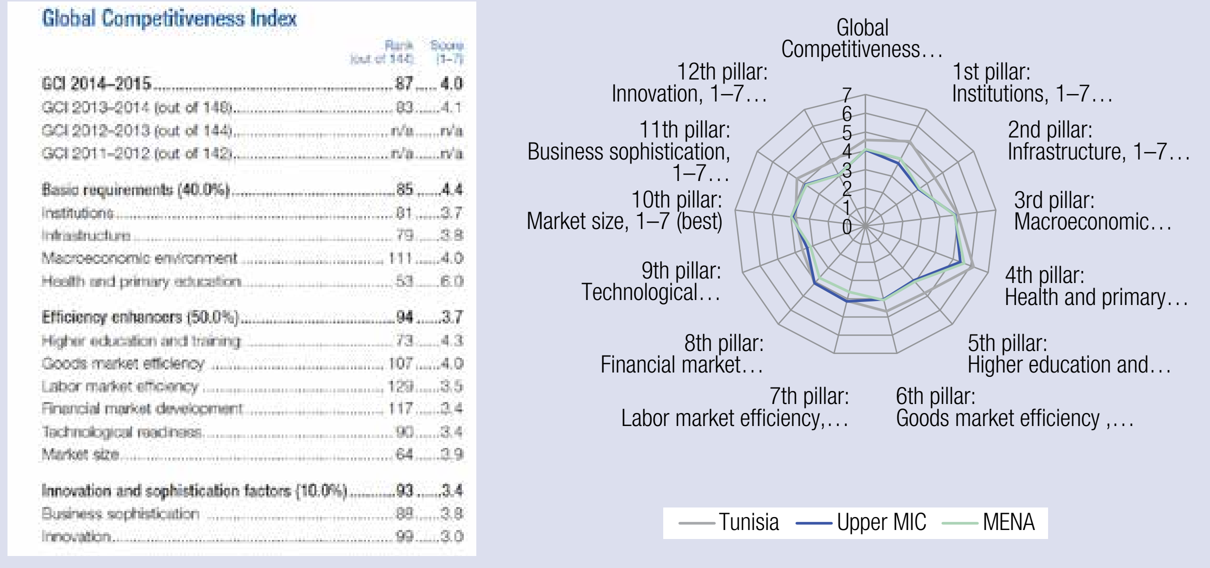
FIGURE 62: Total Health Expenditure and OOP Payments in Tunisia and Comparators



Source: World Development Indicators.

by CNAM's schemes. As of 2011, CNAM expenditures amounted to 1.5 million TND, or 2 percent of GDP, increasing at an average annual rate of growth of 19 percent during 2007–2011 and facing a deficit that equals nearly 0.5 percent of GDP as of 2013. Tunisia also provides around one third of the population with non-contributory health coverage. However, the targeting system is relatively weak and services that are effectively covered are limited and of poor quality. As a consequence, out-of-pocket payments on health and personal care accounted for an average of 10 percent of total household expenditures as of 2010 and approximately 12

FIGURE 63: Physical Infrastructure is not the Most Binding Constraint Per Se....



Global Competitiveness Index

	Rank (out of 144)	Score (1–7)
GCI 2014–2015	**87**	**4.0**
GCI 2013-2014 (out of 148)	83	4.1
GCI 2012-2013 (out of 144)	n/a	n/a
GCI 2011-2012 (out of 142)	n/a	n/a
Basic requirements (40.0%)	**85**	**4.4**
Institutions	81	3.7
Infrastructure	79	3.8
Macroeconomic environment	111	4.0
Health and primary education	53	6.0
Efficiency enhancers (50.0%)	**94**	**3.7**
Higher education and training	73	4.3
Goods market efficiency	107	4.0
Labor market efficiency	129	3.5
Financial market development	117	3.4
Technological readiness	90	3.4
Market size	64	3.9
Innovation and sophistication factors (10.0%)	**93**	**3.4**
Business sophistication	88	3.8
Innovation	99	3.0

....but restrictions in most segments of transport services and access to key transport infrastructure are

FIGURE 64: Extent of Public Ownership in Air Transport

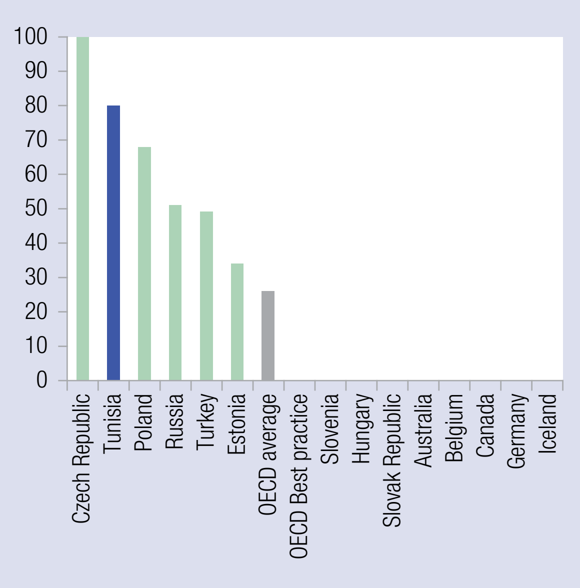
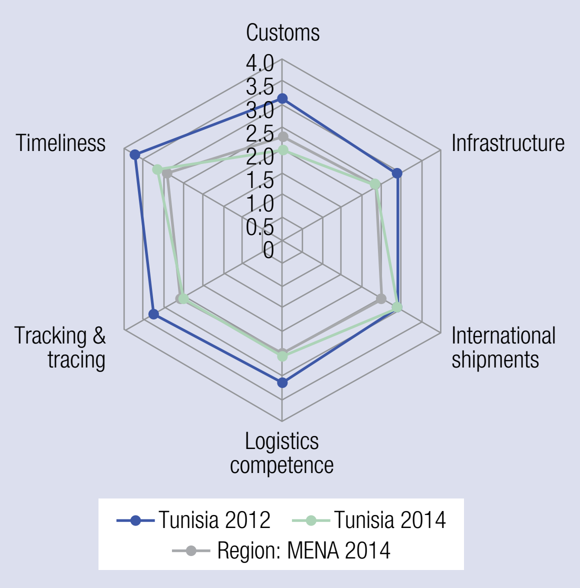


FIGURE 65: Tunisia Logistic Performance Index 2012 and 2014



percent of households faced catastrophic health care payments, threatening poverty and shared prosperity. In addition, the health financing system challenges exacerbate disparities in health status and the use of health services, including among regions. For example, the maternal mortality ratio is over three times higher in rural areas such as Kasserine than in urban areas such as Sousse (70 deaths compared to 20 deaths per 100,000 live births, respectively, as of 2006).

Infrastructure, Connectivity, and Trade Logistics

Connectivity is central to improving competitiveness. Despite its high urbanization rate, Tunisia is characterized by a low agglomeration rate (39 percent) due to relatively low densities. Low agglomeration combines with gaps in infrastructure (e.g. one of greatest rural connectivity deficits in MENA) and service delivery to limit the shared benefits of growth. Recent evidence (Bridging the Spatial Divide)[107] suggests that limited labor mobility and spatial segmentation in labor markets may be driven by potential migrants' perceptions of higher costs associated with commuting and poorer access to services in the peri-urban neighborhoods they would inhabit if they move to major urban areas. Given that almost all movement of people and freight between cities is on road, the development of road transport corridors is likely to have a significant contribution to improving connectivity of lagging regions.[108] Growth in lagging regions will also depend on the quality of infrastructure to support private sector investment and reducing transportation costs of goods to ports/markets. At the same time, private sector participation in road rehabilitation and modernization can help the Tunisian economy enhancing its production potential, hence benefitting growth in all regions.

Important bottlenecks in infrastructure-related services and logistics hinder trade and competitiveness. According to the WEF's Competitiveness Index, Tunisia ranks 79 out of 144 countries in terms of infrastructure provision. Significant previous public investments have in fact resulted in good provision relative to other peer countries. Tunisia has also traditionally been perceived as an example of good practices in logistics in the MENA region. According to the Logistic Performance Index 2012, Tunisia was ranked 41st in the world and the best performer within the MENA region with a score of 3.17 over five (after United Arab Emirates and Saudi Arabia) when the Arab Republic of Egypt scored at 2.98, Morocco at 3.03, and Algeria at 2.41. However, logistics costs related to infrastructure-related services (such as transit costs for containers or shipping

Box 13: An example of collective governance failures and delays in infrastructure investments: the example of Rades port

Rades[a] port has been symptomatic of governance failures and bad incentives present in the country: (i) poor management of the main SOEs in this area (the port concessionaire, STAM and the OMMP, the company in charge of ports infrastructure and management), which led to overstaffing and poor performance ratio (for cranes for instance) but also very limited availability of equipment and inadequate maintenance; (ii) governance problems in customs, such as inadequate auction policy and habits for some brokers to collude with some customs officials, ineffective 100 percent scanning policy leading to increased corruption, and numerous loopholes in several customs; (iii) complicated tariff policy with numerous tariff peaks, which has been an incentive for collusion and corruption leading to long dwell times; and (iv) incentives to use the port as storage area with very low levels of storage tariff (lower by a factor of three to comparable ports in the region). Moreover, the port has suffered from procrastination and delays in infrastructure investments (such as years long delay of the port extension and dredging the channel to a depth of 11m to accommodate the most common feeder vessels),

Given the projected traffic in the coming years, improving Rades port productivity and achieve port expansion should lead to annual savings of up to US$300 million for the Tunisian economy (or up to US$600 per container). This should be mainly achieved by improved crane productivity and reducing container dwell time by at least 30 percent. To improve Rades port performance, governance problems (in customs and SOEs) as well as infrastructure bottlenecks will need to be tackled simultaneously.

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[a] Originally designed solely to carry wheeled cargo, the port of Rades has been adapted over the years to handle container traffic to become the main port in Tunisia with almost 90 percent of the national traffic in the 2000s.However, the port has increasingly faced increasing difficulties and penalized importers/exporters with long container dwell times and increased maritime costs from shipping lines. During the transition period, Rades share in the Tunisian traffic decreased from 90 percent to only (approximately) 66 percent.

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[107] World Bank report, *Bridging the Spatial divide: Labor Market Outcomes in Urban Tunisia*, 2013, mimeo.

[108] In Tunisia, the road network accounts for virtually all movement of persons and over 80 percent of goods transportation. Although the national average road density is 12 km per 100 km^2 (WDI), it is significantly more developed in the denser eastern coastal regions than in lagging regions such as region in the northern and central west of Tunisia.

costs – see Box 13) in Tunisia are high, about 20 percent of GDP against an average of 15 percent in emerging countries and 7–10 percent in European countries.

State-owned companies still dominate Tunisian economy at the expense of effective public spending. Mismanagement of SOEs has been recurrent for years. Some evidence has been documented by the National Commission for the Investigation of Cases of Corruption and Embezzlement in 2011, such as access to state-owned land at prices completely out of step with market prices, abuse of state assets for private purposes, and state banks being used for special access to credit under advantageous terms. SOEs have been used to generate employment, especially after the revolution since their total employment increased by more than 50 percent in less than three years.

The heavy involvement of the state in the form of SOEs, with opaque rules for governance and accountability, has prevented infrastructure-related services from operating efficiently and fairly. In the infrastructure sector there are an estimated 32 SOEs. In comparison in EU countries there are on average nine SOEs in infrastructure/network industries (OECD PMR database). The state is active especially in the field of public services (electricity, water, sanitation, passenger transport). Market segments of transport services that may be supplied by private operators are still serviced by dominant SOEs with market shares larger than 50 percent (see governance sector specific issues). Although there is no single model for managing and controlling state-owned enterprises, neither Tunisia's legislative framework nor the implementation of existing framework provides the transparency and accountability needed for efficient use and management of public funds. Reforms that mimic private sector practices on paper are not implemented or cannot be implemented because of political interference and opacity remains a critical issue in Tunisia's SOE sector. As long as political interference exists in SOE management or public procurement, reforms will not have a strong impact on the ground. PPP could improve the efficiency of public expenditure and the quality of infrastructure services but at present, an institutional and legal environment conducive to the facilitation of a clear strategy for PPP in infrastructure is still missing.

Tunisia's growth requires an energy sector capable to supply continuous, stable power. While the sector thus far has been reasonably able to respond to the demands, significant underfunding over the past decade has curtailed the sector. Tunisia's recovery is driving strong growth in electricity demand (five percent per year on average for annual electricity consumption, 11 percent for peak demand). However little new power generating capacity was commissioned between 2010 and 2014, and risks of shortages are now looming. This strong growth in electricity demand is translating into additional reliance on imports and on hydrocarbons. The Tunisian energy system is extremely dependent on hydrocarbons, with oil and gas meeting 99 percent of energy demand (44 percent for oil, 55 percent for natural gas). Power generation is almost entirely based on natural gas (98 percent), with renewable energy having only a very small contribution. The high level of dependency on hydrocarbons makes the country vulnerable to disruptions in the international oil and gas markets and to price volatility, especially as Tunisia has to rely increasingly on imports. One third of Tunisia's gas consumption is currently imported from Algeria. By 2020 it is expected that gas supplies will fall short of Tunisia's needs. In this context Tunisia's authorities have been contemplating the use of alternatives to gas including a transmission interconnection to Italy for import of electricity and a coal-fired power plant in the medium-term. For the longer term solar and nuclear power are being considered.

The state-owned Tunisian Company for Electricity and Gas (STEG), which owns and operates 88 percent of the generation capacity and acts as single buyer for the remaining 12 percent, is in need of reform.[109]

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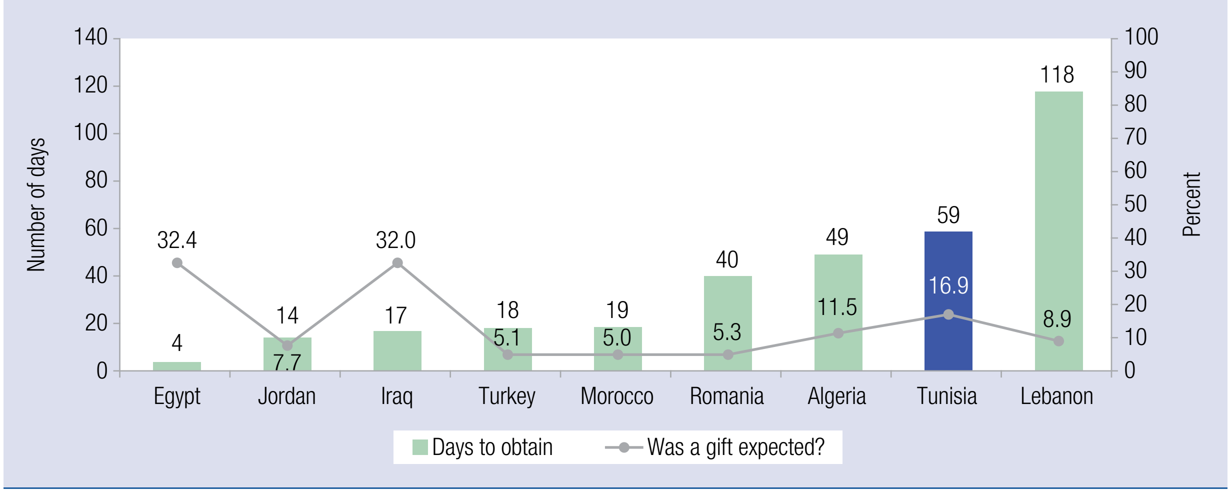
[109] In order to secure sustainable, efficient and cheap financing for investments and reduce losses (technical and commercial) to improve financial viability, STEG should be reformed on the basis of two principles: (i) legislative security through a stable and predictable institutional and regulatory framework, and (ii) transparency in operations, tendering, and pricing.

FIGURE 66: Delays in Providing New Electricity Connections are a Major Obstacle for Firms



Source: lpi.worldbank.org.

This is reflected in the fact that over the past one to two years power outages have increased, and in 2013 Tunisia had to resort to leasing expensive rental power plants to respond to its growing peak demand. Unless concrete measures to address these structural problems are taken, the energy sector—the engine that drives Tunisia's economy—will face serious challenges over the next few years. This will also require addressing Tunisia's increasing dependency and its impact on BoP risks. Actions to reduce the carbon intensity of the economy (in both energy supply through renewables and efficiency, as well as in energy intense sectors such as transport and industry mainly through efficiency measures) are part and parcel of the strategy going forward, as is continued attention to energy subsidy reduction.

Delay in connecting new firms to the electricity grid is perceived as a leading constraint to setting up new businesses in Tunisia, therefore hindering their efficiency and competitiveness. Major differences exist in the provision of the service between regions. "Delays in connecting new firms to electricity"[110] is ranked as the fifth leading constraint to businesses in Tunisia, with one third of firms citing it as a major or very severe constraint. According to the most recent ICA, firm perception of such constraints varies by location within Tunisia (ICA). New connections are reported to take an average of 59 days, which is one of the highest in the region. Waiting for two months means that despite the relatively easy business registration process in Tunisia, setting up new firms is a time consuming process. Long delays in the delivery of services also potentially create more space for discretion. According to the Investment Climate survey, 17 percent of the firms are expected to make informal payments in order to obtain an electricity connection, a relatively high figure when compared to other MENA countries. The level of petty corruption in Tunisia is highest in small (24 percent) and medium (21 percent) vs. large firms (five percent).

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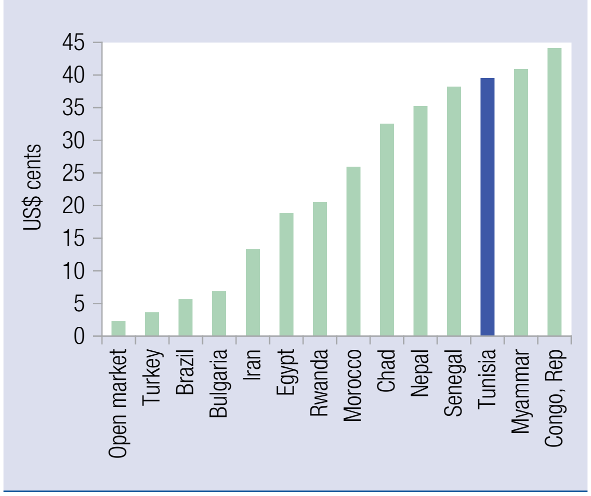
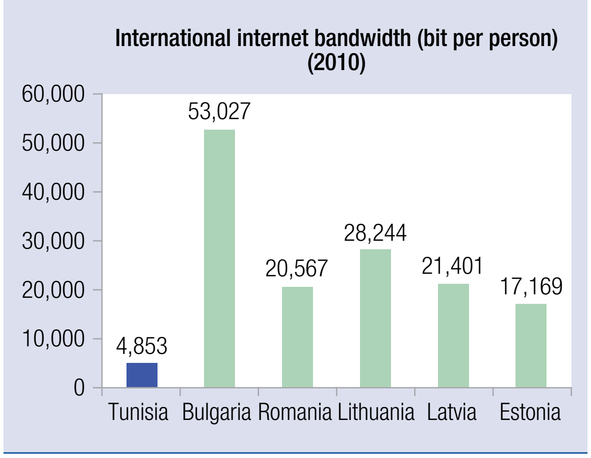
[110] The SOE STEG (Société Tunisienne de l'Electricité et du Gaz) has the monopoly over gas and electricity supply and distribution. Two companies (STEG, which holds 80 percent market shares and CPC, a private company, which holds 20 percent market shares) are the electricity generators, but STEG has the monopoly over the distribution and supply of electricity. In the gas sector, production is ensured by five companies (British Gas; ENI; PETROFAC; PERENCO; and Winstar), while imports are performed by one SOE (ETAP). The SOEs *Société du Réseau Ferrovière Rapide de Tunis (SRFRT)*, *Société des Travaux Ferrovières* (STF) et *Société Nationale des Chemins de Fer Tunisiens* (SNCFT) are the most important enterprises in the railways sector.

FIGURE 67: Cost of International Calls from Skype



Source: Skype.
Note: Cost of call from US to countries.

FIGURE 68: International Internet Bandwidth



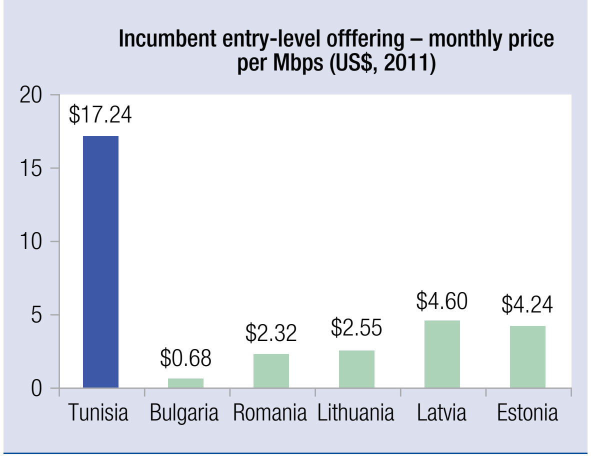
Source: Telegeography Globalcomms Database, Sep. 2011 (prices) and World Bank Development Indicators database (international bandwidth).

Tunisia's transition governments have taken significant steps toward the overhaul of its energy sector. In 2013/2014, Tunisia launched a national debate on the energy transition. The key elements of the energy strategy are: (i) development of national energy resources and infrastructure; (ii) reinforcement of energy efficiency programs (objective is an annual decline of 2.5 percent in energy intensity); (iii) diversification of the energy mix through RE development (objective is a capacity of 3700 MW in 2030, with 30 percent RE in electricity production); (iv) development/reinforcement of interconnections with Maghreb countries and Europe; and (v) reorganization and institutional reforms together with better governance of energy strategy and decisions, and launch of national energy debate on transition.

Increased water scarcity can pose a threat to economic and social development, exacerbating inequalities and preventing growth in key economic sectors. Tunisia's economic and social development has been underpinned by a tradition of successful water and wastewater infrastructure (highest level of wastewater equipment in MENA) and service provision. However significant infrastructure and service-related gaps remain, with several underserved areas accounting for as many as 300,000 people lacking improved sources of drinking water, and one million people without access to an improved sanitation facility, primarily in rural areas (Box 2). These gaps have increased following the slowdown in the past decade in Tunisia's high investment in technology and water mobilization infrastructure. Sustainable water availability in Tunisia is only 440 m3 per capita per year (from 470 m3 per capita in 2005), less than 50 percent of MENA's average, and below the universal scarcity threshold (500 m3 per capita). It is projected to decrease to 360 m3 in 2030 when the population reaches 13 million, with severe water stress occurring by the 2050s under a warming and drying climate. If infrastructure is not upgraded, 7.5 million people stand at risk of water shortages (several cities experienced service interruptions on a large scale in the summer of 2012 which led to civil unrest). Degrading infrastructure and services ultimately impact the well-being of people and could affect the growth of water-intensive economic sectors (such as the agribusiness).

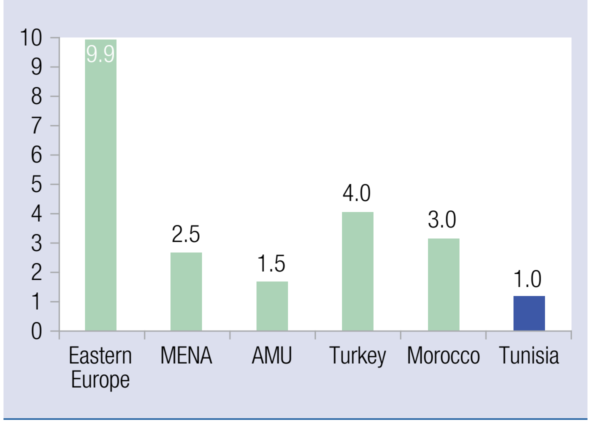
Low levels of competition in the telecommunications sector have resulted in higher costs to consumers, including firms, and hindered Tunisia's potential to compete in international markets and to fully

FIGURE 69: Entry Ticket for International Connectivity ($/Mbps/month) in 2011



Source: Telegeography Globalcomms Database, Sep. 2011 (prices) and World Bank Development Indicators database (international bandwidth).

FIGURE 70: Number of Providers of International Bandwidth in 2011



Source: Ouderni, 2012.

use Information and Communication Technologies (ICT) as a key accelerator of social and economic development. International fiber optic communications (international bandwidth), both for phone and Internet, has been until September 2014 under the monopoly of Tunisie Telecom.[111] The substantial fiber optic infrastructure owned by various SOEs (including the railway corporation SNCFT, and the highway operator Tunisie Autoroutes) mainly served their own corporate needs, with large unused capacity. As a consequence, the cost of telecommunication and internet services in Tunisia is incredibly high, and compares only with some of the least integrated economies in the world (like Myanmar or Republic of the Congo). This has hindered Tunisia's potential to become an internationally competitive player in the global market and has limited the ability of the private sector to develop information technologies at their full potential. Even with much lower per capita income than Tunisia, Morocco and Egypt are better positioned to become regional hubs in the sector, with three and seven operators respectively. These numbers are still much lower when compared to more integrated countries such as in Eastern Europe (10 providers per country on average).

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[111] This is a monopoly on the physical layer of the international network, but alternative licensed operators have the right to have an international gateway and to offer international services to their own clients only. As of September 2014, additional international infrastructure (sub-marine cables) has been established by alternative operators, which will ultimately provide Tunisia with a more secure and competitive access to the global fiber optic network.

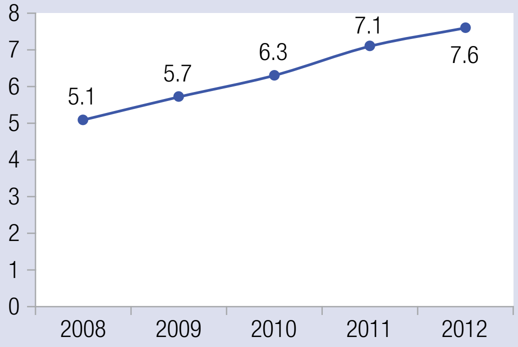
Box 14: ICT potential for poverty reduction and increased shared prosperity

Tunisia's Information and Communication Technology (ICT) [a] **is an important and growing sector**: its contribution to GDP increased steadily from two percent in 2002 to 7.6 percent in 2012 (equivalent to tourism), providing jobs to 50,000 people (1.3 percent of Tunisia's active population).[b] ICT is a sector that attracts significant investment and can provide income even in a phase of depressed economic growth. Average income for ICT jobs, be they in the information technologies sub-sector or in the telecommunication technologies sub-sector, is higher than those in agriculture, industry, and services. While the development of the telecommunication technologies sub-sector has been driven by a limited number of players (three telecoms operators and two independent Internet Service Providers as of 2014), the number of companies in the information technologies sub-sector was multiplied by five from 1,307 in 2002 (for revenues of TND107 million) to 5,275 in 2011 (for revenues of TND800 million). Tunisia completed in June 2014 the consultative process to adopt its new ICT strategy called "Digital Tunisia 2018" which aims at transforming the country into an international digital best practice and to use ICT as a key accelerator of social and economic development. Tunisia also laid the appropriate foundations for e-government through its 2010–2014 strategy[c] and joined the Open Gov Partnership in January 2014 that will contribute to the unleashing of Big Data opportunities. The website www.data.gov.tn displays approximately one hundred links to public databases structured around 17 themes. The website www.opengov.tn is a civil society initiative offering access to governmental data. The impacts could be far reaching, including in terms of job creation and more transparent governance and real-time impact analysis and feedback.

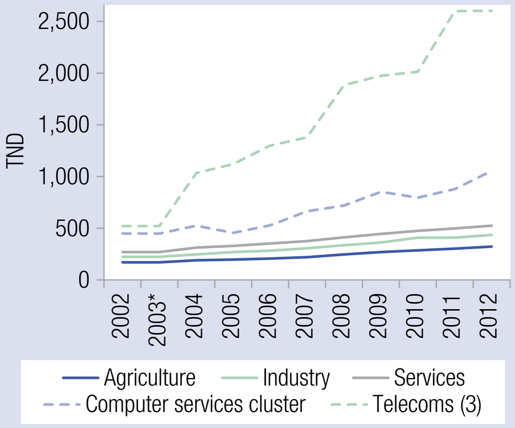
ICT, by including an objective to move toward broadband[d] **for all (e.g. 50 percent of the Tunisian population should have access to mobile broadband by 2018), represents a leapfrog opportunity for Tunisia for poverty reduction and income growth of the bottom 40 percent of the population. Broadband is a powerful driver for sustainable economic growth, job creation, and human skills development and an enabler of democracy and social transformation.**

- Broadband is a general-purpose technology (GPT) with pervasive productivity impacts on multiple sectors of the economy (energy, water, industrial production, services, transport, and so on). Broadband has a similar impact on the transformation of the economy as previous GPTs have had in the past, including the printing press, steam engines, and electricity. Broadband drives competitiveness in manufacturing through information technology-enabled supply chains: broadband powers the most relevant innovations in the production processes likely to shape the future of manufacturing (e.g., digital modeling, simulation and visualization, big data analytics, social and collaborative technologies, and just-in-time supply). Furthermore, broadband enables business process outsourcing (BPO). Broadband also contributes to the competitiveness of the services sector, bringing positive spillover effects to less technology-intensive industries. Finally, the availability of reliable and reasonably priced broadband internet access is a key determinant in foreign direct investment (FDI) decisions.

Added Value ICT/GDP (%)



Average wage (TND)



Note: *No data in 2003, it is considered that wages remained the same as in 2002. NB Telecoms (3)= the 3 operators present on the Tunisian market.

(continued on next page)

Box 14: ICT potential for poverty reduction and increased shared prosperity *(continued)*

- Broadband is also a key enabler of democracy and social transformation, as witnessed by the powerful role that was played by new and social media networking during the Arab Spring. The internet has played a key role in advancing social inclusion, accountability, human rights, and civic engagement. Social networking tools have the potential to enhance citizen engagement in the region, promote social inclusion, and create opportunities for employment, entrepreneurial activities, and social development.

However, broadband is currently available only in the richest part of Tunisia and the current level of broadband prices is not low enough to be truly inclusive. There is an ongoing risk that the bottom 40 percent of population in Tunisia will remain excluded from the information revolution that is shaping the modern world. A representative household in the lowest 40 percent income bracket of Tunisia would need to spend about 41 percent of its disposable income to afford fixed broadband services and about 44 percent to afford mobile services.

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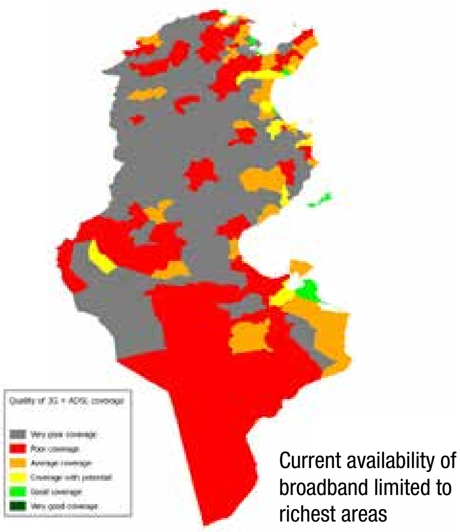
[a] ICT is generally divided in two sub-sectors: the information technologies (IT) sub-sector and the (tele)communication technologies sub-sector.
[b] Source for all data in this para: Banque mondiale, 2014: "ICT cluster analysis," *Competitive Industries and Innovation Program (CIIP) and MENA Private and Financial Sector* – based on data from Institut National de la Statistique (INS).
[c] See: Stratégie de développement de l'administration électronique en Tunisie* « e-stratégie 2010–2014 », http://www.tunisie.gov.tn/egov_tunisia.pdf
[d] Broadband refers generally to a telecommunications connection that is "always on," as opposed to a "dial up" connection via the public switched telephone network (PSTN), and with speed rates higher than those obtained with a "dial up" modem (at least 256 kilobits per second [kbps]).

Broadband Coverage



Current availability of broadband limited to richest areas

TERA Consultants

Source: AFFI-TAF funded Study on Develop Ultra-Fast Broadband (UFB) in Tunisia: Strategic Policy Options and Public-Private Partnerships (PPP), Consortium TERA Consultants (Lead member), GIDE LOYRETTE NOUEL, CERT, EUDOXIA Conseil and CJBMI & ass., February 2014

Affordability of Broadband in Emerging Markets

Country	Mobile BB against average income of lowest 40%	Mobile BB against average income of lowest 60%	Fixed BB against average income of lowest 40%	Fixed BB against average income of lowest 60%
Algeria	—	—	63.31%	50.61%
Djibouti	407.39%	318.34%	116.66%	91.16%
Morocco	32.11%	25.94%	29.03%	23.45%
Syrian Arab Rep.	90.14%	74.59%	36.06%	29.84%
Tunisia	44.18%	34.56%	41.09%	32.14%
Rep. of Yemen	59.86%	49.18%	46.44%	38.16%

Source: Prices: World Bank analysis based on operators' data, January 2013; total income: PPP 2005, Population: World Bank, 2011, *Development Data Platform (DDP); Income Distribution by Quintile*: PovcalNet the online tool for poverty measurement, World Bank, DDP, earliest available information was used.

7

Sustainability

Whether Tunisia can sustain the progress observed in years before the revolution while moving on the path of higher and more inclusive growth depends on the extent to which attention is paid to critical socio-political, economic, and environmental issues. On all these fronts, emerging issues are overlapping with ongoing structural weaknesses and, together, could threaten the effectiveness and impact of identified reforms. There are however also new and unique opportunities to move forward and to strengthen the link between specific policies and a long-term development vision.

Political and Social Stability

Tunisia has suffered from increased instability following the revolution. Apart from the generalized spread of violence in everyday life (increase in burglaries, petty crimes, and assaults), there has been an upsurge in violence that is explicitly socially, politically and religiously motivated. The unrest intensified during 2013 with the assassination of two prominent opposition politicians. Although slightly improved in 2014 with installment of the technocratic government and the agreement of the new constitution and ultimately with the peaceful conclusions of the elections at end 2014, the situation has suddenly deteriorated. The brutal terrorist attack in March 2015 in the Bardo area is yet another blow at an already fragile security situation. Issues of reforming the police and security services will be extremely complex and delicate, and the former have occasionally gone on strike to protest efforts to sanction their members. This uncertain security, political, and policy environment significantly affected investor confidence in Tunisia since the revolution, affecting both domestic and foreign investments. Continued uncertainty on these fronts will undoubtedly affect the sustainability of Tunisia attracting necessary private investment into the country over the coming years.

The volatile regional environment and the difficult security situation, coupled with an economy that is still struggling to take off, might contribute to weaken the initial support of the Tunisia population for democracy. A very recent poll from the Pew Center[112] highlights how today only about half of Tunisians (48 percent) believe that democracy is preferable to any other kind of government, against a vast majority (63 percent) in 2012, soon after the revolution. About a quarter of the respondents replied that in some circumstances a non-democratic form of government is preferable (26 percent) or that the type of government

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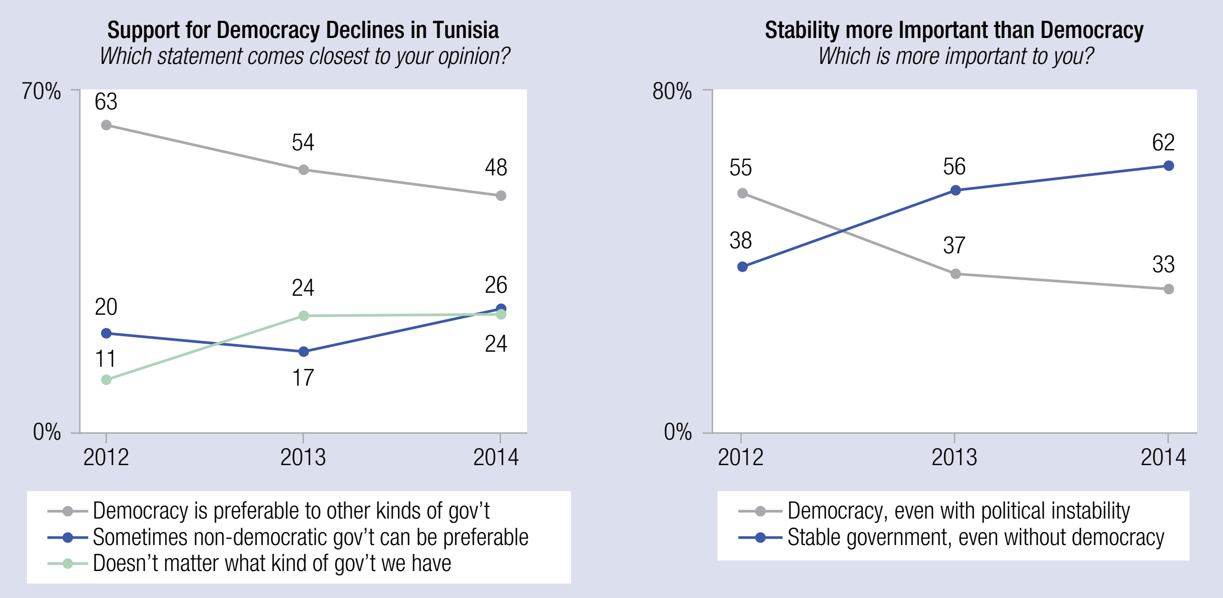
[112] The latest survey in Tunisia by the Pew Research Center is based on face-to-face interviews conducted with 1,000 respondents from April 19 to May 9, 2014. The poll results were released on October 15, 2014.

FIGURE 71: Instability is Weakening Support for Democracy



Source: Spring 2014 Global Attitudes survey. Q19. PEW RESEARCH CENTER.

Source: Spring 2014 Global Attitudes survey. Q106. PEW RESEARCH CENTER.

does not matter (24 percent).[113] According to the poll, a great part of the public's discontent is explained by the economy. Fully 88 percent describe the country's economic situation as bad, and 56 percent say it is very bad. But a majority is optimistic that the economy will turn around soon—56 percent expect it to improve in the next year. Instability also plays an important role: when asked which is more important, having a democratic government with some risk of political instability, or a stable government with a risk it will not be fully democratic, 62 percent of Tunisians say they prefer stability. This has increased dramatically since 2012 when just 38 percent said they would prefer stability to democracy. The toned down enthusiasm and engagement is reflected in the voter turnout for the most recent—October 26, 2014—parliamentary elections, where participation was estimated at 62 percent of the 5.3 million registered voters. Contrary to some international media, which characterized participation as a success, the local feeling is that it is a disappointing turnout, as the absolute number of voters is below that of 2011. Reports suggest very weak political participation among youth, especially in the inland/lagging regions.

Despite waning confidence in democracy's ability to produce results, Tunisians continue to want key features of a democratic system, such as a fair judiciary, competitive elections, the right to protest, and equal rights for men and women. A strong majority—more than nine-in-ten—believe that having a judicial system that treats everyone in the same way (94 percent) is very important for the country's future, up 13 points since last year. Similarly, 92 percent of Tunisians say having honest, regularly held elections in which people have a choice of at least two parties is very important, an increase of 21 percentage points in just a year. Law and order is a priority for most Tunisians: 81 percent believe that stability is crucial for Tunisia's future. More

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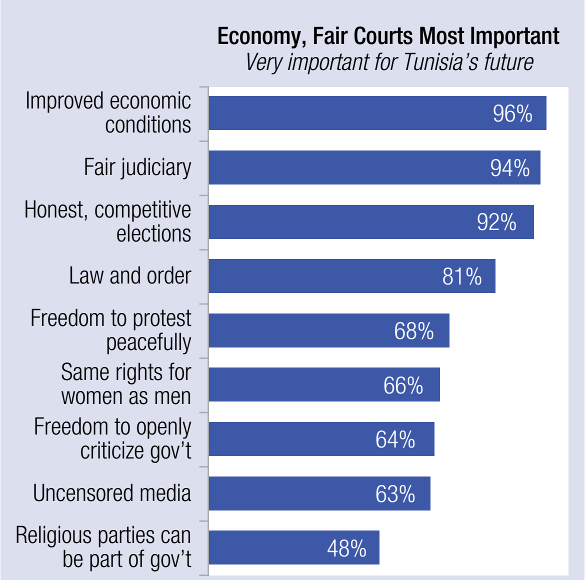
[113] Findings in Tunisia closely reflect those in Colombia and Thailand, the former in partial transition from conflict and the latter in a state of chronic political upheaval. Attitudes in transition countries often reflect the dichotomy of the public's interest in balancing stability with rights and freedoms. In periods of political turmoil citizens may be more willing to trade enhanced rights for greater stability. However, without public engagement and pressure difficult reforms are less likely to be addressed effectively. Implementation of reforms will be heavily dependent on a civil service, which in the past has lacked efficiency and effectiveness.

than six-in-ten think that certain freedoms are critical to Tunisia's future: freedom to peacefully protest (68 percent), equal rights for women (66 percent), freedom to criticize the government (64 percent), and an uncensored media (63 percent).

FIGURE 72: The Economy is Perceived as the Most Important Factor for Tunisia's Future, Followed by Key Features of a Democratic System



Source: Spring 2014 Global Attitudes survey. Q104a–c & f–k. PEW RESEARCH CENTER.

The building blocks of a democratic system and a more open society are in place but more needs to be done to guarantee social stability and to sustain progress toward a just and inclusive society. A crucial step will be for the citizens to regain trust in the public administration and enhance transparency. Achieving greater citizen accountability of authorities and greater citizen participation and feedback in policy making[114] will require greater transparency in government operations and higher standards for public officials. The important actions taken so far to address anti-corruption issues are a step in the right direction.[115] Another important step toward creating a more efficient administration that is closer to the citizens is the ambitious decentralization reform of the public administration foreseen in the new constitution. The development of a regional administrative level, capable of taking into account regional differences and of promoting a more equitable economic development across the country, was identified as a priority in the constitutional reform process as well as the empowerment and increased autonomy of municipalities. The recognition of the importance local administration represents a radical break with past policies, in which the administration was largely centralized. A well-functioning democratic system also needs an independent judiciary system capable to enforce human and civil rights. While progress has been made[116] to ensure that the independence of the judiciary system is respected during transition and after the new system is in place, particular attention needs to be given to implementation of institutional reforms.

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[114] Citizen involvement in policymaking and active participation in the civil society cannot be assumed as an automatic outcome once the opportunity is granted. An assessment of the degree of citizens' participation and its impact would need to include both quantitative (e.g., amount and/or percentage of population that participate) and also qualitative indicators (i.e., usefulness and/or relevance of contributions to the process in question).

[115] In 2011, a Minister in the Prime Minister's Office responsible for Governance and Anti-corruption was appointed and the National Anti-corruption Unit was created. Good governance units have been established in all ministries, public enterprises and regions, and a national anti-corruption strategy was launched on in December 2012. However, there are still many gaps in legislation, institutions and procedures. Of particular note are gaps in the legislative framework regarding: (1) the asset declaration system; (2) the dissemination of laws embodying values and standards for public sector integrity; (3) the lack of participation in the formulation of legislation; and (4) limited controls over the finances of political parties and associations. The existing rules and regulations are also not implemented systematically or in a transparent way.

[116] The revolution left a legal vacuum in which the post-revolutionary judiciary has yet to ensure its independence. The pre-revolutionary judiciary was seen as compromised and lacking independence from the executive branch. After the revolution, judges were dismissed and new once were nominated. This process has been criticized for not being transparent and for being driven by political motivations. In April 2013 the NCA approved a new law to establish an independent commission to oversee the judiciary.

A whole new approach to transparency, media and civil society will facilitate sustainability of reforms by facilitating citizen engagement. The post-revolutionary period has seen an unprecedented expansion of free expression. Under the new Freedom of Association Law passed in 2011, associations can now easily assemble and no longer need accreditation by the Ministry of the Interior. This has led to a mushrooming of new associations, from social movements and community organizations to unions and professional associations. From January 2011 to December 2012, 4,997 associations were created for a total of approximately 15,000 associations, around 3.5 percent of which focus on rights and civil engagement.

At present, the Tunisian media provides for a plurality of opinions. Under the new press law and the law on audiovisual communications enacted in 2011, publishing newspapers has become easier and direct state censorship has ended. In addition, the end of systematic filtering has now allowed the internet to become a major and effective communication and information tool. As a result, the use of the internet has expanded drastically, with a 33 percent increase in ".tn" websites only a few months following the revolution. Although civil society and journalists can now operate generally free from state intrusion, radical groups have limited their activities. Ensuring freedom of speech and of criticisms of the government without fear of retaliation is an important requisite for a functioning and sustainable democratic system.

Macro and Fiscal Sustainability

While Tunisia has remained vulnerable to shocks, lower growth and greater external unbalances threaten macroeconomic and fiscal sustainability. For the three years since the revolution, Tunisia has been running down its policy buffers. The macroeconomic space for expansionary policies has now vanished. While public and external debt remained at an acceptable level compared to international standards, they are expected to reach unsustainable level if reforms are not implemented.

Fiscal Sustainability

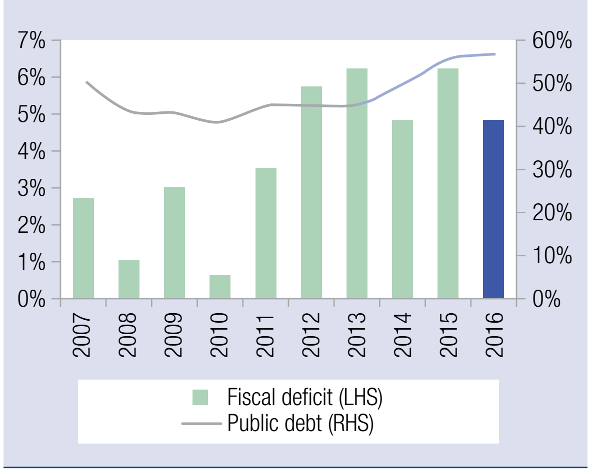
Expansionary fiscal policy since the revolution resulted in growing fiscal deficit and public debt. The fiscal deficit increased from one percent of GDP to 6.2 percent between 2010 and 2013 and the public debt from 40.7 percent of GDP to 44.8 percent during the same period. While this increase was an acceptable range, public debt is expected to reach 56 percent of GDP by 2017 before slowly declining over the medium term, according to the baseline scenario of the recent IMF's debt sustainability analysis. This baseline scenario assumes the fiscal consolidation and growth pick up in 2015, however if fiscal consolidation reforms are not implemented, it would result in growing public debt that could reach around 62 percent of GDP by 2019, while a permanent negative growth shock would increase public debt to about 67 percent of GDP by 2019.

In late 2013, the Tunisian National Constituent Assembly enacted a law on transitional justice that most notably called for the establishment of a truth council, the establishment of a damage and compensation scheme for dealing with reparation requests, and the establishment of new specialized courts. Based on the currently limited information available, implementing the new law and operationalizing the Ministry may prove to be problematic. For instance, there is a lack of clarity as to jurisdiction between the Ministry of Justice and Ministry of Transitional Justice. It is not clear how these issues will be resolved or if efforts are underway to address them. In addition, and because reparation currently appears to be at the forefront of transitional justice in Tunisia, financial implications on the government must be addressed and proper mechanisms must be in place before effective implementation becomes possible. Thus far, institutional reform, prosecution of abuses and prevention of future abuses have taken a back seat to reparation indicating a possible lack of focus and prioritization in terms of improvement of justice delivery and prevention of future crimes.

Public debt dynamics are vulnerable to a slower adjustment path, lower growth, and a marked depreciation of the exchange rates or a shock on contingent liabilities.

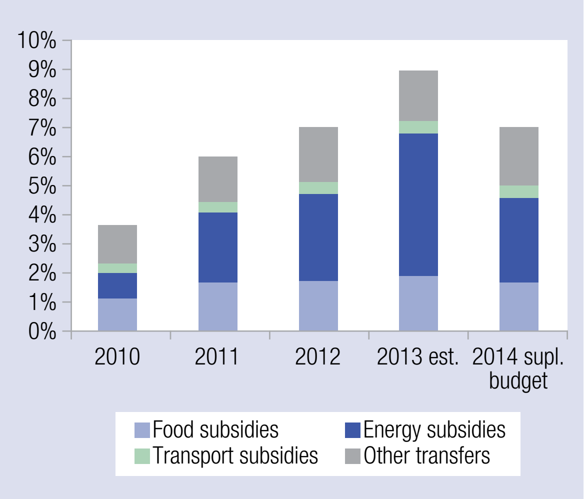
In addition, since the revolution, the budget has remained centered on the growing current spending rather than investment. Notably the wage bill and subsidies continued to increase until 2013, despite freezes on salaries and hiring of public servants and a gradual increase of subsidized fuel prices. In 2013, the wage bill accounted for 12.5 percent of GDP (against 10.6 percent in 2010), and subsidies and transfers represented 7.8 percent of GDP (against 3.6 percent in 2010). Only in 2014, was the expansionary policy put to a halt, leading the way to a medium-term fiscal consolidation, by slowing down the increase in current spending and progressively improving expenditure composition. In particular, spending on subsidies should decrease by 0.6 percent of GDP in 2014, thanks to the initial phase-out of energy subsidies. Measures have also been taken on the revenue side, including streamlining exemptions and widening the tax base. Assuming the intensification of fiscal consolidation over the medium term, the deficit is expected to gradually decline from 6.5 percent of GDP in 2014 to 3.2 percent in 2019. The fiscal consolidation will require continued action on wage bill discipline in the public sector, further phase-out of subsidies, SOE restructuring, and public sector pensions system. To mitigate the social costs of reforms, a better-targeted social safety net system and a new strategy for the financing of social security should be quickly put in place.

FIGURE 73: Fiscal Deficit and Public Debt, 2007–16 (in Percent of GDP, Deficit Excl. Grants)



Note: Data for 2016 are projections.

FIGURE 74: Subsidies by Type, 2010–14 (in Percent of GDP)



Macroeconomic Sustainability

Tunisia's external position has gradually eroded in the face of expansionary policies favoring domestic consumption, delays in structural reforms to support exports, political uncertainly, and exogenous factors. The trade balance deficit widened from 10.4 percent of GDP in 2010 to over 13 percent in 2014. Tourism receipts have been very volatile since the revolution, as the price competitiveness of Tunisian destinations has not offset concerns over the security situation until recently. Remittances have, on the other hand, quite steadily sustained the current account by about US$2.2 billion a year, but the overall imbalance has increased from 4.8 percent of GDP in 2010 to over eight percent by 2014. Foreign direct investment has been negatively impacted by political uncertainty and the delays in reforms. The Central Bank has used up significant reserves in 2011, with the latter dropping from about US$9.5 billion at the end of 2010 (or 4.4 months of GNFS

Box 15: Fiscal risks

Subsidies have become a growing fiscal burden. The Tunisian government controls one third of the CPI basket through subsidized and administered price. This limits the effectiveness of monetary policy, as it has no control over one third of the CPI basket. It also means that control of inflation is very costly to the state budget: while gradual subsidies reforms since the 1990s succeeded in reducing the subsidy spending to less than two percent of GDP until 2006, the trend was reversed due to the recent years' international oil and food price increases, and worsened by the social discontent that contributed to increase the food subsidies in the aftermath of the revolution. As a result, the subsidy spending reached 7.2 percent of the GDP in 2013, approximately 24 percent of total spending. Fuel subsidies reached two-third of total subsidies budget in 2013, against less than a third in 2009, equivalent to almost 90 percent of the combined expenditures for health and basic education. In order to contain the fiscal impact of the rising energy subsidies, the in 2012 government initiated a subsidies reform by gradually increasing fuel prices, by increasing electricity tariffs, and by eliminating energy subsidies to cement companies and electricity subsidies to energy companies.

Fiscal risks and contingent liabilities of SOEs are increasing. Budget expansion since 2011 has been driven by an increase in cross-subsidies and in the civil service wage bill. In addition, losses related to strikes in phosphate production and higher energy bills largely contributed to the worsening fiscal balance. In 2013, external debt from public enterprises guaranteed by the government represented 34 percent of the total external government debt (10 percent of GDP), from which the electricity company STEG accounted for 40 percent. Against this backdrop, the government is initiating a more transparent fiscal risk management system through improved monitoring of cross-subsidies, audits and consolidations of financial situations of the largest companies, and the governance framework of public enterprises.

The deficit of the public sector retirement and social security fund (CNRPS) has increased over the past few years. To ensure the payments of pensions, the government is expected to transfer around 0.3 percent of GDP to the CNRPS in 2014, of which 0.1 percent is a transfer to cover arrears from the transport public company. The deficit of CNRPS is expected to increase faster to reach 1.3 percent of GDP by 2020. The growing deficit reflects a fundamental misalignment between the contribution rate and benefits paid.

imports) to approximately US$7.3 billion toward the end of 2014 (or 3.1 months of GNFS imports), to support the currency first, before limiting interventions to manage an orderly depreciation. While the exchange rate depreciation should sustain exports and the decline in international energy prices provides temporary relief, external imbalances will remain a source of vulnerability over the medium-term that can only be addressed by reforms favoring an adequate supply side response when foreign markets recover, especially in Europe.

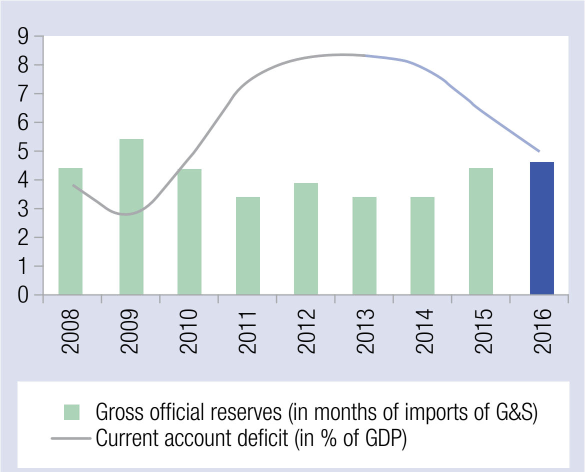
External debt has increased since the revolution, reflecting the fiscal expansion and the widening of the current account deficit. As for public debt, external debt had declined significantly in the 2000s to reach 48 percent of GDP in 2011, but the twin deficits led to its increase to 54 percent of GDP at end 2013. External debt is projected to increase to 62.6 percent of GDP in 2016 before slightly declining to around 61 percent by end-2019, according to the recent IMF's DSA baseline scenario. This scenario assumes a strong fiscal consolidation and cautious external borrowing policies. The interest rate and maturity profile of Tunisia's external debt make it relatively robust to shock, but are vulnerable to large exchange rate depreciation.

Environmental Sustainability

Sharing prosperity with future generations requires addressing the sustainability of Tunisia's development model. Tunisia's ecosystems support its economic development and provide income and jobs to most vulnerable population. For example, the coastal zone is home to over 65 percent of Tunisia's population and to its major industries; it also supports its tourism sector, which relies in its mass on mass beach activity, and which contributes seven percent of GDP (2008) and provides employment opportunities for 380,000 (10 percent of Tunisia's active population). Tunisia's water and soil ecosystems support its agricultural activity that contributes eight percent of GDP and employs 16 percent of the national workforce. Tunisia's development path is however depleting its natural resource stock. The adjusted net savings (ANS) measures the real difference between national income and consumption. It takes into consideration investment in human capital, depreciation of fixed capital, depletion of natural resources, and damage caused by pollution.

While Tunisia's ANS rose from 2.6 percent of GDP in 1980 to 19 percent in 1999, it steadily declined over the past decade to reach –3.2 percent by 2012 due to energy depletion, local pollution damage and mineral and forests depletion (WDI 2014).

FIGURE 75: Current Account Deficit and Gross Official Reserves



Note: Data for 2016 are projections.

Environmental degradation negatively impacts the Tunisian economy. The cost of environmental degradation in Tunisia was estimated at 522 million Tunisian dinars, or 2.1 percent of GDP for the reference year (see Figure 75) (World Bank 2004). The key factors behind this cost are related to (a) public health, in particular with respect to water-related diseases resulting from lack of sanitation in rural areas, respiratory diseases linked to air pollution, and inadequate waste disposal and treatment, and (b) productivity of natural resources, in particular the loss of agricultural productivity due to soil degradation and the impact on property of inadequate waste disposal and treatment.

Tunisia made considerable steps in its environmental and natural resources management; however, important challenges remain. Since the 1980's, Tunisia has put considerable effort toward ensuring environmental protection and management, and has made important achievements in environmental conservation, energy use efficiency, and managing its water resources as a key component in the country's economic and social policies, as well as building country capacity for environmental protection and management. However, important challenges remain: Tunisia's already scarce water resources are threatened by over-abstraction and pollution; challenges pertaining to hazardous waste (including healthcare waste and PCBs); and reconciling the ecosystem conservation with socio-economic development of the local communities. Climate change is expected to exacerbate the pressure on Tunisia's water and biodiversity resources.

Scarce water resources are impinging on agriculture's potential—a sector central to Tunisia's sustainable growth, and continued poverty reduction objectives. Currently, both high value production and water efficiency in agriculture lag behind compared to neighboring countries. Frequent extreme events (drought and floods) translate into large inter-annual crop fluctuations (especially for cereal). This penalizes both internal supply and Tunisian exports, which in turn affect macroeconomic outcomes and poverty, and lead to further exploitation of natural resources. For instance, farmers in the North-West are trapped in a vicious circle of low agricultural productivity and lack of income opportunities, which leads to overexploitation of natural resources and limits opportunities for improving living conditions. In some cases, poverty is directly caused by land degradation due to overexploitation. As such, agriculture efficiency and natural resource management need to be integrated into a sustained holistic public investment effort to foster production and farm revenues—as part of a broader strategy to promote the agricultural sector as a priority for jobs and ensuring food security. At the local level, economic incentives are needed to reverse the ever-higher costs of public investments in agriculture. Appropriate tariffs and subsidies would encourage famers to adopt water saving technologies and reduce losses, increasing yield per unit of land (although these may not resulting in water productivity), building on successful past efforts (a water saving strategy previously implemented resulted in increased awareness of the value of water to economic development), while pursuing well-tested integrated rural development approaches.

FIGURE 76: High Cost of Environmental Degradation

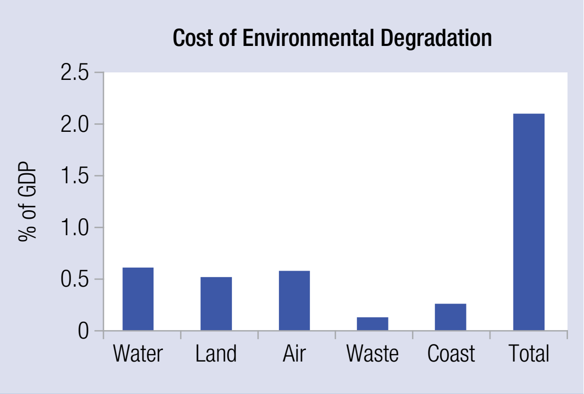
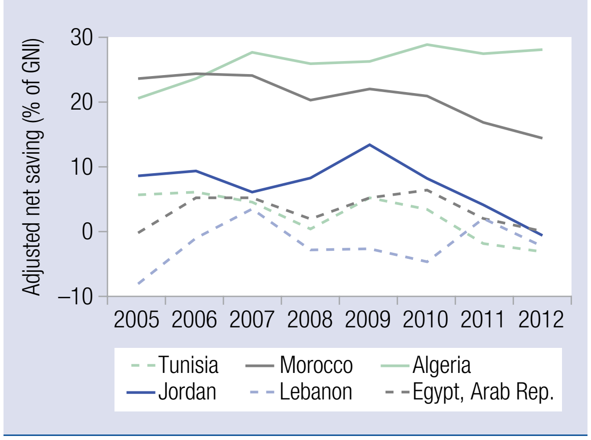


FIGURE 77: Tunisia is Depleting its Resources, De Facto "Dissaving"



The unsustainable use of natural capital reduces the flow of economic and social benefits such that it is more difficult to achieve sustainable development, poverty reduction, and other development goals. The linkages between these issues are stronger in Tunisia because an important proportion of the population is dependent on natural capital. It is therefore important to ensure an inclusive and participatory approach to: (i) consider natural resources as an integral part of a more comprehensive and sustainable socio-economic development paradigm, whereby these resources would be viewed as key support for improved livelihoods; (ii) consistently improve current practices characterized by slow, inefficient and top-down decision-making processes; and (iii) significantly reconcile broad environmental protection concerns and local socio-economic priorities, as well as optimally balance potential gains in natural capital and productivity including at household level (a matrix of opportunities for environmental sustainability is attached in Annex I.D). Furthermore, the approach should be put on strengthening and enhancing sustainable and low-carbon local development practices (by reducing greenhouse gas emissions), improving the capacities of natural ecosystems to sequestrate carbon, maintaining and improving the value of goods and services of natural ecosystems, and reducing the pressures facing these ecosystems.

Disaster Risk Management

Tunisia is vulnerable to floods, coastal erosion and marine submersions. Over the past 30 years the country experienced 2,495 disasters that caused 1,075 deaths, with assessed economic losses of US$1 billion. The disasters destroyed 20.000 houses and damaged another 24,728. While the country's location is beneficial for its ready access to commerce and culture in the Mediterranean coast, Tunis and all coastal towns also face increased vulnerabilities to floods and droughts and extreme weather events. Furthermore, given the rainfall decline, and the over-exploitation of its aquifers, the country's water resources are being depleted, and its aquifers are subject to saline intrusion. Given the effects of climate change and variability, sea level rise, and rapid urban population growth (expected to increase 33 percent by 2030), the exposure of Tunisia to natural adverse events will continue to rise. Lower storage capacity of dams due to erosion, degradation of pastoral ecosystems and soils (notably in the South), and pollution due to solid waste sub-optimal management, are likely to increase conflicts between sectors with economic effects on agriculture, tourism, urbanization, and infrastructure. The effects of climate change are particularly being felt in rural poor areas. Salinization affects

Box 16: The economic cost of disasters

The likely aggregate economic losses in Tunisia from all potential environmental risks has been estimated to amount to a net present value of $1.05 billion, or eight percent of the urban economy of the capital city. About 59 percent of the potential losses relate to submersion risks, with 26 percent reflecting seismic risks and 14 percent from storm surges. An estimated 25 percent of the potential losses by 2030 would be attributable to climate change, with most involving flooding. Floods, a recent and major problem for the city, would likely intensify, rising from a current high risk to a very high risk by 2030, despite the full implementation of the trunk drainage system upgrades under way, on account of the likely 25 percent increase in extreme precipitation events, which can generate flood levels of more than one meter in certain areas of the city. In terms of coastal erosion, the coastline of the Gulf of Tunis has been receding for half a century, despite offshore protections mitigating the trend. In some stretches of the coastline it can recede by as much as 10 meters a year. By 2030, 27 kilometers of the urbanized seafront would be considered at a high risk of erosion, up from 16 kilometers in 2010. Under the assumption of a global sea level rise of 20 centimeters by 2030, damage to sea barriers would appear likely, raising the risk of submersions for the city. By 2030, the study estimates that an expanded stretch of the urban seafront would be at a high risk of submersion

close to half of irrigated areas, high hydromorphy makes land unavailable for production, and increases loss of arable land and capital for vulnerable smallholders. The contribution of natural pasture and range in the feed calendar is decreasing dramatically because of droughts and over-grazing, forcing larger import of feedstuffs in order to cover animal requirements.

There have been limited efforts targeted to manage the risks of natural disasters. Past episodes of natural disasters haven't been followed by assessments and regulatory or operational improvements. No risk assessment has been performed to date, and early warning and communication systems are only partly operational. Cartographic information and geographical databases remain largely absent, along with texts covering specific risks. The National Office for Civil Protection leads various agencies in the prevention and management of disasters, but the structure of this arm of government has barely changed over the decades. Because of the potential damage from earthquakes, floods, sea surges, and tsunamis, it is necessary to install systems of monitoring and early warning, coupled with communications plans for alerting citizens and enterprises. Tunisia would also need monitoring systems to track the retreat of beaches and threats to its coastal barriers. Interconnectedness of hazards and vulnerabilities should be mapped for an effective Risk Reduction Master plan for the country.

Overall, the country would also benefit from a better legal framework for the management of coastal zones, risk awareness and financial risk protection measures. Infrastructure strengthening will be critical in certain areas. Sewerage and drainage structures in some of the cities will require upgrading, within an overarching master plan. The country may significantly benefit from a comprehensive and integrated resilience and risk management information system that incorporates all hazards and all sectors (water, energy, urban planning, infrastructure, governance and social, risk financing and insurance) and works as a digital communication platform to track all the resiliency initiatives, experts and activities, knowledge sharing, capacity building, community feedback and ownership enhancement activities. More specifically the capital city could adopt a holistic approach to increase its resilience to natural hazard by developing an urban resilience master plan that will help strengthen the technical understanding of multi-hazard risks and enhance the city's coping capacity to manage the adverse impacts of disasters. This could be done through the generation and utilization of hazard and vulnerability data, thus supporting the following outcomes: (i) the development of a local platform to support awareness and widespread understanding of the ways in which risks can be reduced; (ii) improvements in the preparedness and response capacity of the City; and (iii) identification of the City's priority development needs to catalyze investments to protect lives, livelihoods, and assets.

8 Criteria/Filters to Identify Reform Priorities

The SCD mandate is to identify the key constraints and reform priorities to progress toward the twin goals. For Tunisia, the diagnostic has been built around two pillars: (i) accelerate growth and private sector-led job creation to increase prosperity; and (ii) improve equality of opportunity for shared prosperity and support those who might be left behind. The objective of this part of the diagnostic is to prioritize from among the many identified constraints and opportunities to focus on those interventions that can be expected to have the broadest impact in accelerating Tunisia's progress toward inclusive and sustainable economic growth. Each constraint has been assessed against its impact on progress toward the twin goals and, specifically for Tunisia, toward the two main pillars identified in the conceptual framework. The areas of opportunity have also been assessed against a number of criteria which include:

- **Preconditions:** Foundational constraints that are prerequisite for resuming growth and improving welfare (notably political and economic stability but also key elements of governance).
- **Maximizing impact on the twin goals:** Potential impact on sustainable poverty reduction and improvement in the welfare of the bottom 40 percent. However, particular attention will be given to the multiple dimensions of shared prosperity, in particular channels of inclusive growth, with a greater role for labor market and employment (and less reliance on universal social assistance and subsidies) and equal opportunities.
- **Complementarities:** Degree to which programs/policies could have positive impacts in other domains that are key to address constraints to growth, inclusion and sustainability (for example energy subsidy reform).
- **Time horizon of impacts:** This criterion would assess the time frame of impacts and weigh quick wins against longer-term impacts. It also supports the process of carefully sequencing reforms.
- **Evidence-based:** This would ensure that there is a clear evidence-base guiding the proposed policies/programs (robust evidence carries greater weight).
- **Citizen participation:** This filter uses the degree to which citizen involvement in the form of increased information, authority, or participation is going to impact the pace and modality of progress toward the twin goals. It also informs the extent to which actions support the building of ownership not just on the "what" but also on the "how" of the reform agenda.
- **Political feasibility:** This would assess the country's political economy, and the governance and institutional issues that would impact the ability to address the constraint. While this criterion is not expected to affect the ranking of the constraints (as the SCD should highlight the biggest priorities, irrespective of political feasibility), but would inform the process of mapping actions into a CPF.

Box 17: Consultations

The SCD was informed by consultations with key stakeholders in Tunisia with separate sessions that were conducted with the government, private sector, and a group of academics, think tanks, and civil society. The main purpose of the external consultations was to seek their insights and inputs into the diagnostics and assess the way they portray the emerging reform priorities for broader improvements in growth and progress toward inclusion. From the discussions held it appeared that most of the messages emerging from the diagnostic are aligned with the assessment and perceptions of both government and civil society. There is also a strong alignment on the most binding constraints as identified in the SCD (a constraining business environment and investment climate; heavy state involvement and lack of transparency and accountability in service delivery to firms and citizens; low quality of education and skills mismatch combined with a dysfunctional labor market). However, there was some degree of freedom in terms of sequencing of the reforms and implementation. The discussions highlighted the importance of tackling the economic reforms (simplify the tax regime; expedite procedure for public investment; encourage private investment and job creation through reforms of the business environment) while paying attention to a renewed social contract, which will empower citizen by informing them (through data and information awareness campaigns) and strengthen the implementation of the legal arsenal to fight corruption and end impunity. New challenges were identified in the declining public support for democracy since 2011, the difficult fiscal situation with a constant increase in the weight of public salaries, subsidies, and debt servicing on the budget and some of the consequences of the Libyan crisis (migration, remittances, and security issues).

- **Sustainability: This filter would assess the present of any** serious constraint on sustainability that could compromise the achievement of the goals and that would need to be addressed to ensure effective reforms. In this sense, it represents a medium-term perspective of the feasibility pre-conditions, and it takes into account political and social stability, the adequacy of the macro and fiscal framework and environmental sustainability.

The ultimate objective of the SCD's prioritization of constraints is to assist in the identification of reforms to support growth and shared prosperity efforts by the Government (and donors), and to inform the World Bank Group's Country Partnership Framework (CPF). The CPF will be defined and agreed upon with the Government of Tunisia and will outline the World Bank Group's work in Tunisia over the next four to five year period. As the SCD is a public document, it is also intended to be a resource for the general public. The role played by sectoral (GPs) and country experts has been essential in rating the constraints according to the criteria highlighted above and selecting the priorities. As the prioritization exercise requires substantial judgment it was also important to ensure that the process was carried out in an open and participative manner. A first brainstorming meeting was held after the review meeting for the Concept Note of the SCD with the relevant World Bank Group team (Tunisia team and GPs experts) to collect suggestions on the identification of reform priorities. Discussions were also held with relevant stakeholders in Tunisia in January 2015 on the concept note of the report (Box 17). The SCD team also engaged with the wider country team during a CPF workshop held in Tunis in January 2015 where the preliminary results of the analytical work and diagnostic were presented and the enlarged team engaged in discussions and working sessions on the selection criteria to identify priorities and areas of engagement for the country to accelerate growth, boost shared prosperity and promote inclusion.

Rating of the criteria and the ranking exercise. The multidisciplinary SCD team consisted of experts across 14 Global Practices and Cross-Cutting Solution Areas from the World Bank, IFC, and MIGA. The team contributed analyses based on existing literature and produced, in some cases, new analyses to identify constraints to inclusive growth. These constraints have then been ranked on the basis of the analytical assessment and country-specific context and according to their impact on: (i) growth, (ii) private sector-led job creation, and (iii) shared prosperity, poverty, and inclusion. The diagnostic identified "overarching" constraints, considered as a prerequisite for any type of reform and their sustainability, and "specific" constraints, which present specific bottlenecks that appear to prevent further growth and to constrain its inclusiveness. The results of the ranking of the constraints by areas are reported in Table 4 below. The definition of the constraints is reported in Annex I Table A.

TABLE 4: Ranking of Constraints by Groups

Overarching constraints – ranking by groups			
	To Growth	**To Private sector job creation**	**To Poverty/Shared prosperity and Inclusion**
1	Macro imbalances	Social exclusion/regional disparities	Social exclusion/regional disparities
2	Social exclusion/regional disparities	Governance	Governance
3	Governance	Macro imbalances	Macro imbalances
Specific constraints (Areas of Focus) – ranking by groups			
	To Growth	**To Private sector job creation**	**To Poverty/Shared prosperity and Inclusion**
1	Business Climate	Business Climate	Human Capital
2	Financial sector	Financial sector	Social Protection
3	Governance-specific constraints*	Labor Market	Labor Market
4	Connectivity and infrastructure-related services	Human Capital	Governance-specific constraints*
5	Human Capital	Governance-specific constraints*	Connectivity and infrastructure-related services
6	Environment, natural resources, and disaster risk management	Social Protection	Business Climate
7	Labor Market	Environment, natural resources, and disaster risk management	Financial sector
8	Social Protection	Connectivity and infrastructure-related services	Environment, natural resources, and disaster risk management

*These constraints refer in particular to the weak management of SOEs and autonomous government agencies affecting the delivery of services in specific sectors

Strong complementarities (as well as trade-offs) exist between different areas of analysis, leading to a different ranking of some of the identified constraints vis-à-vis different objectives (i.e.; growth or social inclusion). The different ranking of each group of constraints (and within each group, of the individual constraints) vis-à-vis the three selected objectives/pillars comes from the assessment of different impact on each pillar of removing selected constraints. For instance, the presence of macro imbalances is perceived as a major constraint to growth—as an overall constraint—but it has not been considered the most binding constraint when it comes to inclusion or private sector job creation (which might seem initially quite counterintuitive. See Table 4). Table B in Annex I presents the ranking of the overarching constraints within each group. That table shows the different "nature" of each constraint, or rather the channels through which they might operate. For instance, even though macroeconomic imbalances are not perceived as the most binding constraint for private sector job creation, although they remain an overarching constraint, the composition of public spending, for instance, and its inefficiency, is seen as the most pressing issue to address to support the private sector (for instance through investment in key infrastructure and rebalancing expenditure toward investment rather than consumption). While all these constraints are considered relevant for progress in the reforms (and their sustainability) the internal ranking might give us a sense of where reforms might be more pressing.

Results of Prioritization

Overarching Constraints

Limited mechanisms for voice and accountability and to address elite capture

Limited mechanisms for voice and accountabilty and the quality of governance and state institutions emerged as overarching constraints to shared prosperity and inclusion. The lack of a functioning

institutional setting to control for corruption/elite capture is the most important governance factor constraining growth and job creation. Recent analysis[117] highlights the importance of "institutions" (measured, as a proxy, by size of government, rule of law and regulations among others) in determining growth patterns in middle income countries (and to avoid the so-called "middle income trap" where countries remain "trapped" in the income ladder and are unable to reach high income levels). The macro dimesion of governance, together with the "social capital" of a nation, including well established institutions which allow citizens participation and ensure protection of their rights, has been recognized more and more as an important factor for a country's economic progress.[118] In Tunisia, governance is also one of the foundations of a renewed "social pact," which is a start to rebuilding the broken trust between state and citizens. At this point in time, it is difficult to assess implementation of most governance reforms that have been anchored in the new legislation. For instance, conflict of interest and financial disclosure frameworks covering public officials, important tools in addressing elite capture, remain weak. Implementation of reforms, including increased governance in sectors, is highly dependent on the capacity of civil servants and public institutions, which, while increasing, will require time and resources for considerable improvements.

Emerging macro vulnerabilities

The macroeconomic and fiscal environment exhibits large vulnerabilities which, if not addressed, will prevent progress toward a more inclusive and sustained growth. A sound macro and fiscal framework (albeit with the structural weaknesses described above as part of the growth diagnostic) have contributed to the remarkable achievements in the past in terms of poverty reduction and human development progress. The recent and emerging macro imbalances threaten some of these achievements (above all in terms of poverty reduction) and might even reverse some of the established gains. Deeper medium-term structural reforms are essential for improving Tunisia macroeconomic and fiscal prospects, and for the country's ability to reduce poverty and boost shared prosperity. Fiscal consolidation should be based on increasing low tax revenues and reducing high spending, particularly on fuel subsidies, where the GOT has taken encouraging steps. On the spending side, the wage bill drift needs to be reversed or at least contained through strict controls on new hiring, freezing of high salaries, and strategic staff reduction. More importantly, any effort on the macro-fiscal consolidation side will need to be coupled with the deep structural reforms necessary to kickstart the structural transformation of the economy, and to address the most binding constraints to growth.

Increased social inclusion and equal opportunities are paramount to social stability and economic participation

The diagnostic highlighted how growth alone will not be sufficient by itself to ensure that the generated prosperity is shared across all segments of the population. To break with the development model of

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[117] IMF "growth slowdowns and the middle income trap." The "middle-income trap" is the phenomenon of hitherto rapidly growing economies stagnating at middle-income levels and failing to graduate into the ranks of high-income countries. In this study the middle-income trap is examined as a special case of growth slowdowns, which are identified as large sudden and sustained deviations from the growth path predicted by a basic conditional convergence framework. The authors looked into the role of institutions, demography, infrastructure, the macroeconomic environment, output structure, and trade structure.

[118] The development of an institutional and legal framework to enable citizens' rights and their engagement in the society (what we have defined here as "social" capital) implies tackling the legal gaps and the institutional weaknesses also at micro level, addressing failures, such as the lack of a functioning system to address cases of corruption, leading to the potential perpetration of abuses of the past.

the past it will be crucial to ensure equal opportunities to all and that the rights and freedom of minorities are safeguarded. These are defined not only as equal access to services but also as putting in place the condition for currently excluded groups of the population to actively engage in social, political, and economic life. This means, first and foremost, to ensure that regional disparities are addressed. It also means to tackle longstanding structural obstacles that prevent youth and women in Tunisia from gaining access to productive and rewarding jobs. Failure to recognize this risks the undermining of political support for a stable, fairer, and democratic society.

Specific Constraints/Areas of Focus

Complementarities, linkages, and tradeoffs exist between all the areas identified in the diagnostic as constraints. These links can't be ignored and call for a more holistic view of Tunisian development than a simple ranking exercise can present. Within each group/area there are specific topics that could act as potential game changers even if they are located in an area that has not been ranked as the highest priority of intervention. The aim of this diagnostic is to present them in a way that would help prioritizing areas of focus but without losing contact with the country's own development priorities. For Tunisia, specifically, the need to "switch gears" in the design of economic policies emerges from each individual constraint, requiring embedding within each specific policy the "soft" side of agency and participation, which is what determines not only economic progress but also social advances. This is the lens through which the areas of focus (and later on the mirrored opportunities) are presented below. A more detailed description of the channels through which these constraints impact growth, private sector development and job creation, and shared prosperity and inclusion is presented in Annex I. A.

An unleveled playing field as one of the biggest constraints to inclusive growth

Tunisia's business environment, its weak market contestability, and the absence of a regulatory environment conducive to private investment are among the top constraints to growth and private sector development in Tunisia. The private sector has been unable to reach its full potential due to the distortions in the regulatory framework that provided privileged access to politically connected firms. The weak business climate continues today to limit new firms entry, along with the competitiveness and efficiencies of existing firms, thereby directly affecting job generation and thus growth. Regulatory capture, stemming from authorization requirements, investment restrictions or fiscal advantages allowed firms owned by Ben Ali's clan to record spectacularly higher levels of output, profits and growth than their competitors. Steps have been taken to address elite capture and other forms of corruption, but progress remains limited and legislative gaps remain. The heavy cost of bureaucracy continues to represent a burden especially for the small entrepreneurs that do not have the means to outsource the handling of administrative requirements; this burden induces small companies to remain informal.

Government regulations and actions in Tunisia continue to be distortive of market development and generate unintended barriers to competition. Sectors in which investment faces restrictions account for over 50 percent of the Tunisian economy, whether through the Investment Incentives Code, the Competition Law, or specific sectoral legislation. Many of these sectors at present remain de facto closed to competition. In addition, there are legal constraints to the sale of the stakes held by the government in publicly controlled firms in some of these sectors. Firms in these sectors de facto benefit from rents that arise because they face limited competition. These firms remain profitable largely thanks to the protection they enjoy in the domestic market—at the expense of the consumers who are forced to buy more expensive and lower quality goods produced by the uncompetitive onshore firms—further reducing investment and productivity. The Competition Law does not in fact support competition and the weak governance of SOEs further undermines the operations of markets.

An undiversified and non-inclusive financial sector prevents efficient allocation of resources

Growth is also inhibited by the lack of an inclusive, stable and diversified financial sector capable of efficiently mobilizing and allocating resources toward the most productive sectors. Weak corporate governance of SOBs and the low level of competition in the banking sector are seen as the third most important constraint in the ranking of factors hindering growth. The financial sector in Tunisia is small and dominated by banks. Limited competition, deficient regulation, low credit intermediation, and widespread governance issues characterize the banking sector. With regards to financial inclusion, a 2014 World Bank study found that nearly 45 percent of Tunisian adults do no use formal financial services (including credit), and that the unmet demand for financial services is estimated to be 2.5 to 3.5 million individuals and 245,000 to 425,000 enterprises. Inadequate bankruptcy procedures allow the survival of inefficient firms and prevent the rechanneling of resources toward more productive uses. The absence of long term refinancing resources for banks mainly through capital markets limits long term domestic lending, and impacts credit affordability. The insurance sector remains nascent and has not been able to respond fully to private sector insurance needs for production and investment purposes.

Low "connectivity" exacerbates inequalities and hinders Tunisia's productivity potential

The "second tier" of constraints to growth, according to the ranking exercise conducted for this diagnostic, includes the lack of connectivity linked to infrastructure deficiencies, which significantly hamper growth and jobs creation in the private sectors. The diagnostic presented several specific examples (from logistics to water or electricity) of how infrastructure-related service deficiencies affect private sector's competitiveness. The heavy involvement of the State in the form of SOEs—with opaque rules for governance and accountability—has prevented infrastructure-related services from operating efficiently and fairly. For instance, while Tunisia is been perceived as an example of good practices in logistics in the MENA region, logistics costs related to infrastructure-related services (such as transit costs for containers or shipping costs) severely hinder trade and competitiveness. Growth in lagging regions has been hindered also by the weak quality of infrastructure, resulting from spatially biased public investment that does not support private sector investment and increases transportation costs of goods to ports/markets. Conversely, private sector participation in road rehabilitation and modernization could help the Tunisian economy to enhance its production potential, hence benefitting growth in all regions, but a functioning framework for PPP is still missing. Finally, the telecommunications infrastructure, broadband, and internet services (as one of the most effective backbone services) appear to be, among all sectors, the area with the highest potential for job creation and growth (and ultimately the development of human capital), thanks to competitiveness enhancing features and complementarities with other dimensions of growth, specifically as an enabler of democracy and social transformation. However, the low levels of competition until recently in the telecommunications sector has resulted in higher costs to consumers, including firms, and hindered Tunisia's potential to compete in international markets and to fully use Information and Communication Technologies (ICT) as a key accelerator of social and economic development.

Unequal opportunities and the lack of productive employment as the most binding constraints to shared prosperity

Inclusion and shared prosperity are prevented by the underutilization of Tunisia's human capital and by unequal opportunities. Stark inequality in the access to and quality of education is a challenge to human capital accumulation for a large share of the population. Education is key to the accumulation of human capital, which is critical to obtaining high quality jobs, economic growth, and shared prosperity. While Tunisia exhibits relatively strong average human capital particularly in education, the poor quality of education generates large inequalities of opportunity among citizens depending on the wealth and income status of their parents. This, in turn, widens inequality in the country, both spatially and over time. Equally important for shared prosperity is removing obstacles to equal access to basic services, which currently differs among population groups and regions or areas of residence. Access to (and quality of) water has been identified, for instance, as a relevant constraint to poverty reduction and to increased shared prosperity.

Labor market rules and institutions, and a fragmented social protection and labor system, are crucial impediments to the achievement of a more shared prosperity. The diagnostic highlighted the lack of any significant role for employment in the past decade in reducing poverty or boosting shared prosperity. Several supply and demand factors contribute to this outcome, including insufficient job creation from the private sector, misalignment of skills, and unequal opportunities that translate in differentiated human capital endowments. The incentives inherent within social security, social assistance and labor regulations hamper job insertion and increase the cost of labor, resulting in inequitable employment outcomes. The current system fails to protect all workers while at the same time hindering job creation for the private sector by increasing costs for labor and reducing flexibility required to be competitive and adjust to the changing global market.

9 Key Opportunities to Accelerate Growth and Boost Shared Prosperity

Opportunities for reforms largely mirror the areas identified as the most relevant constraints to growth, private sector-led job creation and inclusion/shared prosperity. They are based on Tunisia's potential and strengths, which could be unleashed by such reforms. The SCD identified two key drivers of change where it is advisable to take sustained initiatives. These are: (i) promote private sector-driven job creation; (ii) improve equality of opportunities and increase resilience. Within these areas, further efforts have been made to identify some specific actions that could point toward the right direction in the short/medium term but with a view to the long term development goals of the country. Their feasibility of implementation as well as the conditions in place for the sustainability of reforms are taken into account, together with the results of the technical analysis, in the identification and selection of areas where opportunities for advances toward the goals are most compelling. The team also worked on identifying the magnitude of impact of the selected areas/ opportunities and the time horizon (short-, medium-, or long-term) within which each it is expected to see the effect of potential actions/policies adopted to address bottlenecks. All these features together make these areas of opportunities as a (non-exhaustive) platform for reforms that could help guide the future development policies of the country. A detailed presentation of actions/reforms with potential highest impact is presented in Annex I.C. The subsequent sections present the main areas where the SCD sees Tunisia's strengths and where ongoing reforms or dialogue on reforms would sustain progress toward more inclusive growth and a new development model.

Restoring Sound Debt Sustainability and Maintaining Macro and Financial Stability is a Prerequisite for Any Type of Reform

Restoring debt sustainability and assuring macroeconomic and financial stability is central to protecting the income and wellbeing of the less well-off and creating the basic conditions for private investment, growth, and shared prosperity. As mentioned earlier in the diagnostic, emerging macroeconomic imbalances are threatening the space for expansionary policies aimed to support growth. Addressing fiscal risks and ensuring fiscal space for growth enhancing investments are therefore first order policies.[119] Among the critical (though not exhaustive) policy actions needed to restore debt sustainability and assure macro and financial sector stability are reducing fiscal support to public enterprises, reinforcing governance and the

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[119] In June 2013, Tunisia joined a 24-month Stand-By Arrangement program by IMF in an amount equivalent to $1.75 billion. The focus of the program is to contribute to short-term macroeconomic stabilization and lay foundations for higher and more inclusive growth, including by moving forcefully on banking reforms.

oversight and bank resolution framework, reducing public sector wage bills and pension costs, and better managing the public finances, including rebalancing the composition of expenditures toward productive and growth-enhancing investment and away from heavy reliance on consumption subsidies.[120]

Steps have been taken to initiate fiscal consolidation and the recent governments have demonstrated commitment to structural reforms to halt the rise in public debt. The first actions in the reform of the fuel subsidies system have been taken[121] and the adoption of restructuring plans for the major public banks are encouraging steps in the right direction. Initiatives have been taken also to improve budget composition by increasing capital spending—particularly in poorer regions—in line with absorption capacity. These reforms need to be coupled with increased efficiency in the use of resources, and the rebuilding of fiscal buffers. Efforts are also undergoing to improve the revenue side, and in the near future progress on a comprehensive tax reform strategy (following a recent National Tax Consultation and the adoption of the new tax code) is envisaged for a more transparent, efficient, and equitable system. Finally, the contingent favorable shock on the oil price could facilitate progress in some of these actions as potential net gains materialize from the price differential with the benchmark originally assumed as part of the Budget Law.

Strengthen the Link between Growth, Welfare, and Citizens Participation

The main challenge for Tunisia today is to identify channels to strengthen the link between growth, welfare and citizens participation/agency. **Having a political space conducive to address this issue is also its greatest opportunity.** Tunisia, as most middle-income countries, has made considerable strides in terms of meeting the basic needs of the population (as shown in the improvement of human development indicators). However, as shown also in recent analysis, to progress further middle income countries need to strengthen the link between growth and social progress. Although growth would not necessarily determine further social progress, advances in terms of citizens' participation and agency, and improved governance in the economy and in the society at large would unleash the potential for higher growth thanks to a more dynamic private sector and enhanced human and social capital. For countries like Tunisia, this would require putting policies in place to ensure that opportunities are equitable and institutions capable of implementing and safeguarding rights.

Reforms to address governance gaps, particularly in relation to enhancing civil and political rights have been initiated and represent a crucial step toward a more just, open, and inclusive society. Since the 2011 Revolution, Tunisia has passed new elections regulations, allowing for greater public engagement in the election process and enhancing accountability of elected officials. The successful completion of the election cycle by the end 2014 are the testimony that the building blocks of a democratic system are fully in place and represent a structural break with the past. Citizen engagement has been enhanced by government decisions allowing citizen participation in the public service assessment process, delivery of public services and legislative drafting, and a public consultation website was created to promote participation in policy making. The newly adopted constitution enhances the right to access to information together with a number of civil rights including: academic

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[120] The implementation of a tight monetary policy and a more flexible exchange rate policy are also essential to reducing external vulnerabilities, improving Tunisia's price competitiveness, and rebuilding foreign exchange buffers

[121] For example, all energy subsidies to the cement sector have been eliminated since 2013. Recent increases in electricity and fuel prices, and the introduction of a reduced electricity tariff for households consuming less than 100 kWh, are also steps in the right direction. Public spending savings from these measures are estimated at 0.2 percent of GDP. Eliminating energy subsidies for the other energy-intensive industries and increasing electricity and fuel prices for industrial users will result in an additional reduction in public spending of 0.5 percent of GDP in 2015.

Special Focus: Women's economic empowerment is paramount to achieve an open and inclusive society and to accelerate growth.

Tunisia is at the forefront of gender equality in the MENA region. Recognized as a principle, in its Code of Personal status, in relation to socio-economic, cultural, and political rights since 1956, gender equality is enshrined in the new 2014 Constitution, with its Article 21 proclaiming full equality of female and male citizens. As a result, Tunisia has the highest representation of women in the legislature in the MENA region, which is also comparable to OECD average. Women represent an extremely valuable asset while at the same time remaining an untapped pool of resources; willing to work but unable to find suitable jobs. Finding a way to break the barriers to their active participation in the economy will therefore free the country's potential to accelerate growth and move up the income ladder. Active economic participation in turn also contributes to expand women's agency and choice, increasing their voice and ability to influence society and challenge established norms that limit women's rights and hinder economic and social development.

freedom; rights to peaceful assembly and demonstration; freedom to establish political parties, unions and associations; the right of workers to strike; and freedoms of expression, opinion, thought, and publication. The extent to which citizens can adequately exercise these rights will impact social and political exclusion. At the same time, the recently established (and still to be strengthened) framework to address elite capture and other forms of corruptions will impact the way citizens will actively engage in the economic development of the country.

Sustain Reforms of the Business Environment to Prevent Elite Capture in the Future

Reforms of the business environment have great potential for growth, private sector job creation, and ultimately inclusion. Removing the barriers to entry and competition would substantially improve the performance of the Tunisian economy and boost the ability of the most productive firms to grow and create good quality jobs. This is the time where the socio-political space for this type of reform is open and therefore the opportunity to advance is the greatest. The removal of barriers to market competition should start with backbone services sectors—the most shielded from competition in the past—and sectors with high potential for jobs creation, notably commerce and telecommunications in order to open up investment in these sectors. The gains from higher competition in Tunisia would be considerable and result in faster jobs creation. There is ample empirical evidence internationally on the substantial benefits of allowing greater competition. The empirical analysis presented in the 2014 Tunisia DPR found that a five-percentage-point decrease in firms' profit margins (driven by greater competition) would translate into additional GDP growth of around 4.5 percent per year and approximately 50,000 new jobs per year. Since the 2011 revolution, important measures have already been taken to enhance competition and promote a level playing field. A draft competition law, for instance, that reinforces the role and independence of the Competition Council is under consideration and is expected to be adopted in 2015. The Council can play a key role in stimulating competitive forces to the benefit of consumers, including lifting barriers that may be preventing retail and wholesale prices from falling toward their competitive levels. Enhancing the independence of the authority would constitute a valuable step toward ensuring it can fulfill this role.

An open and engaged public-private dialogue should accompany deeper regulatory reforms. Many of the regulations and practices that create market power rents however, still exist and many companies continue to benefit from them. A drastic simplification of the pool of regulations hindering private sector activity with a view to reducing the room for discretion in their implementation is critical for a private sector-driven growth and ultimately inclusion. Moving forward, it will be crucial to build on a strong public-private sector dialogue on regulatory reform and develop tools to ensure that existing and new regulations are fit for purpose and serve the public and private interests. Detailed areas of opportunities where reforms are already ongoing or where conditions might be in place for their implementation are provided in Annex I.C.

Develop a National Financial Sector Strategy to Increase Economic Opportunities

Improving access to financial services for both households and firms is critical to catalyzing private sector development, improving access to essential services, and increasing economic opportunities for the most vulnerable.[122] Strengthening access to credit to firms, particularly those with no credit history and limited collateral (mostly MSMEs and startups), and developing alternative sources of financing will enable resources to be channeled to the most productive projects and allow companies to expand and invest productively.[123] Some programs to improve access to finance for high value added exports have been already implemented, with support of the WBG.[124] There is indeed space for additional support and instruments to be tested with a sector-specific focus and with a more inclusive lens (for instance, focusing on addressing regional disparities in access to finance). To improve the efficiency of the banking system and competition within the sector, the most compelling reforms should focus on the restructuring state owned banks (SOBs), strictly enforcing bank regulations, and revising procedures to deal with banks in financial difficulty. At the household level, increasing financial inclusion (access to and usage of formal financial services: accounts, consumer and housing finance, insurance) is critical to support access to basic services (housing, education etc.), spur income generation and employment as well as help manage economic shocks. Financial inclusion is also positively correlated with financial stability and greater efficiency of financial intermediation, both important prerequisites for job creation and private sector development. Further reform and expansion of the microfinance sector should be pursued together with the development of innovative financial instruments and approaches to cater to the needs for non-salaried and low-income households. The development of a national financial sector strategy, championed by the Central Bank and/or Ministry of Finance, represents a clear opportunity to agree on a road map of actions to achieve both sector development and stability objectives.

Identify and Invest in Sectors Where Tunisia Holds a Strategic Advantage

A new, modern type of sector-focused strategic development policy[125] **coupled with reforms to incentivize formal employment would support the structural transformation of the economy and advance progress toward a more inclusive growth.** The government can play an active role in accompanying the development of high potential sectors through horizontal measures and addressing coordination failures. Policies to improve the overall business environment could be complemented with targeted interventions aiming to create jobs in specific sector and regions. Indeed, as discussed above, higher investments alone do not necessarily guarantee that the economy will create the jobs needed to improve the opportunities and standards of living of all Tunisians. It is important, therefore, that the government, in close consultation with social partners, also identifies sectoral policies for employment creation. This implies mapping key sub-sectors and value chains within the economy to understand the potential for job creation and the types of bottlenecks and regulatory failures that would need to be removed to achieve it. This mapping would provide information about the

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[122] More details on reform areas in Annex I Table C2.

[123] Better performance in the banking sector could increase the level of credit to the private sector by at least 10 percent of GDP, which could generate in excess of US$10 billion in additional investments to be injected in the economy over the next 10 years, corresponding roughly to an additional 38,000 additional jobs per year (Tunisia 2014 DPR).

[124] These include the third export development project and the MSME facility.

[125] Industrial policies pursued will have to change their nature that has so far not targeted market failure and have favored firms, rather than sectors.

types and level of investments that are necessary, the quantity of jobs that can be created, their composition in terms of skills, and their regional distribution. Annex V presents the results of an ongoing sector diagnostic work and business opportunities for some key sectors as identified by IFC strategy.

These policies will also need to be accompanied by reforms to consolidate social insurance regimes and align labor regulations to incentivize formal employment and better protect living standards. In terms of social insurance, greater harmonization among private and public sector regimes, improving portability and aligning financing with benefits more explicitly will help to improve incentives for job creation, sustainability and coverage. In terms of labor regulations, curbing the growth of labor costs[126] while improving income protection and services to workers would go hand in hand with social insurance reforms. Employment protection legislation plays a critical role in shielding workers from the negative consequences of arbitrary actions by employers, thereby facilitating industrial stability, the build-up of firm-specific human capital, and innovation. When employment protection and contracting is too rigid, however, firms' ability to respond quickly to changes in technology or market demand in terms of hiring or retraining is hampered. Moving forward, it is important to accompany the targeted investment policies with the flexibility of employment policies, as well as better-targeted ALMPs, that are crucial for efficient job reallocation, greater job creation and economic growth. Strengthening inclusive social dialogue will help support the development of an integrated social protection and labor system needed to achieve the right balance between flexibility and security.[127]

Build on the Policy Dialogue on Important Reforms to Improve Equity and Efficiency of Social Assistance Programs and Strengthen Resilience

Greater targeting of universal price subsidies and social safety nets will improve equity and fiscal space needed to jump-start graduation programs to productive livelihoods. Strengthening Tunisia's social safety net system is a necessary complement to pro-growth reforms in order to effectively protect the poor and vulnerable from unforeseen shocks, maintaining purchasing power and living standards. The current excessive outlay on untargeted subsidies fails to reach the poorest and paradoxically largely benefits the better off, thus exacerbating inequality. Existing cash transfer and health cards programs, which benefit the some of the poor, can be better targeted by further developing the recently conceived unique identification system for all social protection and labor programs and introducing exit strategies to ensure equitable access and transition to work for the able-bodied. Combined with the fiscal deficits facing the social security system (pensions and health insurance), inadequate coverage and sustainability of social protection programs highlight the need for comprehensive reform beginning in the near term. The new "Social Contract" signed between the government and social partners in 2013 shows the commitment of the government to developing the policy dialogue on important reforms such as labor regulations, social security reform, subsidy reform, social assistance reform, reform of employment programs, and investment policies targeting lagging regions. Further steps in this direction[128] are needed, and are likely to have a significant impact on growth and inclusion.

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[126] Reducing the tax-wedge, rationalizing redistributive arrangements, reforming dismissal procedures, and reducing discretion in the setting of the minimum wage.

[127] See Annex I table C3.

[128] As already demonstrated by the progress on the social protection reforms with the development of a unified social registry and a unique identification system with a link to the national identification card.

Decentralization as a Gateway to Increase and Equalize Opportunities

Inclusive growth can be promoted by policies aimed at addressing spatial inequalities in access to and quality of basic services, access to good infrastructure, and more generally targeting institutional failures that generate unequal "opportunities." We argue in this diagnostic that equal opportunities are a crucial part of the "shared prosperity" goal**.** Increasing parity of access to quality basic services (notably water, health, and education services) in lagging areas will improve people's employment opportunities, their quality of life, and ultimately contribute to long-term economic growth. Improving the governance, institutional and regulatory framework to allow both more accountable and efficient services would incentivize investment and allow more viable service provision, hence reducing enduring inequality in access and quality across regions.[129]

The government commitment to decentralization could improve provision of services at the local level. The new Constitution includes clear commitments to decentralization, local governance, and empowered local entities. The provisions of the new Constitution create the framework for fully devolved and empowered local governments with autonomy for executing their mandates of providing local services according to transparent principles of participation by, and accountability to, their electorate.[130] The expansion of formal authority of local governments requires reform of the intergovernmental fiscal transfer system and measures to increase the capabilities of local governments including through measurement and public dissemination of local government performance. Over time, these measures are designed to lead to better provision of services and infrastructure and improved governance in part through greater accountability of local governments to their electorate and to the central government.

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[129] See Annex I Table C4

[130] To this end, the Constitution lays down the mandate for local governments to achieve the following: (i) financial and administrative autonomy; (ii) participatory local democracy and open election of municipal representatives; (iii) formal assignment of functions according to principles of subsidiarity; (iv) own source revenues and transparent, objective, and predictable systems of inter-governmental fiscal transfers, including consideration of issues addressing equity, equalization, and national policy priorities; (v) governance structures that ensure participatory governance and accountability of municipalities to electorates in decision-making and program implementation; (vi) inter-municipal cooperation in metropolitan areas; and (vii) restructuring of the *tutelle* system to play an ex-post rather than an ex-ante oversight role.

Annex I: Matrix of Identified Constraints and Opportunities

Identified Constraints

	Accelerate growth and private-sector-led job creation	Poverty/shared prosperity and inclusion
	Pre-requisites	
	(a) Macroeconomic imbalances	
Spending composition biased toward current spending (e.g. subsidies) rather than investment	Energy subsidies in particular reduce incentives for labor-intensive job growth, and in long-term, reduce technological innovation/competition for key industries to boost value	Subsidies reduce fiscal space for productive investments (economic, infrastructure) and safety nets targeted to boost consumption/purchasing power of bottom 40 percent and the poor.
Deteriorating external position	Decrease financing buffers—as seen by the decrease in forex reserves. This increase the country vulnerability to external shocks and therefore undermines investors' confidence	
	(b) Governance over-arching constraints	
Limited implementation of new measures to ensure increased citizen voice, and public sector accountability and transparency	Public sector entities not accountable for failing to provide adequate operating environment for private sector; lack of transparency creates information asymmetry	New civil and political rights not enforced, limiting inclusion; poor have less resources to access alternative mechanisms for voice; information asymmetry impacting citizens; limited information and mechanisms to challenge government decisions that do not serve the public interest
Weak institutional capacity to ensure effective delivery of public services	Public sector agencies are unable to provide the services (e.g., business registration, construction permits, land title) needed by the private sector to operate; corruption (bribery, abuse of office) raises the costs of doing business; dispute resolution mechanisms (courts, arbitration, mediation) ineffective, further limiting private sector opportunities	Poor lack resources to supplement lack of public services, thus suffer from poor services or non-delivery of services altogether; creates undue burden on prosperity The extent to which citizens can adequately exercise their rights will also impact social and political exclusion
Lack of legislative and institutional framework to effectively limit state/elite capture	Elite capture prevents competition in the private sector, which in turn can prevent establishment of new enterprises and limiting private sector-led job growth The estimated amount of illegal money lost from Tunisia due to corruption, bribery, kickbacks, trade mispricing, and criminal activity between 2000 and 2008 was, on average, approximately two percent of GDP per year (approximately US$1.2 billion per annum	Elite capture is perpetuated by economic and political exclusion of the non-elite

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	Accelerate growth and private-sector-led job creation	Poverty/shared prosperity and inclusion
Waning public support for democratic reforms in light of political and security instability	Public willingness to trade reforms for stability decreases government incentives to undertake difficult and comprehensive reforms	Public willingness to trade reforms for stability decreases government incentives to undertake difficult and comprehensive reforms
Regional disparities in access to (and quality of) services and opportunities	May contribute to limited labor mobility and greater mismatch of jobs/unemployment; may limit the ability of enterprises to grow and flourish in lagging regions	Exacerbates inequity and limits upward mobility, threatens political instability and undermines legitimacy of public institutions for revenue generation and social contributions (tax evasion, opting out of social security, etc.)
Lack of mechanisms to engage youth into the social, political and economic life. High level of inactive and unemployed youth	Lack of private sector dynamism combined with labor policies and regulations that tend to lower wages and discourage (especially formal) job creation, particularly for educated youth.	Young people are most susceptible to having informal jobs. The proportion of individuals who have informal jobs in the private sector is almost 50 percent higher among young people (57 percent) than adults (33 percent). The low quality of youth employment is also reflected in their lack of job satisfaction: a vast majority seem to be dissatisfied with their work (44 percent of the landlocked regions and 38 percent on the coast), citing the main reason of job dissatisfaction is lack of income.
Focus Areas		
1. Business environment and Investment Climate		
Weak contestability and competition: government regulations and actions are distortive of market development and generate unintended barriers to competition	Negative impact on investment, employment generation and ultimately economic growth. Limited competition also limits productivity and efficiency in some sectors, ultimately having a negative impact on competitiveness	Limited competition increases prices for end consumers and negatively affects the quality of goods and services. It prevents the creation of a level playing field, and for some sectors, creates unnecessary barriers for small and local players.
Regulatory burden in establishing, operating, and closing business	Increased cost and time of doing business; perceived as a key binding constraint for PSD by private sector; negative impact on competitiveness, investment, and eventually growth	Heavily regulated market access acts as smokescreen for rents extraction by politically connected firms who receive privilege access to lucrative activities. Reduces transparency, increases the scope for corruption, cronyism, and arbitrariness
Trade barriers, limited integration in GVCs	Stuck in low-value added; limits exports and investments, negative impact on growth and job creation	Impact exacerbated if we link it to marginalized sectors or regions
Inefficient and ineffective delivery of services by agencies influencing PSD, and limited/ineffective private sector participation	Key agencies (FIPA, APII, CEPEX) not fulfilling their mandate effectively and efficiently jeopardizes the ability to execute business climate reforms, negatively impact exports and investments; and eventually growth	Other institutions (tax authority, competition council, etc.) not fulfilling their mandate effectively and efficiently negatively impacts transparency, equity, and the creation of a level playing field
2. Financial Sector		
Weak credit environment	Weak credit risk sharing information system, restrictive interest rate regulation, loose banking sector regulation and inefficient bankruptcy regime limiting access to credit and firms' activity growth.	Borrowers without credit history or collateral (startups, youth, and women in particular) having limited access to credit opportunities.
Fragile public banking sector	Ailing state owned banks jeopardizing overall financial sector stability and future credit growth.	Public banks not fully participating in the financial inclusion agenda.
Lack of competition in the banking sector	Poor financial innovation and financial services quality maintaining the gap between supply and demand.	Supply/demand gap issues are stronger in lagging regions, where banking sector competition is even shallower.
Limited financial inclusion among households and micro businesses	Financial exclusion stymies the emergence of new businesses, reducing income generation opportunities among poor households, and depresses private sector employment prospects, particularly in rural areas. Financial inclusion is positively correlated with financial stability and greater efficiency of financial intermediation, both of which are important prerequisites for job creation and private sector development.	Financial exclusion makes it more difficult for poor households to manage economic shocks, generate income, and invest productively in health and educational outcomes for their families. It also makes it more difficult for governments to provide social transfers at a reasonable cost.

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	Accelerate growth and private-sector-led job creation	Poverty/shared prosperity and inclusion
Underdeveloped capital markets	SMEs, large firms, and households having limited opportunities in terms of access to long term financing to finance their large projects.	Difficult access to long term financing, limiting affordable housing policies.
Underdeveloped insurance sector	Poor solvency in certain insurance segments (compulsory motor insurance) and institutions, weak supervisory framework, underdeveloped market infrastructure and fraud impede a healthy development of the sector to respond to private sector insurance needs for production and investment purposes. Poor institutional investor base (insurance companies) to fuel demand for capital market products.	Limited development of insurance services which makes it difficult for poor households to manage economic and social shocks and which increase likelihood of drifting into poverty at the occurrence of such shocks.
3 Labor Market and Social Protection		
Skewed wages and benefits between public and private sectors (particularly SMEs and self-employed)	Reduces incentives for private job growth and exacerbating public sector employment queuing, wage bill and sustainability of public spending	Gender: Women have a higher preference for employment in the public sector than the private sector, especially women who live in landlocked regions. Youth: Jobs in the public sector are most preferred by young people though they are less likely to get a job in the public sector. When it comes to judging government "efforts to create and improve employment opportunities," more than half of young people are very dissatisfied. By Region: Particularly in the landlocked regions, the public sector fulfills a semi-safety net function, hiring a higher proportion of young people who have lower levels of education. On the coast, on the other hand, the public sector is rarely a source of employment for young people who have not completed high school.
Lack of effective and efficient ALMPs and public employment services to help unemployed (including youth, women, and the poor) find a job. (Lack of institutions to efficiently deal with labor market imperfections)	Targeted ALMPs and effective public employment services could help curb unemployment and boost growth. The current high unemployment levels, especially for women and youth, clearly impact the long-run growth potential for the country. In 2014: only 50 percent of the total working age population participated in the labor market. Among those who participate in the labor market: 18 percent are unemployed; 41 percent are in low quality jobs as wage employees in the informal sector or are self-employed (ex. Farmers, un-paid workers). With a very low participation rate for women (just under 26 percent compared to 71 percent for men) and youth in the bottom decile (40 percent do not participate in the labor market, and only around 20 percent are employed).	In general, women are more likely to be inactive or in low quality jobs. Youth are much more likely to be inactive or unemployed. The poor, overall, are more like to be unemployed or in low quality jobs. Across all deciles, inactivity and unemployment among youth are worse than among the overall working age population (2.5 to 3 times more likely than adults to be unemployed). The share of youth labor market inactivity increases across deciles and reaches 80 percent among the richest. Around two out of three youth with tertiary education are unemployed. In the poorest households, less than 20 percent of workers are in formal wage employment in the private or public sectors. The majority are in irregular wage employment (40 percent), or self-employed in agricultural or non-agricultural activities. Compared to the richest households where nearly 75 percent of workers are in formal wage employment.
High tax wedge impinging on benefit level, job creation and equity	Contributes to low productivity, low-value added sectors and impinges growth acceleration and quality of jobs	Impinges sustainability of social insurance, health insurance and efforts to institute unemployment insurance
Lack of unemployment insurance (UI) leaves workers vulnerable to shocks	Impinges flexibility needed to promote job creation and boost quality of jobs	Lack of social protection leaves workers prone to shocks and inability to enhance living standards

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	Accelerate growth and private-sector-led job creation	Poverty/shared prosperity and inclusion
Increasing deficits and fragmentation among CNSS, CNAM and AMG regimes, impinging on equity	Likelihood increases for high informality (and low-productivity)	Inequality in benefit levels and lack of portability reduces mobility
Poor targeting and leakage of social safety nets and consumption subsidies	Reduces capacity for boosting purchasing power of bottom 40 percent and lagging regions for contributing to growth in lagging regions	Impinges on resilience and inclusion
Lack of graduation mechanisms for social safety nets	Reduces employability and narrows potential labor force for attracting investment	Exacerbates intergenerational vulnerability and poverty
4. Governance-specific constraints		
Public Investment: Weak preparation and selection of public investment projects.	Delays important investments which could support private sector growth	Missed opportunity to close the spatial divide and gap in infrastructure
Public procurement as bottleneck for execution of investment projects	Given public procurement's importance in budget execution (it accounts for 18 percent of the Tunisian GDP and 40 percent of the State budget), any improvements to public procurement will be reflected in the service delivery efforts and broader economy and growth. Public procurement is a huge market from which small and medium-sized enterprises (SMEs) in Tunisia should be deriving a significant share, considering their overall contribution to and makeup of the economy. Therefore, the extension of SME access to government contracts can be viewed as a trigger to promote economic growth in the region and create jobs	Regional and local public services and civil servants in Tunisia are suffering from a weak capacity in terms of procurement management and processing, resulting in huge bottlenecks and delays in implementing development projects in local level. Any improvement of capacity and institutions at the local level and better decentralization of procurement oversight will help local governments implement their investment programs resulting in job creation and better share of prosperity and access to service delivery.
Weak management of large and medium-size cities and inadequate policies to enable different sets of cities to realize their capabilities	Risk to exacerbate the duality of the economic model, enlarging the gap between the big coastal cities and the rest of the country	Imbalances in ownership of the economic development agenda are reflected in unequal access and outcomes and spatial disparities
Corporate governance for private companies	Lack of good corporate governance practices including partial lack of awareness and lack of "peer pressure" in applying good practices	
5. Infrastructure [includes energy] and logistics		
Despite a high urbanization rate, the country is relatively low density limiting the potential to leverage economies of scale and agglomeration	Low density increases cost of delivering services and competitiveness of cities. A stronger focus on urban planning and transit-oriented development reduces the impact of congestion and, in the case of city ports (such as Tunis), support private sector investment in and around cities	A stronger focus on high-density and transit-oriented development would contribute to better access to jobs and opportunities
Heavy state involvement and opaque rules for governance and accountability, and very low overall openness to private investments in infrastructure across sectors- have dragged down operational efficiency of key infrastructure services and delayed critical investment decisions (including power, water and transport)	Poor performance of transport SOE is resulting in poor level of services, and budget on the state, contributing to poor performance of the transport sector in supporting freight and logistics. A typical example is the port of Rades, whose performance is very much constrained not only by infrastructure but also the performance of STAM Inefficiencies in public spending (e.g. untargeted subsidies) and lack of integrated strategy of water, agriculture, and natural resource management. Traditional public investments cannot respond to desired economic and social needs in long term given in climate risks and population growth. 1) High capital investment and maintenance for inter-basin conveyance canals and storage infrastructure are ever costlier due to higher cost of withdrawals, weighing on government budget and utility financial sustainability and performance, ultimately affecting quality of services. 2) Policy decisions are prone to inefficiencies due to misaligned incentives.	Urban transport SOE financial situation and heavy centralization of decision making, contribute to deteriorating level of services to people living in cities. This in turns reduces urban poor access to opportunities and services Challenges of financial sustainability and governance/management in service providers (rural and urban utilities) impacts their ability to expand services to presently unserved population, and provide reliable (no cut), continuous (24/7), and sustainable services.

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	Accelerate growth and private-sector-led job creation	Poverty/shared prosperity and inclusion
Poor connectivity across the country leading to dramatic under realization of potential for local economic development	Limited public investment in the road sector connecting lagging regions to Tunis and coastal areas is limiting attractiveness of these regions to private sector investment, which would result in job creation and growth	People living in lagging regions feel more isolated and neglected than those in coastal areas. Limited maintenance contributed to poor state of local roads and limited access to services and opportunities
	ICT potential: Poor broadband connectivity across the country is limiting the impact at local level of the Government ICT strategy “Tunisie Digitale 2018” in terms of yearly job creation in the ICT sector (from 7,500 in 2013 up to 25,000 in 2018) and in terms of ICT exports (from 950 Mio DNT in 2013 up to 4,000 in 2018)	Poor availability of broadband outside richest areas is leading to an ongoing risk that the bottom 40 percent of population in Tunisia will remain excluded from the information revolution that is shaping the modern world
Inefficiency of logistics infrastructure and associated high logistics costs linked to infrastructure-related services and trade facilitation bottlenecks hinder trade and competitiveness	Example of the Port of Rades: in addition to poor performance of STAM, the port current infrastructure needs upgrading to better handle containers. Improvement in logistics requires better coordination and multi-modal approach with a stronger role for railways.	Poor logistics performance contributes to higher cost of transportation, resulting in higher cost of imports and uncompetitive local products. This contributes to vulnerability of poor people and higher cost of goods.
6. Human capital		
(a) Education		
Skills mismatch due to weak linkages between the curriculum in the education system and the skills demanded by the private sector	Skills mismatch due to weak linkages between the curriculum in the education system and the skills demanded by the private sector There is a severe discrepancy between the competencies required by the labor market and the subjects students are studying in higher education. Choice of fields of study in the landlocked regions of the country are less adapted to the private sector: University graduates from landlocked regions are twice as likely to study literature and humanities, and less likely to study economics and law (21 percent) or to pursue engineering studies (nine percent) compared to graduates on the coast. It is possible that the fields of study in the landlocked regions reflect the lack of variety of opportunities that exist in the private sector, with higher education supporting primarily the needs of the public sector. The rates of underemployment and mismatch are exceptionally high among university graduates, reaching 30 percent for technicians and 36 percent for those with a bachelor’s degree in humanities. At the same time, the distribution of skills favors occupations that have less demand in the labor market, to the detriment of occupations such as machine operations, craftsmen, accountants, and salesman. Such mismatch between demand and supply of skills prevents an efficient allocation of resources and limits growth	Skills mismatch due to weak linkages between the curriculum in the education system and the skills demanded by the private sector The lack of private sector jobs in landlocked regions is also reflected in higher unemployment rates for the highest levels of study (in comparison to the regions on the coast), due to the mismatch between the skills of university graduates and those sought in the labor market.
Low quality of education (showed in standardized tests results), quality of teachers in public schools	Low quality of learning outcomes at the primary and second levels result in low quality of inputs to vocational and higher education, and thus has a negative effect on the skills of their graduates. This acts as a constraint to growth by limiting the potential for firms to tap into high quality skills required to move up the value added chain as well as the innovation ladder	Disadvantaged interior regions suffer from even lower quality of education services due to poor infrastructure and less qualified teachers

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	Accelerate growth and private-sector-led job creation	Poverty/shared prosperity and inclusion
	(b) Health	
Despite availability of health coverage, households out-of-pocket spending remains important, threatening poverty and shared prosperity	Narrows household investments in other productive investments/purchasing power needed to simulate consumption/growth	Exacerbates intergenerational vulnerability and poverty. Out-of-pocket payments remain high, accounting for nearly 37 percent of total health expenditure in 2013. In consequence, the incidence of "catastrophic" health expenditures and the incidence of impoverishment due to out-of-pocket health payments are also high. In addition, there is a lack of targeted resource allocation policies based on population needs and performance-based provider payment mechanisms, which leads to geographical inequity.
Low quality of health facilities		The quality of services is reportedly lower in underserved areas and in public facilities with notable differences in staff treatment, waiting times, and basic amenities. As a consequence, despite a significant improvement in the health status of the Tunisian population during the last two decades, progress in health outcomes has been uneven.
7. Natural Resources Management/Disaster Risk Management		
Centralized management model of forests and rangeland in Tunisia contributes to institutional and market failures, and to the inefficient use and degradation of these resources.	Lower productivity in the agricultural and livestock sectors results in low-value added jobs, preventing asset accumulation, and preventing the release of labor and capital to support the growth of the non-farm sector.	This is a key constraint to achieving reduction in poverty and shared prosperity particularly among the poorest communities of the North-West and Center-West parts of Tunisia. Degradation of forestry and rangeland resources lowers the productivity of associated agriculture and livestock economic sectors, on which households depend for their livelihoods.
The current legal framework constitutes the main bottleneck to implement the articles of the constitutions related to the management of natural resources.	See above.	Sector-specific policies and institutional reforms are needed to respond and implement the new constitution to improve and ensure co-management of natural resources. This will support economic growth and will help protect services provided by these resources and increase the productivity of other sectors such as agriculture and livestock. Because the poor depend on these sectors, these policies will also support inclusive growth. Furthermore, improved management of these resources will also help protect water resources for rural and urban areas, and reduce vulnerability to climate change.
Absence of effective disaster risk management systems enabling substantial impact (in financial and human terms) of disasters	Environmental degradation is a development issues for Tunisia that could reverse development gains. Of particular interest: industrial pollution and mining sectors.	Lately, the civil society has been very vocal raising local community concerns on water pollution from phosphate mining. There have been protests and conflicts among local communities and mining companies due to lack of investments in environmental protection. Many mining companies have limited funds to put in place sound environmental systems aimed at reducing pollution. This is an area where the public and private sector can work together to improve the health and safety of local communities by bringing financing as well as the knowledge to reduce industrial pollution.

Ranking of Constraints in Specific Areas

Area/Theme	Constraint Channel	Growth	Private sector-led job creation	Shared prosperity and inclusion
(1) Business Climate and international trade	Weak contestability and competition: government regulations and actions are distortive of market development and generate unintended barriers to competition	1	1	1
	Heavily regulated market access as smokescreen for rents extraction by politically connected firms who receive priviledge access to lucrative activities	2	2	2
	Tariffs and tax evasion hamper competition and give a strong unfair advantage to lager and better connected firms	3	4	3
	Investment climate constraints: establishing, closing and operating a business, weak contestability and competition, administrative complexity and uneven enforcement, access to skilled labor	5	3	4
	Services sectors underperform—as consequence of heavy regulation and unfavorable business climate—and undermine the competitiveness of the entire Tunisian economy	4	5	5
(2) Financial sector	Underdeveloped non-banking financial institutions and longer-term debt and equity markets, no capital markets	3	3	2
	Weak access to finance	2	1	1
	Weak corporate governance and severe lack of competition in the banking sector	1	1	3
(3) Infrastructure and services, connectivity, transport and trade logistics, and urban development	Inefficiency of logistics infrastructure and associated high logistics costs linked to infrastructure-related services and trade faciliation bottlenecks hinder trade and competitiveness	1	1	4
	Heavy state involvment and opaque rules for governance and accountability—and very low overall openness to private investments in infrastructure across sectorshave dragged down operational efficiency of key infrastructure services and delayed critical investment decisions (including power, water and transport)	3	2	4
	Failures of electricity sector widen inequality and affects businesses	6	6	7
	Low level of competition in telecommunications results in higher costs to firms and consumers	5	2	6
	Poor connectivity across the country leading to dramatic underrealization of potential for local economic development	2	4	3
	Transportation costs disproportionately affect the poor, specifically those in rural areas	4	5	2
	Unequal acces to improved water and sanitation (by location such as urban/rural, urban/peri-urban, region) and poverty quintiles; distributional impacts of quality disparities	7	7	1
(4) Human Capital (Education, health)	Low quality of educations (showed in standardized tests results), quality of teachers in public schools	1	2	1
	Skills mismatch due to weak linkages between the curriculum in the education system and the skills demanded by the private sector	2	1	2
	Despite availability of health insurance, households out-of-pocket spending has been increasing, threatening poverty and shared prosperity	3	3	3

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Area/Theme	Constraint Channel	Growth	Private sector-led job creation	Shared prosperity and inclusion
(5)(a) Social Protection	Informal and low productivity employment, with half of labor force in informal sector	2	1	8
	Social security system face significant deficits and inadequate coverage	3	6	7
	Lack of social protection as constraint to inclusive growth	5	5	1
	Unemployment benefits and support are lacking and health insurance benefits do not cover sufficiently middle and low-income and informal workers.	6	3	4
	Weak job creation particularly in disadvantaged regions	1	2	3
	Poor quality of jobs esp. for more disadvantaged workers	4	4	6
	Lack of an effective targeting mechanism	6	8	1
	Absence of social safety net system	8	6	5
(5)(b) Labor Market	Labor policies and regulations tend to lower wages and discourage job creationparticularly for educated youth	1	1	1
	Lack of effective and efficient ALMPs and public employment services to help youth and the unemployed find a job.	2	2	2
(6) Governance-specific constraints	Public procurement as bottleneck for execution of investment projects	5	2	7
	Weak preparation and selection of public investment projects.	2	3	6
	Weak management of SOEs and autonomous government agencies and lack of strategic vision and monitoring tools for the sector.	1	1	4
	Lack of equity, fairness and efficiency of the taxation system	4	3	1
	Weak management of large and medium-size cities and lack of ownership from them of the economic development agenda	3	5	2
	(Partial) data availability for evidence-based policy making	7	7	4
	PFM system does not permit predices detection of waste and corruption—is one of the most vulnerable areas to corruption	5	6	3
(7) Environment, natural resources, and disaster risk management	Environmental risk in all its aspects (agricultural land as a resource, deficient wastewater systems, destroyed water table) is related to poverty	1	2	1
	Climate change impacts suggesting more rapid warm-up than global average, annual reduction of precipitation, effects on snow water storage, effect on tourism and other vulnerable sectors (agriculture, electricity, water, coastal zones, forestry, public health, and human settlements and infrastructure)	5	3	5
	Absence of effective disaster risk management systems enabling substantial impact (in financial and human terms) of disasters	6	4	6
	Scarce water resources are impinging on agriculture's potential- a sector central to sustainable growth and continued poverty reduction objectives	1	1	2
	Water mobilization model not sustainable—high capital/high maintenance investment (inter-basin transfers canals, development of aquifers) ever costlier and politically sensitive	4	5	4
	Lack of integrated strategy of water security, water resource/wastewater management, and agriculture to increase income (e.g. exports performance in ag), equity, quality and sustainability (e.g. internal food supply; stop or reverse overexploitation of water resources)	3	6	3

Identified Opportunities

1. Level the Playing Field for Private Sector Job Creation

	Improved business climate and increased competition	Improved service delivery and governance of agencies influencing PSD	Improved competitiveness of export-oriented GVCs	Accelerate telecoms liberalization and sector reforms	Reduced skill mismatch between supply and demand
Expected impact on the two goals/pillars	Creation of level-playing field, increased transparency, reduction of time, effort and cost of doing business will all increase Tunisian competitiveness	This will allow such institutions to fulfill their mandate in an effective and efficient manner, and will ensure proper participation of private sector (examples: FIPA, CEPEX, APIA, Competition Council, etc.)	This will lead to increase in exports and in investments, rise in value-added, and integration in GVCs will have a direct impact on growth and private sector-led job creation	Will contribute to making telecoms services more affordable	This will alleviate a key binding constraint highlighted by the private sector, and significantly increase competitiveness
Magnitude of impact on Pillar I	Strong impact on (i) growth, (ii) private sector-led job creation.	Strong impact on (i) growth, (ii) private sector-led job creation. Strong impact on value added and jobs in demand	Strong impact on (i) growth, (ii) private sector-led job creation. Strong impact on value added and jobs in demand	Strong impact on (i) growth, (ii) private sector-led job creation. Strong impact on value added and jobs in demand	Strong impact on (i) growth, (ii) private sector-led job creation. Strong impact on value added and jobs in demand
Magnitude of impact on Pillar II	Increased competition and transparency, and reduced corruption can certainly have a strong impact on inclusion / participation	Impact can be strong on Pillar II if we link our operations/TA to service delivery n underprivileged regions.	Impact can be strong on Pillar II if we link our operations/ TA to underprivileged regions. Built-in PPD components in operations/TA to ensure participation	Strong	Impact can be strong on Pillar II if we link our operations/ TA to people living in underprivileged regions.
Time Horizon	Medium	Medium	Medium	Short	Medium
Evidence base				The experience of the past decade has clearly shown that competition (and in particular facilities-based competition) is the most important driving force for accelerated and sustainable telecommunications market development together with the set-up of independent regulatory authorities. Competition enables private investment, incentivizes operators to be more efficient, and, as a result, ensures maximum benefits for end users both in terms of quality and prices.	

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	Improved business climate and increased competition	Improved service delivery and governance of agencies influencing PSD	Improved competitiveness of export-oriented GVCs	Accelerate telecoms liberalization and sector reforms	Reduced skill mismatch between supply and demand
Feasibility of implementation (Political/ Social, capacity constraints)	The feasibility depends on the type of reform: reducing the role of the state or liberalizing key sectors or eliminating the dichotomy are certainly more difficult than streamlining procedures and incentives.	Requires strong commitment for reform and appetite to take tough decisions from government; also requires larger budgets and more flexible GOT hiring and procurement rules; also requires a better organized private sector	For multiple sectors, strong commitment by the private sector, the administration and at the political level; sometimes easier, more impactful and targeted than economy-wide reforms. Strong interest by Tunisian govt. for sectorial approach	Affects interests of the three global operators and therefore may face resistance; Incumbent SOE may also cause additional resistance if not allowed to have level playing field with competitors	A new area of intervention advisable to start with pilot sectors, and then roll out once successful. It is important to highlight that while this opportunity is common to many economic sectors in the economy, grabbing it will depend on a sectorial approach and strong participation by firms in the various sectors (sector by sector)
Sustainability	Strong delivery unit and capacity building activities to ensure implementation; buy-in from private sector	This opportunity is a pre-condition for the sustainability of all other T&C opportunities mentioned before!	Strong delivery unit and capacity building activities to ensure implementation; buy-in from private sector	Government's commitment for sector reforms	Funding mechanisms needed to ensure continuity; well organized private sector, and good coordination with public and private service providers

2. Financing Growth and Inclusion

	Improve credit environment	Improved access to finance to high value-added exports	Reduce public banking sector fragility	Improve banking sector competition	Increase Financial Inclusion	Develop capital markets and insurance sector
Expected impact on the two goals/pillars	Improve access to credit opportunities to firms and in particular to those with no credit history and limited collateral (mostly MSMEs and startups). Increase quality of loans provided by banks through better regulation on risk management and revised bankruptcy regime.	This will alleviate a key binding constraint highlighted by the private sector, and will increase in exports, and improve competitiveness	Lower the threat of a systemic banking sector crisis in case of a bank run in one or several SOBs. Increase quality and quantity of loans provided by one-third of the supply side.	Improve quality of financial services delivery, launch new products meeting clients' demand, lower the cost of financial services and credit.	Financial inclusion (access to and usage of formal financial services) is critical for household welfare by spurring private sector economic activity and helping manage economic shocks. Financial inclusion can also help address joblessness because it helps grow microenterprises. Financial inclusion contributes directly to financial stability and is such an important contributor to a growth enabling private sector.	Capital market: Improve access to long term financing for SME and large companies in order to develop large investments and activity growth/ diversification. Allow more ambitious affordable housing policies. Insurance: Healthy development of the sector to respond to private sector insurance needs for production and investment purposes. Help households manage economic and social shocks and reduce likelihood of drifting into poverty at the occurrence of such shocks. Development of an institutional investor base for capital market products.
Magnitude of impact on Pillar I	Growth: Strong Jobs: Strong	Strong impact on (i) growth, (ii) private sector-led job creation.	Growth: Strong Jobs: Strong Banking crisis would have strong/long-term detrimental effect on economic growth and shared prosperity	Growth: Strong Jobs: Strong	Growth: Medium Jobs: Medium	Growth: Medium Jobs: Medium
Magnitude of impact on Pillar II	Strong: Inclusion of firms/individuals currently excluded from credit opportunities.	Impact can be strong on Pillar II if we link our operations/TA to underprivileged regions and marginalized sectors.	Strong: A banking crisis would have strong negative impact on firms/households losing their savings.	Medium: Will help indirectly boost job creation for youth, women, low-skilled, vulnerable	Strong: Welfare and equity improvement through access to financial services	Medium: Capital markets: Long-term finance is key to mortgage affordability. Will help indirectly boost job creation. Insurance: Insurance instruments should limit the vulnerability to various risks of households. In the absence of proper risk hedging mechanisms like insurance, the poor stand to lose their earnings, liquidate their assets, migrate and face several other hardships, which in turn only trap them into a deeper and vicious cycle of poverty.

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	Improve credit environment	Improved access to finance to high value-added exports	Reduce public banking sector fragility	Improve banking sector competition	Increase Financial Inclusion	Develop capital markets and insurance sector
Time Horizon	Short	Short	Short	Long	Medium	Long
Evidence-base	34 percent of firms deem that access to credit is a major constraint.		SOBs have very large NPLs portfolios (25–30 percent), limited solvency margin and liquidity.	Limited range of banking products, poor service delivery	A 2014 study conducted by the World Bank demonstrated that nearly 45 percent of Tunisian adults do not use formal financial services, and that 19 percent of Tunisians use them in a very limited manner	Funds levied by firms on capital markets (stock exchange and bond market) remain low by international comparison. Insurance penetration and density are low by regional and international comparison.
Feasibility of implementation (Political/Social, capacity constraints)	Feasible, but requires stronger buy-in from the authorities (Central Bank and Ministry of Finance). The regulation on excessive lending rates is a politically sensitive issue.	Feasible. Some programs have been already implemented with Bank support (EDP 3, MSME facility, etc.), strong appetite for some instruments; need to focus on marginalized sectors and/or regions	Feasible, but requires on-going dialogue with the SOBs and the authorities (Central Bank and Ministry of Finance). The restructuring of SOB (which include severance packages) is a politically/ socially sensitive issue.	Feasible, but will depend on how fast the other constraints (credit environment, stability) will be addressed.	Increasingly feasible, but a dialogue should be engaged with the new Minister of Finance and Central Bank authorities in order to address the Micro-finance Institutions / Micro-finance Associations duality (a politically sensitive issue) and on broader policies to promote financial inclusion.	Feasible, no political/social capacity constraints.
Essential Preconditions	Yes, dialogue on-going.	Strong delivery unit and capacity building activities to ensure implementation	Yes, dialogue on-going	Yes, dialogue on-going.	Yes, dialogue on-going.	No.
Sustainability	Dialogue and gradual approach needed. Evidence base needs to be strengthened on the issues related to the collateral regime.		Dialogue and gradual approach needed.	Evidence base needs to be strengthened (diagnostic and impact assessment).	Dialogue and gradual approach needed. Evidence base needs to be strengthened regarding Micro-finance Institutions vs Micro-finance Associations development on social and economic impacts.	Dialogue and gradual approach needed; evidence/ impact analysis needed.

3. Strengthen Employment and Build Resilience

	Strengthen active labor market programs and create contestable markets for ALMPs	Improve the employability of university graduates	Redesign a new industrial policy to support productivity, job creation and to mitigate regional disparities	Consolidate social protection and labor identification systems and align labor regulations with job growth	Improve sustainability of social insurance financing	Improve social safety net coverage and target energy subsidies
Expected impact on the two goals/pillars	Strengthen quality and incentives of labor market programs, vocational training, and university transition to work by targeting strategic sectors and contracting with private sector training providers and firms. (ii) Create contestable markets for ALMPs by involving the private sector, thereby driving service delivery of employment services. These public-private partnerships deliver employment services by creating strong systems of publicly funded but privately provided employment services. Their impact can be high as the outcome indicators (e.g. job placement) are easily measurable and can be effective especially for vulnerable groups in lagging regions.	The impact on growth will be through the increase availability of skills for firms and an increased utilization of human capital	Identification and focus on sectors and value chains where the potential employment effects are the greatest, particularly in lagging regions. Reallocating capital, or increasing investments in certain sectors can have very different consequences in terms of the number and composition of jobs created. But if the investments go to the right sectors there can be important direct and indirect (through value chains) impacts on jobs.	Support social dialogue council and unified social protection and labor framework for labor regulation, unique identification harmonization across programs, and unemployment insurance reforms.	Improve coverage and sustainability of financing for social security as integrated system across pensions, health insurance and unemployment insurance. (ii) Reduce taxes on labor and other labor costs, while guaranteeing adequate income protection to workers. The focus should be on reducing the tax wedge, rationalizing redistributive arrangements, reforming dismissal procedures, and reducing discretion in the setting of the minimum wage.	Improve targeting implementation, administration, and payment modalities for social safety nets and subsidy reform.

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	Strengthen active labor market programs and create contestable markets for ALMPs	Improve the employability of university graduates	Redesign a new industrial policy to support productivity, job creation and to mitigate regional disparities	Consolidate social protection and labor identification systems and align labor regulations with job growth	Improve sustainability of social insurance financing	Improve social safety net coverage and target energy subsidies
Magnitude of impact on Pillar I	Growth: Med Jobs: Medium Public employment services can be augmented by employment services provided through public-private partnerships (PPPs), tying payments for services to contractor performance through outcome-based contracts or "payment by results."	Medium/Strong	Strong The impact of higher private investments on jobs will depend on where the investments go and how they are financed. New investments in capital can, for instance, substitute for labor and reduce the number of jobs. Investments in a given sector might also imply fewer investments and less demand for intermediate or final consumption in another sector and therefore less job creation there.	Growth: Medium Jobs: Strong	Growth: Strong Jobs: Strong Will depend on fundamental reforms in the current social insurance systems to address unfunded liabilities; harmonize benefits across different schemes while assessing their costs; and reviewing financing mechanisms to separate insurance and redistributive functions. For example, a 10-percentage-point reduction in the cost of labor could be associated with a five-percentage-point increase in formal employment.	Growth: Strong Jobs: Medium
Magnitude of impact on Pillar II	Strong: Inclusion of low-skilled/vulnerable, PPP approaches. The PPP based service delivery model using contestable markets can better target "hard to place" jobseekers, disenfranchised workers, or those workers disconnected from market opportunities. Therefore, it has the potential to improve opportunities for youth and workers in the bottom deciles.	Medium/Strong	Strong: Since different economic activities rely more or less on different types of workers (by gender, age, types of skills) and have production units in different regions, changes in the distribution of investments imply changes in the composition of jobs that will affect the labor market outcomes on different population groups (particularly most vulnerable workers), depending on the sectors and regions where these investments will take place. If investments go to subsectors and value chains that create jobs for vulnerable workers there can be important effects on welfare.	Medium: Welfare and equity improvement	Strong: Welfare improvement If redistributive arrangements are made explicit and better targeted, the reforms above can be accompanied by an increase in coverage of social insurance programs (including unemployment benefits	Strong: Welfare and equity improvement

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Time Horizon	Short/medium	Short/medium	Medium/long	Medium	Medium/Long	Medium
Evidence-base	ALMPs in place but need improved efficiency; Findings from Professor Dan Finn (University of Portsmouth), Richard Johnson (World Bank), Milan Vodopivec University of Primorska) look at the experience in OECD countries like Australia, the UK, and the U.S. in the rationalization, design, and implementation of PPPs in the delivery of publicly-funded employment services	The rates of underemployment and mismatch are exceptionally high among university graduates, reaching 30 percent for technicians and 36 percent for those with a bachelor's degree in humanities. Lack of required skills and qualifications among education system graduates is identified by the ICA 2012 as the second leading perceived constraint to firm operations	There is strong evidence that jobs are created by the entry and growth of new or current business. This requires new investments, with careful attention to where they are made.	Lack of unified social protection and labor system and coordinated social insurance financing reduces benefits, sustainability and labor flexibility for job growth.	Wide deficits; broad disparity in benefits between private and public; weak benefits for low-skilled/high informality. Experience in ECA and LAC on improved protection/ flexibility and better quality of jobs in private sector. Evidence on reforming the social insurance system to expand coverage and improve incentives to create formal sector jobs point at the important role of the tax-wedge for formal employment. The evidence also indicates that in order to expand the coverage of social insurance programs to informal sector workers, it is important to rely on well-designed and targeted redistributive arrangements.	High cost of subsidies, inequity, and poorly targeted safety nets are shown to exacerbate vulnerability. Experience in LAC and EAP on improved welfare from targeted safety net programs.

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	Strengthen active labor market programs and create contestable markets for ALMPs	Improve the employability of university graduates	Redesign a new industrial policy to support productivity, job creation and to mitigate regional disparities	Consolidate social protection and labor identification systems and align labor regulations with job growth	Improve sustainability of social insurance financing	Improve social safety net coverage and target energy subsidies
Feasibility of implementation (Political/Social, capacity constraints)	Moderately feasible, requires additional trust building with private sector.	Employability of HE graduates is one of the main issues in the country. The Bank is already providing TA and preparing a new operation	To be determined.	Feasible, but labor regulation reform remains highly sensitive.	Moderately feasible, requires additional tri-partite trust building. It is important to understand the fiscal, economic and social implications of these alternative financing options. Moreover, the fiscal space for such reforms needs to be assessed. Reducing payroll taxes, for example, might imply having to increase other types of taxes (consumption or property taxes).	Increasingly feasible, requires improved targeting / database to be in place and dialogue with sectors potentially impacted.
Essential Preconditions	Yes, dialogue on-going.		In the past, investments in labor intensive sectors have most likely been relatively low because: (i) the various subsidies regulated through the current investment code, and (ii) the high tax wedge imposed by the social insurance system (more than 35 percent of wages). Many employers and workers can evade the latter by creating or taking informal jobs, but for larger formal sector firms this is more difficult—or potentially expensive—which would lead to current strategies to save on labor.	Partially. Dialogue ongoing on unique identification and early dialogue on unemployment insurance; not on labor regulations (contracts, firing).	Sustained political motivation and will. Dialogue on-going	Yes, dialogue on-going.
Sustainability	Good governance for accountability and PPP.	Modernizing the management of the sector, providing more autonomy to universities, move to a performance-based financing	Yes, given the middle-to long-run time horizon.	Evidence base needs to be strengthened on labor regulations' impact and unemployment insurance scenarios/impacts.	Well-implemented social dialogue.	Dialogue with potential impacted sectors.

4. Improve Access to and Quality of Services. Reduce Spatial Inequality

	Develop a holistic vision and reform plan for the education sector based on a comprehensive diagnosis of sector performance	Improve quality and reduce disparities in general education	Develop a strategy and action plan for the health coverage reform based on a comprehensive diagnosis of the current health coverage system	Strengthen institutions to improve voice and accountability	Expand the geographic coverage of broadband networks to provide broadband for all	Support the development of ICT content, applications and services with high impact on citizens
Expected impact on the two goals/ pillars	Indirect impact. This is seen as a prerequisite to improving both the quality of education and employability (reduce skills mismatch)	Impact on growth and on inclusion via better access to quality education services	This will contribute to the preparation of sound reforms aiming at improving health coverage, which helps lift people out of poverty and drives economic growth	Impact on inclusion and shared prosperity via an increased “social capital.” Strengthening the institution and legal frameworks that allow citizens to act collectively is a necessary condition for successful development and social progress	Will mitigate the risk that the bottom 40 percent of population in Tunisia will remain excluded from the information revolution that is shaping the modern world	Will use ICT as a key accelerator of social and economic development
Magnitude of impact on Pillar I	Medium/strong	Medium/strong	Medium	Medium	Medium	Medium
Magnitude of impact on Pillar II	Medium/strong	Medium/strong	Strong	Strong	Strong	Strong
Time Horizon	Short: (implementation) Long: (impact)	Medium/long	Short: preparation Medium: implementation Long: implementation and impact	Short	Medium	Medium
Evidence-base	International experience in transition countries shows that a comprehensive and shared vision is needed to ensure support to any major education reform	Poor performance of Tunisian students in international standardized tests (TIMSS&PISA). Higher drop-outs and repetition and lower performance in national exams for students in interior	International experience, including in Turkey, shows that a comprehensive and shared vision is needed to implement major health coverage reforms		Broadband is a key enabler of democracy and social transformation, as witnessed by the powerful role played by new and social media networking during the Arab Spring. The internet has played a key role in advancing social inclusion, accountability, human rights, and civic engagement. Social networking tools have the potential to enhance citizen engagement in the region, promote social inclusion, and create opportunities for employment, entrepreneurial activities, and social development	Progress in online service delivery continues in most countries around the world as shown in the United Nations E-Government Survey, further enhancing public sector efficiencies and streamlining governance systems to support sustainable development.

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	Develop a holistic vision and reform plan for the education sector based on a comprehensive diagnosis of sector performance	Improve quality and reduce disparities in general education	Develop a strategy and action plan for the health coverage reform based on a comprehensive diagnosis of the current health coverage system	Strengthen institutions to improve voice and accountability	Expand the geographic coverage of broadband networks to provide broadband for all	Support the development of ICT content, applications and services with high impact on citizens
Feasibility of implementation (Political/ Social, capacity constraints)	Educational reform is on the top priorities of the government A national dialogue on education has just been initiated	There is a general awareness of quality and disparity issues in the country. However, there might be resistance from a conservative administration and unions. Also, political parties may have different views on curriculum reform	In 2012, the Government launched a “dialogue sociétal pour les politiques, stratégies et plans nationaux de santé.” Phase 1 included broad consultations with key stakeholders and civil society whose outcome was a consensual declaration summarizing the main areas for health system reforms, including health financing reforms. The second phase, which has just been initiated, includes the preparation of a national health strategy Health reforms are on the top priorities of the new government	The Government has introduced several initiative to make progress toward this end, e.g., Open Government strategy—the Urban Development and Local Governance program which is introducing mechanisms to increase transparency, accountability, and citizen participation in governance	Strong support from all sector stakeholders and citizens; May be affected by competing priorities for the use of the proceeds of the Telecoms Development Fund	Tunisia laid the appropriate foundations for e-government through its 2010–2014 strategy and joined the Open Gov Partnership in January 2014 that will contribute to unleash Big Data opportunities. The website www.data.gov.tn displays a hundred links to public databases structured around 17 themes. The website www.opengov.tn is a civil society initiative offering access to governmental data.
Essential Preconditions	Serious engagement of key stakeholders including unions, parents and employers	Adoption of a shared vision for the future of education	Engagement of the key stakeholders, including the MoH and Health Social Insurance Fund	none	Government’s commitment to implement its ICT Strategy “Tunisie Digitale 2018”	Government’s commitment to implement its ICT Strategy “Tunisie Digitale 2018
Sustainability	To keep the momentum and engagement of stakeholders, it is important that such process is done quickly (within one year)	Modernizing the governance of the sector, moving to school-based management, stronger involvement of stakeholders, stronger role for private sector, and more transparency and access to information	The preparation has already started, with the Bank and WHO’s support. It is important to keep the momentum.	Sustained support from relevant interest groups to ensure these reforms are advanced; responsive financial and technical support from development partners to minimize claw back		

Environmental Sustainability

	Legal and institutional reforms in the management of Tunisia's silvo-pastoral ecosystems	Strengthen policies to increase Tunisia's resilience to climate change	Development of effective disaster risk management systems
Expected impact on the two goals/pillars	Sector-specific policies and institutional reforms are needed to respond to and implement the new constitution that aims to improve and ensure co-management of natural resources such as forests and rangelands. These reforms will support economic growth, protect services provided by silvo-pastoral ecosystems resources, and increase the productivity of other sectors such as agriculture and livestock. Because the poor depend mainly on silvo-pastoral ecosystems in Tunisia, these policies will also support inclusive growth. Higher productivity in the agricultural and livestock sectors results in higher-value added jobs, asset accumulation, and the release of labor and capital to support the growth of the non-farm sector. Furthermore, improved management of these resources will also help protect water resources for rural and urban areas, and reduce vulnerability to climate change.	Develop a supportive policy and institutional framework for low-carbon local development practices and Tunisia's resilience to climate change will help to strengthen economic growth and promote poverty reduction and inclusive growth.	Mitigates the potential higher impact in financial and human terms of disasters on the poorest and most vulnerable segments of Tunisia's population and supports the promotion of inclusive growth and equal opportunities.
Magnitude of impact on Pillar I	Medium	Medium	Weak
Magnitude of impact on Pillar II	Strong: particularly on the most disadvantaged communities in the western interior part of the country.	Strong	Strong
Time Horizon	Short	Long	Short
Evidence-base	Evidence for the need for this reform is based in international good practice, which recognizes the inter-connectivity between ecological, social-cultural, economic and institutional structures and supports integrated landscape management. Healthy ecosystems provide valuable adaptation mechanisms, support people's well-being and can alleviate poverty especially of the rural poor. Ensuring the full integration of the full range of goods and services provided by ecosystems in decision making and public policy would allow the transition to the green economy. The first and priority objective of the new national strategy for the development and sustainable management of forests and rangelands, 2015–2024 adopted by the government is the adaptation of the institutional and legal framework of the sector and capacity building	Strong. Building effective disaster risk management systems improves the resilience of populations (particularly the poor and vulnerable) to disasters.	Strong. Building effective disaster risk management systems improves the resilience of populations (particularly the poor and vulnerable) to disasters.

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	Legal and institutional reforms in the management of Tunisia's silvo-pastoral ecosystems	Strengthen policies to increase Tunisia's resilience to climate change	Development of effective disaster risk management systems
Complementarities with other areas	Reforms in the management of Tunisia's silvo-pastoral resources complement the efforts of water and agriculture global practices—protection of water resources for urban areas (water supply) and agriculture (irrigated and rain fed agriculture).	Strengthening Tunisia's resilience to climate change requires strengthening national capacity in the key relevant sectors such as water management, agriculture, and energy.	Improved disaster preparedness and
Feasibility of implementation (Political/ Social, capacity constraints)	The forestry administration and the Ministry of Agriculture through the Ministry of Finance requested officially Bank support to support these reforms through the preparation of a new operation on the sector. Main constraints: Lack of strategic and legal frameworks for the sustainable management of rural landscapes Lack of decentralized decision making and the weakness of grass-roots associations Capacities in the forestry administration to perform the proposed reforms	Open access to information, more accountable institutions, new laws and a new constitution may enhance governance and transparency essential for effective climate change responses.	Good practice examples are available from other countries
Essential Preconditions	Yes, Tunisia's new constitution directly addresses the issues pertaining to environmental natural resources and climate; it also mentions a shift from centralized management model toward allocating more decision powers at the regional and local levels.	Yes	Requires strong coordination among different sectors (health, education, transport, agriculture, energy, etc.) at the national and local levels.
Sustainability	Current government commitment and local communities' participation will strengthen the support for the reforms.	Inter-agency coordination as well as strong coordination between different levels of government and non-government actors is required to ensure the sustainability of reforms.	Strong coordination among various government and non-government actors to ensure effective disaster risk management system.

Annex II: Existing Analytical Work and Key Knowledge Gaps

Selected Studies

Theme	Report	Authors
Growth	The Unfinished Revolution: Bringing Opportunities, Good Jobs and Wealth to all Tunisians (2014)	World Bank Group
	Towards Innovation Driven Growth (2010)	World Bank Group
	Towards a New Economic Model for Tunisia – Identifying Tunisia's Binding Constraints to Broad-Based Growth," 2013	Millennium Challenge Corporation, AfDB
	Overcoming the Binding Constraint to Economic Growth in Post-Revolution Tunisia," 2012,	D. Pickard & T. Schweitzer, John F. Kennedy School of Government, Harvard University
Poverty and Shared Prosperity	Mesure de la pauvreté, des inégalités (2012)	INS, World Bank Group and African Development Bank
	Poverty and Shared Prosperity Diagnostic (2014)	World Bank Group (draft from Poverty GP)
Inclusion (Gender and Youth)	Breaking the Barriers to Youth Inclusion in Tunisia	World Bank Group
Trade/Infrastructure/Logistics	Advancing Tunisia Global Integration (2014)	World Bank Group
Competitiveness/Investment Climate	World Bank Investment Climate Assessment / Enterprise Survey, 2012	World Bank Group
	Investment Code & Framework Regulatory Simplification Bankruptcy Law & Debt Resolution	World Bank Group (IFC)
	IFC Doing Business Indicators, 2014	World Bank Group (IFC)
Financial markets/Access to Finance	FSAP update (January 2012)	World Bank Group
	Modernization of Public Registry MSME Finance MSME finance survey	World Bank Group (IFC)
	Joint IFI Needs Assessment on Local Capital Market Development	Deauville Partnership and Arab Debt Market Development Initiative)
Social Protection and Labor	Labor Policy to Promote Good Jobs in Tunisia	World Bank Group
	Bridging the Spatial Divide: Labor Market Outcomes in Urban Tunisia.	World Bank Group
	Tunisia Pensions Study (2012)	World Bank Group (mimeo)
	Towards Greater Equity: Energy Subsidies, Targeting and Social Protection in Tunisia. Washington DC: World Bank.	World Bank Group (2013)
	Consolidation and Transparency: Transforming Tunisia's Health Care for the Poor. Washington DC: World Bank.	World Bank Group (2013)

Theme	Report	Authors
	Tunisia Social Security Financing Reform and Labor Impacts Policy Note	World Bank Group (forthcoming)
Health	Governance and Productivity: Transforming the Health Sector in Tunisia	World Bank Group (mimeo)
	White Paper (*Livre blanc*)	WHO
ICT	Broadband Networks in the Middle East and North Africa, Accelerating High-Speed Internet Access	World Bank Group (2014)
	Etude de diagnostic pour le développement du haut débit et très haut débit en Tunisie – Proposition de stratégie haut et très haut débit et implémentation de PPPs	Consortium TERA CONSULTANTS (lead member), GIDE LOYRETTE NOUEL, CERT, EUDOXIA Conseil and CJBMI & ass (2014)
	Analyse de la chaîne de valeur TIC	World Bank Group (2014)
Urban and Spatial Development	Tunisia Urbanization Review 2014	
	Poor Places, Thriving People	World Bank Group (2011)
	The Political Economy of Decentralization in Tunisia	World Bank Group (2013)
	Breaking the Barriers to Youth Inclusion World Bank Group (2014)	World Bank Group (2014)
Sustainable Development (water, agriculture, DRM, etc.)	Tunisia Urbanization Review 2014	World Bank Group
	Financial Diagnostic of Office National de l'Assainissement.	World Bank. February 2014.
	Projet National de Sécurisation de l'Alimentation d'Eau Potable (National Potable Water Security Investment Program).	République de Tunisie, Ministère de l'agriculture, des ressources hydrauliques et de la pêche, Secrétariat d'Etat de la Coopération Internationale, Société Nationale D'Exploitation et de Distribution des Eaux. February 15, 2015.
	La gouvernance des services de l'eau en Tunisie – Surmonter les défis de la participation du secteur privé	OECD. June 2014 Études de l'OCDE sur l'eau.

A.1. New Analysis as Input to the SCD

Theme	Analysis	Objective
Poverty and Shared prosperity	Analyses of regional disparities, vulnerabilities and labor markets post-revolution.	To assess the role of employment/wages vs. transfers on income bottom 40 percent
Social and Political sustainability	Citizen participation (voice and accountability)	To assess the degree to which the transitional justice framework addresses legislative and practical gaps in enforcing citizen's rights and government accountability, and improves general access to justice
Jobs	Cross-cutting "jobs" analysis with both supply and demand side constraints and policies	A comprehensive diagnostic of the role of employment (and jobs) in driving shared prosperity and inclusion.
Water	WASH (Water, Sanitation and Hygiene diagnostic)	To assess the extent to which income and regional disparities affect equal opportunities in access to (and quality of) water and sanitation services

Key Knowledge Gaps

The SCD has drawn from existing studies (see Table A for a selection of these studies) as well as undertaken some new analyses (see table A1), specifically: (i) on poverty diagnostics, using two rounds, 2005 and 2010, of the Household Budget Consumption survey; (ii) a comprehensive jobs strategy; (iii) a study on transitional justice; (iv) water, sanitation, hygiene (WASH) and poverty diagnostic; The SCD has also identified areas that are clearly important for achieving progress toward the twin goals but where key data and knowledge gaps currently limit the ability to outline clearer and well-substantiated policy directions. Table B below highlights: (i)) critical data and/or knowledge gaps that cannot be filled immediately, but are crucial to address over time to assist countries achieve their development goals; and (ii) future areas of analysis or research where available evidence is inconclusive.

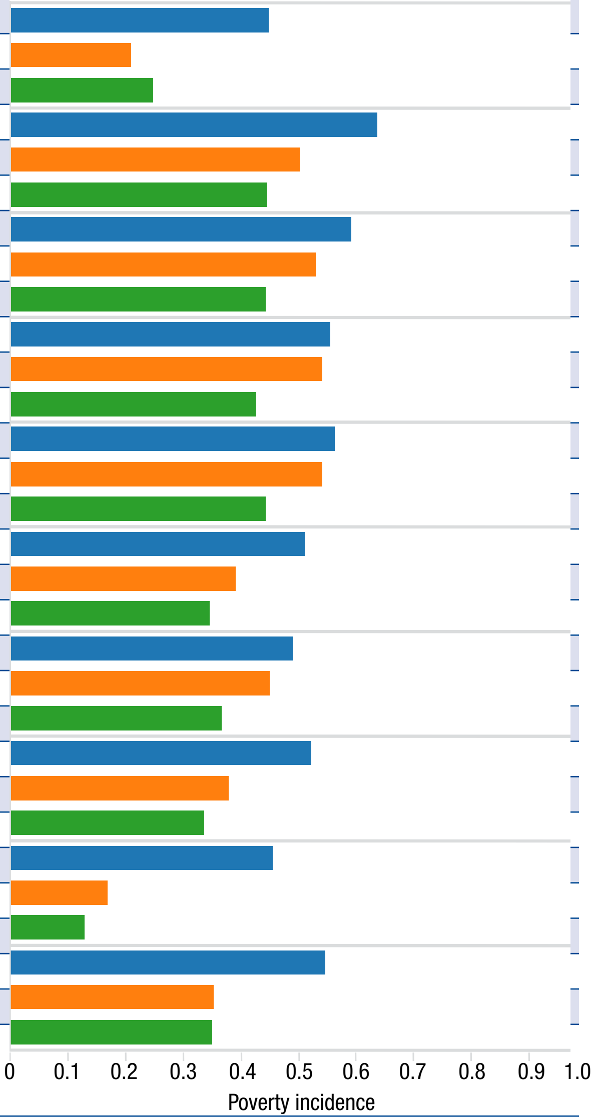
TABLE B: Key Knowledge Gaps

Theme	Knowledge gap	Objective	Prioritization/Status of delivery (or Delivery Risk)
Poverty and Shared prosperity	Deeper analyses of regional disparities, vulnerabilities and labor markets post-revolution.	To assess the role of employment/wages vs. transfers on income bottom 40 percent as well as the main drivers of poverty reduction	High Priority/the forthcoming Tunisia Poverty Assessment will present the most important aspects of the analysis
		Deeper analysis of the contribution of agriculture to poverty reduction and shared prosperity	High Priority
Fiscal sustainability	Debt Sustainability Analysis	To assess fiscal risks and various scenarios of fiscal consolidation	High Priority/high risk to delivery due to lack of access to disaggregated and detailed debt data
Social and Political sustainability	Citizen participation (voice and accountability)	To assess the degree of citizen involvement in the form of increased information, authority or participation	High Priority/medium risk due to the need to identify appropriate tools for the analysis and to engage civil society in the diagnostics
	Gender Assessment	To assess gender imbalances in the areas of economic participation, agency, and social norms, and access to justice in order to identify concrete policy actions to increase social inclusion	High Priority/medium risk related to data access
	Impact of the volatile regional environment, specifically in the neighboring Libya	Attempt an assessment of the social and economic impact of the uncertain situation in Libya, impact on informal trade, and pressures on social assistance	High Priority/high risk related to data availability
Jobs	Sector-specific analysis of job creation potential	To have a comprehensive diagnostic at sectoral level of demand and supply constraints to job creation	High Priority/low risk
Environment and Natural Resources sustainability	Update of cost of environmental degradation in Tunisia Estimate value of ecosystem services Analysis of potential for payment for ecosystem services Update institutional analysis of environmental and natural resources management in Tunisia	Update on contribution of Tunisia's environment and nature resources to the economy.	Low priority/low risk

Annex III: Supplemental Poverty Charts

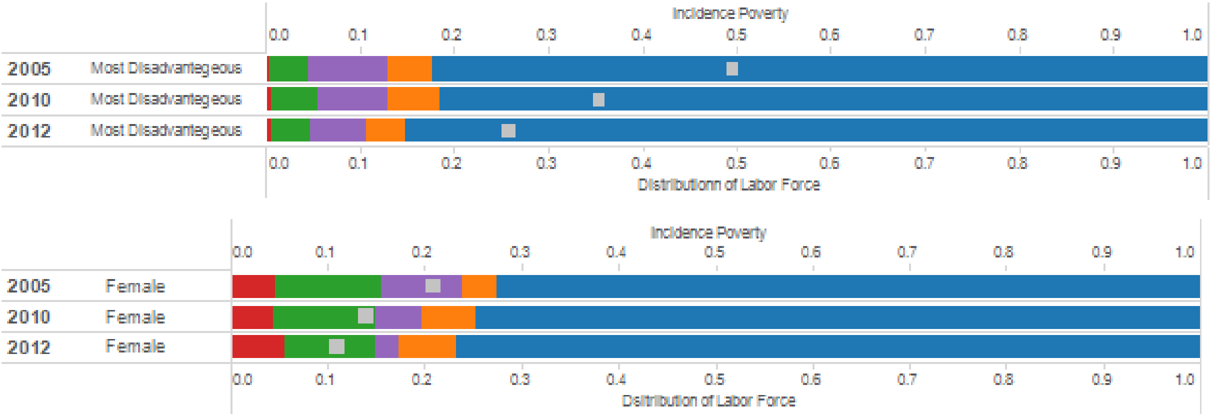
TABLE AIII.1: Poverty Incidence Among Most Disadvantageous Population Groups in Tunisia, 2005–2012

Head educational attainment	Region	Location	Gender	Age group	Year
No education	East	Urban	Female	Under 18	2005
					2010
					2012
	West	Urban	Male	Under 18	2005
					2010
					2012
			Female	Under 18	2005
					2010
					2012
		Rural	Male	Under 18	2005
					2010
					2012
			Female	Under 18	2005
					2010
					2012
Primary	West	Urban	Male	Under 18	2005
					2010
					2012
			Female	Under 18	2005
					2010
					2012
		Rural	Male	Under 18	2005
					2010
					2012
				Over 60	2005
					2010
					2012
			Female	Under 18	2005
					2010
					2012



Source: World Bank (forthcoming) poverty assessment using HBCS 2005 and 2010 and LFS 2012.

TABLE AIII.2: Poverty, Opportunities and Labor Occupations



Source: World Bank (forthcoming) poverty assessment using HBCS 2005 and 2010 and LFS 2012.

Box AIII.1: Revised methodology for poverty estimates

Official poverty and inequality estimates prior to the 2011 revolution were not trusted by the public. The official estimated poverty headcount rate was 3.8 percent in 2005, with the rate in rural regions estimated twice as high, at around eight percent. Poverty rates would reach 13 percent in the most disadvantaged regions, such as the Center-West region These estimates were based on a poverty line of 400 TND per year (equivalent to $0.75 per day), which was considered very low for a country like Tunisia. There was a sense, both from the government side and the public at large, that the methodology behind such estimates warranted a systematic assessment. The Tunisia interim government asked the Bank to review the official methodology for the analysis of the 2010 Household Budget and Consumption Survey (HBCS), which serves as the key input for poverty monitoring in Tunisia, and assess trends using past surveys according to revised methodology. The openness of the transitional Government to revisit the methodology to assess poverty provided a unique opportunity to contribute and build a robust methodology that more accurately represents the reality in the country.

Summary of the revisions. The basis of the estimation of poverty is the data collected by the INS in its National Budget Survey, which includes household consumption data. A "poverty line" is defined which is the minimum consumption expenditure necessary to meet essential needs, including food and non-food items. The estimate of essential food consumption expenditures is obtained by estimating the cost of a food basket that ensures a minimum number of calories essential for meeting energy requirements. This involves two steps. First, the recommended caloric requirement is calculated from the anthropometric data and the level of physical activity in different categories (large cities, small towns, rural areas) reported in the survey. These are in accordance with the calorie guidelines of the WHO. Second, the cost per unit of calorie consumed by the poorest 20 percent of the population is estimated from the survey data. These two estimates are combined to provide a food poverty line. Two alternative estimates are obtained for essential non-food expenditures of the poor. In the first method, the expenditures on non-food items of households with per capita total consumption just equal to the food poverty line are taken. This is added to the food poverty line to give the rock bottom (food and non-food) poverty line. In the second method, the expenditures on non-food items of households with per capita food consumption exactly equal to the food poverty line are taken. This is added to the food poverty line to give the upper threshold of poverty. The poverty line (in terms of consumption per capita per year) was estimated at 1,277 dinars in 2010 in the big cities, 1,158 dinars in smaller towns, and 820 dinars in rural areas. The corresponding estimates for the extreme poverty line were 757, 733, and 571 dinars respectively.

Annex IV: Sector-Focused Diagnostic for Employment Creation

Sector-focus diagnostic (Competitive Industries Initiative)

Context and methodology

Four “*pilot*” sectors were shortlisted with the government: Electronic components, Pharmaceuticals (human medicine cluster), Garments, and IT services. Based on literature review and preliminary analysis, these offered a balanced mixed-basket in terms of value-added and volume of jobs created, potential impact on structural transformation, and contribution to regional development. It must be note that this is not a choice of “strategic sectors,” but a choice of a starting point on larger sector work.

The shortlisted sectors were analyzed based on four lenses that were defined in consultations with the government, the UTICA, and the UGTT: i) Exports profile (volume, complexity, and destination of exports based on the *Product Space* tool by *Haussman et al.*); ii) Impact on employment (volume, quality and adequacy to demand, based on INS and API statistics); iii) contribution to regional development (spatial concentration of firms/jobs in the territory, based on API and INS data); and iv) competitiveness (based on the Competitiveness Diamond methodology by M. Porter).

	Common Constraints	
Access to Finance	• Specially working capital, especially SMEs for garments and IT services	Electronic Components
Labor Regs. & Skills Mismatch	• Inadequately educated labor force (e.g. middle-management in IT services and Electronics), weak collaboration between firms and training centers	Garments
Governance & Institutions	• Inadequate service offering from industrial development agencies • Absence of platform for sectoral public private policy dialogue to respond to specific and evolving needs • Low implementation capacity in line administrations	IT Services
Value Chains/Access to Markets	• Inadequate service offering from export and investment promotion agencies: weak sector/value chain specificity and knowledge among agencies • Limited access to information on export markets • Poor local demand: (1) no pull from public procurement; (2) Onshore-offshore dichotomy preventing development of value chains and B2B exchange	Pharma/ Health Services

	Cluster or Sector-Specific Constraints
Business Climate	• Opaque and slow authorization process (pharma) • Regulatory restrictions: price controls, clinical trials, cap on outsourcing (pharma); regulations on e-commerce, e-payment and mobile banking; customs procedures on hardware (IT services)
Governance & Institutions	• Fragmented regulatory body and public procurement creates market crippling distortions (pharma) • Suboptimal coordination among firms / professional associations (garments, pharma, electronics)
VC/Access to Markets	• Bottlenecks related to quality conformity: high costs of certification and testing, compliance with EU norms (electronics, IT services)
Labor Regs. & Skills Mismatch	• Labor behavior: strikes and attendance (garments)

(continued on next page)

Sector-focus diagnostic (Competitive Industries Initiative) *(continued)*

The analysis and subsequent policy recommendations were developed based on structured public private dialogue (PPD) where key actors in each sector (circa 120 in all four sectors) are invited to participate to the diagnostic, the elaboration of a concrete action plan, and the implementation thereof. The PPD is nurtured by technical analysis notes by the World Bank and external consultants.

Conclusions of the Diagnostics phase

The objective of the diagnostics phase was to prioritize constraints to competitiveness and growth base on their severity (through PPD). Three categories of constraints were finally identified: a) economy-wide, or "horizontal," constraints that weigh in heavily on the analyzed sectors (or most); b) "vertical" constraints that are common to studied sectors/clusters but that can only be effectively tackled through sector/cluster-specific reforms and actions; and c) "vertical" constraints that are cluster/sector specific.

The most prominent examples of economy wide constraints that are particularly binding in the analyzed sectors include: i) Severe lack of access to finance, particularly for working capital; ii) low implementation capacity of the government and administrations; iii) the ramifications of the onshore/offshore regime, that prevent the development of competitive value chains in Tunisia by complicating B-2-B exchanges between offshore firms, or between onshore and offshore firms; iv) low level of soft, cognitive, and behavioral skills due to a decaying basic education system; and v) the bottleneck that the Rades Port has become, hindering flexibility and reactivity to the market.

The following chart illustrates some of the "vertical" constraints, common to various sectors or specific to any, in terms of their relation to the economy wide constraints identified in the SCD.

Sector Note on Tourism in Tunisia[131]

Tourism is important for jobs and foreign exchange earnings in Tunisia. The sector directly employs over 400,000 people across the value chain of 230,000 hotel rooms and roughly 190 tour operators and travel agents. An additional estimated 300,000–400,000 are employed in a range of ancillary and supporting services such as restaurants and bars, taxis, and a range of retail outlets, such as tourist bazaars, linked to the tourism sector. This value chain is a lifeline in many parts of Tunisia. The sector accounts for six to seven percent of GDP and about 15 percent of foreign-currency earnings. In 2012, headline indicators showed signs of gradual improvement although data from the World Trade Organization indicated that the rebound was overstated and affluence of tourists remained well below pre-revolution levels. The current situation, following the improvement in political and social stability, offers the opportunity to look at the sector's variety of structural problems and seek ways to address them by capitalizing on opportunities.

Tunisia is a viable and attractive tourist destination, however, the sector is crippled by structural failures that will limit its future growth and economic potential. First, the sector has for the past four years been affected by the unrest following the revolution in January 2011, the continuing political uncertainty in the region, and the protracted crisis in the Eurozone. Underlying these externalities are structural failures in the sector as a result of its tourism policies and market focus. Tunisia is an example of rapid development of a classic mass tourism coastal destination. The core product is "3S" (sun, sand and sea) and over 80 percent of visitors are Europeans coming on tour operator packages. Tunisian tourism developed remarkably rapidly, from just 4000 beds in 1962 to nearly a quarter of a million today, and with over six million arrivals in 2014 it is the third most visited destination in Africa (after Egypt and South Africa). Tourism development was initiated by the government with a series of incentives for hotel construction, and has been implemented mainly by the Tunisian private sector, with substantial support from the banking sector. In the eighties and nineties tourism boomed and Tunisia became firmly established as a cheap beach destination attracting budget tourists, but totally reliant on European tour operators. Cheap credit, incentives,

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[131] Sources: 2011–2014 World Tourism Organization Reports, Economist Intelligence Unit, and IFC-collected data and analysis (2012–2014).

and quick returns to investors fueled an over-supply of mass market beach hotels many of which were built by "investors" rather than "hoteliers." While initial efforts to create a larger hotel offering were successful, the sector has remained trapped in a monoculture and monopoly of low added-value 3S package holidays catering to middle-income clients in Europe, and more recently in Eastern Europe. Economic benefits, particularly employment and revenues, have remained low relative to the number of tourists and the number of hotel rooms, and quality of service has also remained unsatisfactory due to weak professional training. Weak tourism policies have subsidized less qualified investors and made issues with NPLs more widespread and chronic, while poorly planned tourism developments have resulted into damages to the environment, including on the isle of Jerba.

The opportunity to revitalize the sector can sustain a path to job creation and economic growth. In the short term, given the improvement in the security and political situation, the relative cheapness of Tunisian package holidays could help to attract cash-strapped visitors from western Europe, in addition to those from eastern Europe, notably Russia, Poland, and the Czech Republic. The Open Skies Agreement negotiated with the EU can also open up Tunisia to low-cost airlines and help tourism to grow. In the longer term, however, Tunisian tourism will continue to perform below its potential unless it overcomes its long-standing structural problems. An ambitious action plan is needed to restructure both the debt and underlying assets on a large scale (an AMC seems to be the best way to go but political sensitivity is slowing down the reform process). This action plan also requires a broad-based legal and regulatory reform of the insolvency regime (a draft bankruptcy law is pending Parliament approval). There is also the need to modernize the tourism sector governance (in particular the reform of the ONTT, the public agency in charge of tourism sector promotion). Furthermore, while diversification and innovation in the tourism business model are quite urgent, also the capacity of attracting new capital and management capable of offering higher quality and diversified products come at a very high position in the ranking of priorities.

Sector Note on Agribusiness in Tunisia[132]

Agribusiness is one of the leading industrial sectors in Tunisia. With about 1,000 private companies it contributes to about three percent of GDP and employs more than 70,000 people. Since the beginning of the 1990s, the sector has witnessed a fast modernization to respond to the local demand's needs and the growing power of supermarkets, and to resist to the fierce competition of imported products. In this context, the PMN (Programme de Mise à Niveau, EU 960 million) has been aiming at lifting up the quality, productivity, and management's levels of Tunisian companies with the aim to align their compliance with norms and regulations of EU markets. In line with this, Tunisia has also significantly strengthened its expertise in the organic agriculture sector in recent years, including by improving synergies with research centers and key main players.[133] In addition, in recent years an innovative techno-pole dedicated cluster specializing in food industry was created in the north of the country.[134] The agribusiness sector has benefitted from investment

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[132] Sources: National Data: http://www.tunisieindustrie.nat.tn/fr/download/CEPI/mono_iaa.pdf,

[133] Already, some key players like Danone and Poulina groups have incorporated into their production system innovative biotechnological applications.

[134] Examples of benefits of the Investment Code include: 10 years of tax exemption on profits, payment of tax at a reduced rate of 10 percent from the 11th year for export revenues and agricultural projects, the possibility of the sale on the local market for 30 percent of sales agricultural export business with payment of the required duties and taxes.

incentives[135] through the Investment Code. However, a number of constraints have remained and currently indicate a risk that will limit progress and growth in the industry.

The key constraints for the agribusiness sector include market failures, artificial market protection, underdeveloped production supply and processing capacity, and weak strategic planning for export development. Market failures are caused primarily by horizontal segmentation of the subsectors, government-regulated pricing policies, and frequent state intervention into private sector matters. In turn, horizontal segmentation is due to the lack of direct communication within the different actors in a subsector and the lack of incentives to communicate important market information. Some artificial market protection has also historically been established through import tariffs and quantitative restrictions, the government control of some marketing channels, and the dominant market positions of inefficient parastatals. These have combined to provide price umbrellas and remove the incentive for many firms to become more efficient and competitive. On the supply and processing side, major constraints appear in land supply, technology adoption, working capital, packaging, and management capacity. These limit the ability of the Tunisian agribusiness sector to exploit potential resources and maximize economic activity. Lastly, there has been weak strategic planning for export development at both state and private sector levels.

Opportunities in agribusiness are crucial for Tunisia, particularly with respect to selected products, including olive oil, dates, and fresh fruits.[136] With 70 million rain-fed olive trees and 1.6 million hectares of arboricultural land for olive oil, Tunisia holds the second widest surface in the world (19 percent of global surface). Currently, Tunisia produces about 172.000 tons of olive oil per year, with 127.000 tons for exports. This subsector offers 20–40 million labor days per year and plays an undeniable ecological role in terms of preserving the soil against desertification. The olive oil sector contributes with about 15 percent of the value of the final agricultural products and 45 percent of the total agricultural exports. By upgrading drip irrigation, soil preservation, and technology of olive oil mills, the sector could increase productivity, while further support to olive oil production to export packaged and branded products would improve competitiveness, provide more value added, and increase job creation. Dates production comes at the second place, following olive oil, with 16 percent of agribusiness exports. In the country there are about 5.4 million palm trees including: about 3.5 million of the more prestigious Deglet Nour variety (65 percent). Every year, some 60,000 Tunisia farmers produce about 190.6 thousand tons of dates, about half for exports. The dates subsector provides opportunities for job creation and improved export offerings, assuming the size of plantations are improved and more integration with value added products (e.g. dates pasta for energy bars) is achieved.

Lastly, Tunisia should further capitalize on its strategic geographical position. Tunisia sends her products to about 138 export destinations. Among the major markets and initiators of business ventures remain those of the European Union (Italy, France, and Spain). New destinations included the US, Canada, Russia, Japan, other Middle East countries and Sub-Saharan Africa (Niger, Senegal and Ivory Coast) where agriculture and food security remain crucial issues. Latin American countries, particularly Brazil, have recently shown interest in partnering with Tunisia, including on cereal production. Other segments deemed strategic could be dairy and meats.

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[135] Located in the north, the Competitiveness Cluster of Bizerte houses the Technology AGRO'TECH food, which extends over 45 ha located precisely in Menzel Abderrahman. The division also 3 higher institutes and one national school engineers. As part of the national industry promotion strategy food, it specifically targets 9 sectors considered priority: olive oil, canned fish and seafood, cheese, cereals and derivatives, potato and derivatives, wine, fruits and vegetables, and conservation food products. Furthermore, the pole also has an industrial space 112 ha for the sale. To date, the network has 30 partners AGRO'TECH (23 Tunisians and 7 foreigners) and a core of industrial consists of over 100 companies. The goal is to leverage both national partners continually foreign.

[136] IFC has available data on olive oil and dates. Fresh fruit needs further research.

Sector Note on Healthcare in Tunisia

Over the past six years, spending for health care in Tunisia has grown, due to increasing public spending, particularly with respect to public health insurance through the Caisse National d'Assurance Maladie (CNAM), which patients use to pay for both public and private sector services. This led to a reduction in out-of-pocket spending as well as improved affordability and access to health care. At $2.8 billion, total healthcare spending is currently at 5.7 percent of GDP, up from 5.3 percent in 2008, half of which is sustained directly by the private sector. Over time however, the public sector capacity has remained almost flat in concomitance with a period of major political change in the country and in the administration of government, which caused a lot of delays the public sector. In parallel, private sector capacity has continued to expand, including with respect to infrastructure. In addition, Tunisia has more developed health care services than either of its big neighbors, Libya and Algeria, and private Tunisian clinics and other health providers have been experiencing a rising number of Libyan and Algerian patients, including an estimated half million or more Libyans who now reside permanently in Tunisia.

Despite good opportunities for growth, the health care sector has been facing key challenges. The shortage of construction materials and lack of qualified labor has led to price inflation and project delays in the whole country. Protracted periods of protest and civil unrest, more lucrative post-conflict reconstruction in Libya, as well as significant migration of Libyans to Tunisia have contributed to a slow down of the pace of construction of health care facilities. Futhermore the sector has suffered from an increased complexity of regulatory environment and delays in decisions for licenses and construction permits, due to the turnover in the political and administrative arms of government, and less experienced civil servants. Additionally, the regulations put in place by the Ministry of Health during 2011–13 have posed further constraints to private sector health development, by limiting the acquisition of important medical equipment, including PET/CT scanners, a type of latest-generation medical imaging used mostly for cancer diagnosis and treatment.[137] Nonetheless, private sector health service capacity has been expanding to meet the demand, which has continued to outstrip supply in both public and private sectors. This expansion, however, took place for the most part in Tunis and a few other cities, including Beja and Monastir.

Despite the challenges in the health sector, Tunisian private health care is expected to continue to grow and increasingly become a valuable partner to the public health care system. Current trends show that the private sector has been expanding its role of health care "provider" by making substantial investments in health care infrastructure, while the public system has been expanding its role of health care "purchaser." Although the current regulation climate is less favorable to private healthcare than it was prior to the events of 2011, recent changes in the Government of Tunisia are expected to bring about policy shifts in favor of the private sector. The expansion of private health care in Tunisia could also benefit from health tourism. Tunisia already receives significant numbers of patients from Algeria and Libya due to having more developed health services. Tunisia also receives some patients from francophone Sub-Saharan Africa. A smaller proportion of health tourists also come from Europe (mainly France and Italy) for cosmetic surgery. This is in keeping with health tourism trends in many other countries that receive such patients: the majority, over 80 percent typically, travel to seek better care than is available where they live and a smaller group seeks lower cost care. Thanks to its strategic geographic position and its African location and proximity to Europe, with educated professionals and private clinics, Tunisia has potential to grow as a regional destination for health care and health tourism, contributing to growth of the Tunisian economy.

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[137] PET/CT licenses have been reserved for the public sector, but the public sector doesn't have the funds to buy the equipment, so Tunisia simply has no PET/CT, resulting in lower treatment quality for patients. Several private players would be willing to make the investment if the government would permit them.

Annex V: A Historical Perspective on the Political Economy of Reforms

To a great extent, the period after the country's independence in 1956 can be divided in three stages: (i) the post-independence time under President Bourguiba through 1987; (ii) Ben Ali era from 1987 to 2011 and (ii) the 2011 onwards post-Arab Spring time, with a new Constitution and a renewed social dialogue.

Post-Independence Until 1987

Bourguiba and the Concentration of State Power

A leader of the anti-colonial movement and first president of an independent Tunisia, Bourguiba is often remembered for his secular and progressive reforms. However, it is also during these years that the high level of state intervention was carved. Bourguiba's earliest policies focused on female emancipation, public education, family planning, a modern, state-run healthcare system, and a national campaign to improve literacy. Yet over his 30-year rule, Bourguiba also oversaw the steady concentration of political power and decision-making. In 1963, all political parties other than his Neo-Destour Party were outlawed, and in 1975 the Tunisian National Assembly voted Bourguiba president for life.

Along with the concentration of decision-making, the centrally driven development model meant a high level of state intervention in all aspects of the economy. At independence in 1956, Tunisia lacked the basic elements of a functioning economy. Bourguiba embarked on a project to build the country's infrastructure and create the administrative and financial institutions of a modern state. One of the priorities was to move the economy away from reliance on natural resources, agriculture and mining, toward industry and manufacturing. In line with his secular outlook, and to undermine any potential rival center of power, Bourguiba also nationalized various religious land holdings and dismantled several religious institutions. State banks, a general insurance company, as well as a variety of state run companies were established in commerce, transportation, mining and all other major sectors. These efforts produced significant achievements, despite a difficult external environment, but resulted in the public sector controlling large segments of the economy and preventing the emergence of the private sector.

Economic Liberalization (1970–1980) Followed by an Economic Standstill (1980–1987)

Following the failure of a five-year experiment with a socialist economic model, and the threat of social unrest, Bourguiba changed course and became one of the Arab world's earliest proponents of economic liberalism. The main steps of the economic program include the introduction of the Investment Code, which, despite amendments is still the framework currently in place. It offered major financial incentives and tax relief for foreign investors and the initial privatization of some state owned enterprises. While the program delivered results in both growth and job creation, family members and business partners of the regime appeared to enjoy a disproportionate share of the profits. This link between government and business, and the extraction of profits by privileged insiders, became a pattern in the process of liberalization later reached an even much larger scale under the successor Ben Ali regime.

The push to open up the economy was undermined by the fact that the government continued to exercise extensive control and key sectors were still heavily restricted. As continues to this day, prices were still largely administered, the financial sector entirely managed by the government and the most lucrative parts of the economy protected by very high custom taxes and import restrictions. Further, the new, flourishing export-oriented enterprises were concentrated in a small number of regions, thus increasing regional disparities and encouraging urbanization and migration to the Tunisian North-East. By the mid-70s, the liberalization program met with resistance from the trade unions, with the main trade union, UGTT, demanding job guarantees and salary adjustments. This led to a general strike in 1978, which the government was successful in breaking down, though at the cost of growing political repression and autocratic drift.

By 1980, Tunisia faced the dual challenge of an economic slowdown coupled with internal instability, and looked for foreign support as a remedy. Tunisia was deeply in need of investment finance as the three different income resources of the 1970s, namely domestic oil revenues, labor remittances, and foreign borrowing withered**.** In a sign of how dependent Tunisia was on remittances, and in turn how vulnerable to external actions, the sudden decision by Libya to expel tens of thousands of Tunisian workers in 1985 pushed the country into further socio-economic instability. The rise of the "Movement of the Islamic Tendency," (currently Ennahdha), inspired by the Iranian revolution and the Egyptian Muslim brotherhood presented yet another challenge. Tunisia stood at the brink of a political and economic crisis. The country turned to the IMF for support, but much like today the economy was in urgent need of restructuring, with the dominant social forces unwilling to initiate changes that might affect their privileges and diminish their political control.

The implementation of the structural adjustment program in late 1980s represents a turning point in economic policymaking in Tunisia since its independence. This program was aimed at: (i) preserving the stability of the macroeconomic framework and financial balances, (ii) integrating Tunisia into the world economy, (iii) redistributing income by reconciling social and economic policies; and (iv) reducing poverty and broadening the "middle class" group. The reforms were expected to boost economic growth that would trickle down to the population, in order to improve income levels and employment.

Ben Ali Era (1987–2011)

The Constitutional Coup and the Beginning of the "Economic Success Story"

Ben Ali's era was marked by high economic growth and prudent macro-economic management as well as social and political stability at the high price of repressed civil liberties. After his constitutional coup to

Box AV.1: Social policy under Ben Ali as a regime's tool for cementing legitimacy and control

A common feature of Tunisia's development model under Ben Ali was the strong commitment to social spending. The level of public expenditure for social policies remained consistently high, at around 19 percent in 1987–2005 (Ben Romdhane, 2007). In particular, spending on education and health doubled during the 1986–2002 period, while expenditure on social welfare increased by 214 percent. Where necessary, reductions in social spending on food subsidies (by 52 percent over 1986–2002) were compensated by increases in the minimum wage (ibid.). In addition to the National Programme for Aid to Needy Families created in 1986 to help the poor, Ben Ali also established two social programs, the National Solidarity Fund, also known as: 26-26: (1992) and the National Employment Fund, dubbed: 21-21: (2000), to improve basic infrastructure in deprived areas and promote employment opportunities. The population coverage of social security also saw remarkable progress over the years, being among the broadest in the Arab world (approximately 85 percent of the population).

While improving Tunisians' welfare, social policy was, first and foremost, an instrument of power and control in the hands of the regime (Hibou, 2006; Ben Romdhane, 2007, Paciello 2011). The ruling party itself directly approved the list of families that benefited from state social services, using the generous social policies to compensate for the lack of civil and political liberties. Social policy thus served to discourage the emergence of a democratic order insofar as most Tunisians were willing to accept the lack of political freedom as the price to pay for socio-economic development and welfare (Ben Romdhane, 2007). Through the massive reduction of income poverty, the regime was also able to reduce the risk of social tensions, eventually inhibiting the chances for Islamists to gain terrain in poorer areas (Harrigan & el-Said, 2009). However, during Ben Ali's ruling, many of the resources that were originally designed to improve people's welfare, as the above mentioned funds, went unaccounted for and were distributed through clientelist networks (Kallander, 2011) by the ruling party (RCD)

seize power, Ben Ali at first introduced a limited political opening, allowing other parties to compete in elections. This opening however was quickly reversed, after the presumed electoral success of Ennahdha in 1989. This prompted a repressive campaign against the Islamist party.[138] Ben Ali's success in suppressing Islamists, along with his pro-western foreign policy, has moderated Western criticism of what some have characterized as Tunisia's slow pace in improving democratic practices. The positive image conveyed by Ben Ali ensured a stable increase in GDP growth through trade relations with the European Union,[139] a revitalized tourism industry, and sustained agricultural production. For a time, many of the country's political forces were aligned with Ben Ali's project, as they welcomed the economic revitalization.

The Constitution, a New Social Dialogue and Political Trends

Process Toward a New Constitution

Following a period of social and political instability immediately after the revolution, the compromise and consensus enshrined in the Social Agreement—*Pacte social*—paved the way for the drafting of the new constitution. The launch of a Social Dialogue and the signing of the Social Pact in 2013 between the Ennahdha-led government, the parliamentary opposition, mediated by the Labor Union (UGTT) and the Tunisian Trade, Industry and Handicrafts Union (UTICA), which committed the different political factions to work together in a Unity Government for the socio-economic reforms and transformation needed to guarantee peace and stability for the period 2012–2014. The pact covers industrial relations and social protection,

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[138] This campaign forced their leader, Rached Ghannouchi to flee overseas.

[139] A key pillar of Ben Ali reforms program had been the integration of the Tunisian economy into the world economy, together with action to reinforce competitiveness. The liberalization program saw an important step with the country's accession to the WTO in 1995 and the implementation of a number of free trade agreements (FTAs) with main partners. The association agreement with the European Union (EU), which began to be fully implemented in 2008, represents the major trade agreement signed by Tunisia. In parallel, a host of programs and economic policy actions aiming at reinforcing competitiveness were committed during the same period. They sought the consolidation of tax and financial legislations reforms; more deregulation of investments, trade and prices; rebalancing of the roles of the public and private sectors; modernization in the administration of the financial and banking systems; improvements in infrastructure; and development of human resources and upgrading of firms and production sectors.

Box AV.2: Achievements under the new Constitution

While Tunisia's new constitution names Islam as the country's religion, it guarantees freedom of worship, a secular rule of law, confirms women parity in political bodies, and lists a number of rights including that of access to information. Its main achievement is its social orientation, the broad scope of political, personal, social, human and civil rights and the regulation of the relationships between government branches. Particular attention is paid to preserving and further guaranteeing women's rights, and the equality of female and male citizens is proclaimed in Article 21. The Tunisian constitution also affirms Tunisia is a "civil state," confirms the right to conscious and limits the parliament in restricting freedoms and fundamental rights, especially through the newly created constitutional court (Article118). In view of the former authoritarian regime, Article 32 asserts "The state shall guarantee the right to information and the right to access to information…" Tunisian civil society, with the support of international institutions, strived to ensure access to information was recognized as a prerequisite for transparency and accountability of the government, allowing citizens to make informed choices, and safeguarding them against mismanagement and corruption.

Also, the inscription of Chapter Six in the constitution is an effort to further guarantee the check and balance processes. The five Independent Constitutional Committees (Articles 125–130): independent regulation bodies for the elections; media; human rights; sustainable development and rights of future generations; and good governance and anti-corruption not only secures a number of rights and freedoms that were, for the mot part, flouted since independence, but also results in the President of the country not holding office for more than two five-year terms (Article 75). The article also states "The number and duration of Presidential terms may not be amended or increased."

employment and vocational training policy, and underlines the importance of social dialogue as a genuine pillar of a democratic transition toward greater social justice.[140] The general agreement is that the constitution represents a compromise between all political fronts.[141] Extensive deliberations were held especially around the topics related to the national identity of the country, the place of Islam, the definition of rights and freedoms, and the equality between men and women. It took more than two years to complete every article of the new constitution. Civil society (including trade and business unions) was very vigilant and influential during the drafting process. Over 6,000 citizens, 300 civil society organizations, and 320 university representatives provided input to a nationwide dialogue on the constitution. The document was approved, in the end, by an overwhelming 200 of Tunisia's 216-member NCA. The finalization of the constitution has established and created a space for "public debate" that has not previously existed in Tunisia.

Tunisia's Present Political Landscape

The recent elections resulted in a politically heterogeneous government, but also clear economic and social priorities and agenda. Nida Tounes won the largest number of votes in both the parliamentary and presidential elections of 2014. It was not a decisive victory, however, as Ennahdha retained significant pockets of support in the center and south of the country. Nida Tounes ended up with a majority in the parliament, with 86 seats as opposed to Ennahdha's 69, and the control of the presidency and the right to nominate the new prime minister. In the formation of the new government, the lack of a clear majority forced Nida Tounes to seek a consensus among the other parties. The new prime minister was a consensus figure and the rest of the cabinet is drawn from a range of political parties to ensure a parliamentary majority. On economic themes, there is strong coherence among the different parties on reforms and the best model for Tunisia. Yet the political heterogeneity of the new government was the source of some controversy, especially around the inclusion of Ennahdha, as one of the primary organizing principles of Nida Tounes was its opposition to the Islamist

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[140] It also highlights the UGTT's pivotal role, for a long time suppressed under the former regimes, in the construction of a new Tunisia.

[141] Essentially between Ennahdha, who had a total of 85 seats out of 217 within the National Constituent Assembly, and the other political parties with more secular tendencies.

party. More recently, criticism has quieted in the face of the new government's unprecedented approach to governing. An energetic program has been launched of visiting economically disadvantaged regions, holding ministerial meetings in situ and making decisions on concrete actions, and including civil society and media as meaningful participants. The focus on addressing priority needs has so far not presented any challenges to the delicate political consensus. It remains to be seen if the current unity around immediate actions will serve as a solid foundation for the implementation of major reforms. A crisis related to security, another of the government's priorities, and spillovers from the Libyan conflict could exacerbate the still palpable political divisions and put a strain on political unity.

Still empowered by the revolution, and with rights consolidated in the new constitution, citizens continue to be an active and vocal social force. There is immense expectation on the part of citizens that the government will address the many root causes of the revolution. Along with consecrating individual rights, the constitution also enumerates a number of government responsibilities, which the new government is striving to deliver on. The first actions have been focused on lagging regions. The prime minister is visible throughout the country at present, and his visits on the whole have been welcome. This sets the stage for rebuilding the trust between citizens and the state. Ministerial meetings have identified and agreed upon specific actions for the development of each locality visited. Social stability will depend critically on the ability of the current government to listen to and communicate with citizens and to ensure that any action taken on the identified priorities is recognized by the population as a step forward toward a more inclusive development model.

Annex VI: The Social Progress Initiative

The Social Progress Imperative is a non-profit organization that has elaborated an index for social progress to be used alongside GDP per capita as a key measure of the success of a country. The ultimate objective is to inform governments, businesses and civil society organizations by reframing how the world measures success-putting the real things that matter to people's lives at the top of the agenda. The Social Progress Index offers a framework for measuring the multiple dimensions of social progress, alongside three dimensions: Basic Human Needs, Foundations of Wellbeing, and Opportunity (see figure below).

The first dimension, Basic Human Needs, assesses how well a country provides for its people's essential needs by measuring whether people have enough food to eat and are receiving basic medical care, if they have access to safe drinking water, if they have access to adequate housing with basic utilities, and if they are safe and secure. Foundations of Wellbeing measures whether a population has access to basic education, ICT infrastructure (mobile, internet ideas and information from both inside and outside their own country), and if they have more than basic healthcare and can live healthy lives. This dimension also measures a country's protection of air, water, and land, resources critical for current and future wellbeing. The final dimension, Opportunity, measures the degree to which a country's population is free of restrictions on its rights and its people are able to make their own personal decisions, and whether prejudices or hostilities within a society prohibit individuals from reaching their potential. This dimension also includes the degree to which advanced education is accessible to all those in a country who wish to further their knowledge and skills. Advanced education unlocks almost unlimited personal opportunity. The Social Progress Index framework is that it integrates Opportunity, an aspect of human wellbeing that is often ignored or kept separate from more foundational and material needs such as nutrition and healthcare, into the definition of social progress. Together, this framework aims to capture an interrelated set of factors that combine to produce a given level of social progress. Social Progress Index scores at the overall, dimension, and component levels are all based on a 0–100 scale. This scale is determined by identifying the best and worst global performance on each indicator by any country in the last 10 years, using these to set the maximum (100) and minimum (0) bounds

Social Progress Index		
Basic Human Needs	Foundations of Wellbeing	Opportunity
• Nutrition and basic medical care • Water and sanitation • Shelter • Personal safety	• Access to basic knowledge • Access to information and communications • Health and wellness • Ecosystem sustainability	• Personal rights • Personal freedom and choice • Tolerance and inclusion • Access to advanced education

The Social Progress Index measures and benchmarks Tunisia with respect to other countries in the world. From this index and its sub-components, it shows how Tunisia has scored relatively low with respect to its income-peers in terms of social progress (scoring less than 44 out of 100 and ranking 90th out of 132 countries). This is due mostly to the lack of opportunities (defined as access to higher education, tolerance, inclusion) and personal freedom. While basic needs have been fulfilled, access to basic services continues to be under-achieved.

SOCIAL PROGRESS INDEX RANK: 69/132
GDP PER CAPITA RANK: 67/132

TUNISIA

Basic Human Needs	**Score (100)** 77.72	**Rank (132)** 56	🟨	**Foundations of Wellbeing**	**Score (100)** 66.76	**Rank (132)** 77	🟨	**Opportunity**	**Score (100)** 44.39	**Rank (132)** 90	🟦
Nutrition and Basic Medical Care	**93.31**	**58**	🟨	**Access to Basic Knowledge**	**91.07**	**70**	🟨	**Personal Rights**	**51.02**	**75**	🟨
Undernourishment			🟨	Adult literacy rate			🟦	Political rights			🟨
Depth of food deficit			🟩	Primary school enrollment			🟩	Freedom of speech			🟨
Maternal mortality rate			🟨	Lower secondary school enrollment			🟨	Freedom of assembly/ association			🟨
Stillbirth rate			🟨	Upper secondary school enrollment			🟨	Freedom of movement			🟨
Child mortality rate			🟨	Gender parity in secondary enrollment			🟨	Private property rights			🟨
Deaths from infectious diseases			🟨								
Water and Sanitation	**82.67**	**63**	🟨	**Access to Information and Communications**	**59.5**	**73**	🟨	**Personal Freedom and Choice**	**64.30**	**76**	🟨
Access to piped water			🟨	Mobile telephone subscriptions			🟨	Freedom over life choices			🟨
Rural vs. urban access to improved water source			🟨	Internet users			🟨	Freedom of religion			🟦
Access to improved sanitation facilities			🟨	Press Freedom Index			🟦	Modern slavery, human trafficking, child marriage			🟩
								Satisfied demand for contraception			🟨
								Corruption			🟩

(continued on next page)

(continued)

SOCIAL PROGRESS INDEX RANK: 69/132
GDP PER CAPITA RANK: 67/132

TUNISIA

Shelter	**72.49**	**56**	🟨	**Health and Wellness**	**78.47**	**25**	🟨	**Tolerance and Inclusion**	**36.01**	**112**	🟦
Availability of affordable housing			🟦	Life expectancy			🟨	Women treated with respect			🟩
Access to electricity			🟨	Non-communicable disease deaths between 30 and 70			🟩	Tolerance for immigrants			🟨
Quality of electricity supply			🟨	Obesity rate			🟨	Tolerance for homosexuals			🟨
Indoor air pollution attributable deaths			🟨	Outdoor air pollution attributable deaths			🟨	Discrimination and violence against minorities			🟨
				Suicide rate			🟨	Religious tolerance			🟨
								Community safety net			🟦
Personal Safety	**62.41**	**64**	🟨	**Ecosystem Sustainability**	**38.02**	**108**	🟦	**Access to Advanced Education**	**26.24**	**96**	🟦
Homicide rate			🟨	Greenhouse gas emissions			🟨	Years of tertiary schooling			🟨
Level of violent crime			🟨	Water withdrawals as a percentage of resources			🟨	Women's average years in school			🟦
Perceived criminality			🟨	Biodiversity and habitat			🟦	Inequality in the attainment of education			n/a
Political terror			🟩					Number of globally ranked universities			🟨
Traffic deaths			🟨								

🟩 Relative strength 🟨 Neutral 🟦 Relative weakness

Strengths and weaknesses are relative to 15 countries of similar GDP:

Ecuador, Thailand, Albania, Dominican Republic, Azerbaijan, China, Colombia, Macedonia, Peru, Algeria, Armenia, Bosnia and Herzegovina, Serbia, Jamaica, and South Africa

SOCIAL PROGRESS IMPERATIVE
www.socialprogressimperative.org

Source: http://www.socialprogressimperative.org/data/spi.
n/a = no data available.

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