



## 1. AN OVERVIEW OF THE GENERAL MACRO-ECONOMIC CONTEXT IN TUNISIA

Tunisia has, since 1986-87, been engaged in a programme of liberalization and structural adjustment intended to establish market mechanisms and freedom of domestic and foreign trade, to encourage private initiative, and to activate the privatization of public enterprises.

This policy of liberalization and openness which has been followed for nearly ten years now has already produced the following results:

- q Resumption of growth: +4.5% per year between 1987 and 1996, despite four years of drought.
- q Improved competitiveness: exports have increased at an annual rate of 6.75%, and accounted for 43% of GDP in 1996.
- q A sound financial situation: the budget deficit was brought down to 3.8% of GDP in 1996 after reaching a high of 6% in 1986, and service on the debt was reduced to 17.7% of export proceeds, after peaking at 28% in 1986.
- q Lastly, improved living conditions and an improved standard of living: today, Tunisia's middle class represents 60% of the population, with only 6.7% of the population afflicted by poverty, compared with 11% in 1985.



## 2. THE FREE-TRADE AGREEMENT WITH THE EUROPEAN UNION

Tunisia is now moving away from protectionism and industries that substitute for importation, adopting a new development strategy oriented towards development pattern intended to assure its integration into a global economy through exportation and the achievement of greater competitiveness.

Tunisia was the first country of the southern Mediterranean to sign a free-trade agreement with the European Union. Furthermore, it did so only a few years after joining the GATT, which subsequently became the World Trade Organization.

The orientation towards gradual integration into the world economy is now considered irreversible in Tunisia. The establishment of a free-trade zone with the EU (Tunisia's first economic and commercial partner) is considered to be a means for gaining a firmer foothold in the world economy.

The establishment of a free-trade zone with the EU is an element in the logic of expanded structural adjustment of the Tunisian economy, and is perceived as an opportunity to confirm and intensify efforts that began in 1986-87, and to induce substantial transmittal of growth.



This rooting in a more highly developed economic area, joined with the potential effects of synergy and emulation that will result from confronting such an area, should in the medium term draw the economy upward towards competitive reconversion and greater economic efficiency.

The success of this free-trade zone will depend upon one fundamental element, Tunisia's ability to generate high growth rates; Only by this means can the country meet the challenges involved in improving the standard of living and decreasing unemployment, against a background of dwindling budgetary resources and growing job demand.

The effects of the free-trade zone with Europe are well known. First, dismantling of tariffs will lead to a drop in budgetary revenues. The cumulative shortfall in the state budget over twelve years is estimated at approximately 4 billion dinars.

Second, the Tunisian industrial fabric will have to reconvert itself, abandoning activities which cannot meet international competition and effecting a strategic repositioning of other activities.

Lastly, there will be a strengthening of the share Europe represents in Tunisia's foreign trade; it is estimated that the European Union's share in Tunisian imports and will increase by two points.



The potentially favourable effects of the creation of a free-trade zone on manufactured products can only be indirect. They should result from improved competitiveness, associated with lower prices for inputs imported from the European Union and possibly also from adjustments towards better productiveness generated by the removal of protection of the national economy.

The most direct advantage that Tunisia's economy expects to derive will probably result from broader and less expensive access to imported capital goods and intermediate goods, which should improve productivity in Tunisian industry.

On the macroeconomic level, the most decisive advantage is expected to result not from free trade itself, but from the attendant reforms that will have to be made for restructuring and modernization, if the country is to withstand the shock of deprotection.

Finally, on the political level, the establishment of the free-trade zone will once and for all confirm the choices modern-day Tunisia has made in the economic, cultural and civilizational spheres, and will enhance the credibility and irreversibility of these choices in the eyes of the international economic community.



Convinced of the well-foundedness of its chosen options, Tunisia initiated its own unilateral implementation of the free-trade agreement it signed with the EU in July 1995 without waiting for it to be ratified by the 15 member countries. With that that process of ratification by the European countries now nearly complete, Tunisia has already begun the process of tariff dismantling with the appropriations law for 1996, first removing protection on capital goods that have no locally-manufactured equivalent.

Tunisia is well aware of how great a challenges it has assumed in publicizing its clear, unalterable determination to join the global economy through the free-trade agreement with Europe.

Studies already carried out estimate the growth potential related to this openness at a minimum of 2 points per year. These same studies indicate that the potential for growth may be even greater, depending in large part on Tunisia's ability to attract and stimulate the flow of foreign direct investment.



### 3. THE NECESSITY AND CONDITIONS FOR FOREIGN DIRECT INVESTMENT

Foreign direct investment will, first of all, provide support for the balance of payments without additional indebtedness, in a natural context of increasing importation. Next, it will make it possible to increase gross fixed capital formation, which alone can create jobs and wealth. Lastly, the alliances and joint ventures it will create will facilitate technological transfers and the integration of Tunisian businesses into the planetary development strategies of the large international groups.

Tunisia has prepared itself on many fronts to welcome this highly desired foreign investment.

#### 3.1 ON THE FINANCIAL FRONT

Important reforms were initiated as early as 1989, with the creation of structures and procedures for control of the financial sector. Stock exchange capitalization increased rapidly, going from 543 million dinars in 1991 to 4 billion in 1996.

Interest rates moved downward, helped along by the containment of inflation.

The financial system now in place comprises some twelve commercial banks, eight development banks, and several offshore banks and financial companies. Thus it is able to respond to any creditworthy request for financing. In a word, Tunisia today raises no hindrances to the development of business because of unavailability of credit.



With respect to investment grade, Tunisia has, in recent years, received very respectable ratings from large international agencies: Moody's: Baa3 (October 1996); IBCA: BBB<sup>-</sup> (September 1996).

In the area of foreign exchange, Tunisia introduced current convertibility of the dinar, as specified in article 8 of the International Monetary Fund, in 1993.

### 3.2 ON THE TAX FRONT

Tunisia's tax system in the early 1980's was relatively complex, dissuasive, and not very effective. In 1988, the three taxes on turnover were replaced by a single system of value added tax, fiscal distortions were removed from the system, and collection was improved, with elimination of duplication.

In the area of direct taxation (individual and corporate income tax), the new code enacted in 1990 has simplified the system and set a ceiling of 35% on the marginal rate of taxation.

Quantitative restrictions on foreign trade have been replaced by customs duties, the average rates of which have generally been lowered and their breadth narrowed.

The free-trade agreement with the European Union should simplify the system still further and result in renewed reduction of rates.



### 3.3 INFRASTRUCTURE

The scope and quality of infrastructure in Tunisia have been improving consistently since 1990. The country now has a good supply of infrastructure, and is well ahead of the other countries in the region with respect to electrical energy production, potable water distribution, sanitation and transport networks.

Growth in the sector of telecommunications, transport and electricity distribution has been faster than growth in GDP, a trend which should undergo further strengthening in the future by the deregulation of a number of government monopolies and the involvement of the private sector in the production, financing, management and maintenance of urban infrastructure and utilities.

Here it should be noted that Tunisia has, following an international call for tenders, just awarded the first BOT contract for a 350-MW electrical power plant to a private international consortium.

Other opportunities should follow in the fields of highways, wastewater sanitation and garbage collection and management.

All these new openings will reinforce the quality of infrastructure in Tunisia and enhance the country's attractiveness for foreign direct investment.



### 3.4 PERSONNEL SKILLS

The changes that Tunisia's economy is experiencing because of membership in a global economy are causing a quantum leap in the vocational training needs of businesses. The objectives of the 9th plan for economic and social development include that of increasing training capacity from 9,500 graduate trainees per year in 1996 to nearly 50,000 in 2001, a gigantic effort that will require greater involvement of the private sector in training activities and programmes.

It will also call for representatives of the professional world to participate in defining the programmes being dispensed by the public sector, and in managing and financing public-sector training centres.

Lastly, it will require the introduction of new training formulas, namely professional trainee guidance and alternate work/training programmes.

Vocational training should be seen as a partnership between the public authorities and the business world, one which raises the skills of each party so as to meet the needs of a demanding, open economy.

### 3.5 GOVERNANCE

This concept, which appeared recently in the literature on foreign investment, expresses a government's ability to ensure transparent management of business, with simple written procedures being applied with absolute fairness to all. While there is no objective measure for this criterion, it can be of considerable weight in a foreign investor's decision.



Tunisia enjoys an excellent reputation in this respect. It is proud of being a country governed by the rule of law, where the law applies to all and where institutions play their role uninfluenced by pressure groups.

### 3.6 THE LEGAL SYSTEM

The unified code of investment incentives enacted in 1994 has brought the advantages granted the various economic sectors into line with one another, codifying them with respect to both their extent and the methods by which they are granted.

In the area of labour law, a number of worksites have been undertaken on the basis of negotiations between Union and Employers Organizations to give businesses the greater flexibility needed to adapt their staff size to a rapidly developing environment, ensure greater productivity in the public sector, and disengage the state from wage negotiations, thereby involving both sides still more in the preparation of sectoral collective conventions.

Important reforms have been made in commercial law, to bring Tunisia's legal apparatus into step with international developments.

Here reform is being carried out daily, and foreign direct investment is now entirely unrestricted for industrial and service companies oriented towards export. The limit of investment was also recently raised to 49% for companies working for the domestic market.

In the services sector, a number of activities were opened entirely to foreign investment in March 1997, without limit as to percentage.



By these means, Tunisia is drawing the greatest possible benefits from its competitive advantages in the international arena of foreign direct investment.

It may have taken the country thirty years to accept the idea of openness to the world and to the global economy, but today that openness is a conscious, well accepted and fully voluntary reality, the result of a cultural and civilizational option which is fully consistent with Tunisia's history as a melting pot.



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