



# The Rebirth: Tunisia's potential development pathways to 2040

## Economy

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Last updated 12 May 2023 using IFs v7.45

## Economy

### Growth

Published in 2015, Tunisia's five-year development strategy emphasises the promotion of private sector development for economic growth and job creation, a vibrant civil society and strong international partnerships. [1]

However, thus far little progress has been made. Instead, rising expenditure has increased public debt from 40% of GDP in 2010 to an estimated 73% of GDP in 2019, consuming more than 22% of the budget, although the budget deficit has dropped from 7.4% of GDP in 2016 to 3.9% in 2019. [2]

With the current account under pressure, dwindling foreign reserves, a weakening currency, an unemployment rate of over 15% and inflation at approximately 6.5%, the Tunisian economy is struggling.

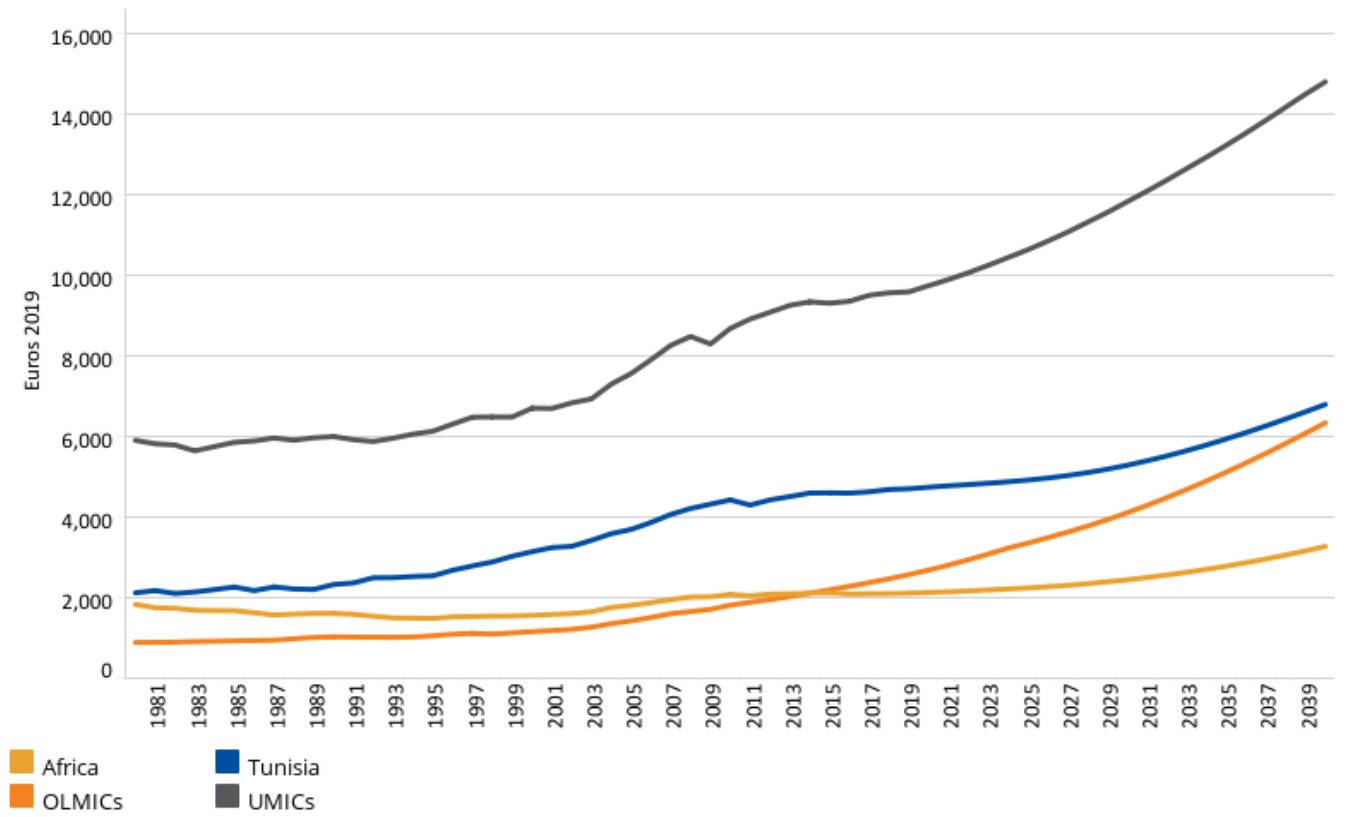
Tunisia's significant subsidies on energy, fuel, food and transport and a large public service wage bill are exacerbating inequality and straining government's coffers.

According to the IMF, 'the richest 20 percent of Tunisians consume 28 percent of all subsidies, while the lowest 20 percent only receive 14 percent.' [3] Civil service wages represent the biggest public expenditure item at about half the total budget, or 15% of Tunisia's GDP. [4]

Since 2000, Tunisia's growth rate has fallen below the average for OLMICs, a trend projected to continue even beyond 2040. However, the IMF reported economic growth of 2.5% in 2019, up from 1.8% in 2018. [5]

On the Current Path, Tunisia will experience an average annual economic growth rate of 2.4% between 2019 and 2040 compared to an expected average annual population growth rate of 0.6%. Incomes will improve, but more slowly than in its OLMIC peers (see Chart 4), and the gap between Tunisia's per capita income and the average for OLMICs is expected to narrow. Tunisia is also expected to fall further behind the average for UMICs. This dynamic is concerning, given its significant human capital endowment, which should enable significantly more rapid growth in incomes.

Chart 4: Per capita income



Source: IFs version 7.45, historical data from World Development Indicators

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**Economic structure**

Since 2010, tourism, manufacturing and efforts at expansionary policies have driven Tunisia’s growth. [6] The service sector [7] is estimated to make the largest contribution to GDP (between 50% and 60%) and is set to remain dominant to 2040. [8] Tourism, a major contributor to services, has suffered in the last few years owing to terrorist attacks and other security issues, but has shown signs of recovery since 2018, recording a 42.5% jump in revenues in the first half of 2019. [9]

Manufacturing is the second largest contributor to GDP at an estimated 29% in 2019, according to IFs, which is above the OLMICs average. The country also has a large information and communications technology (ICT) sector that contributes over 4% to GDP, significantly above OLMICs’ averages.

Agriculture plays a small but important role at roughly 12% of GDP, while the energy sector contributes a meagre 2% of GDP. On the Current Path, the GDP contributions of agriculture and energy will decline modestly although still increasing in absolute dollar terms.

However, industrial production has been falling, especially in the mechanical and textile sectors, which have suffered from a drop in external demand owing to competition from China and Tunisia’s high production costs. [10] In addition, the production of phosphate, a major source of revenue and domestic stock of foreign exchange, halved between 2010 and 2016 in part due to labour and union strikes. Oil and gas production also nearly halved over this period. [11]

The performance and profitability of Tunisia's many large state-owned companies continue to decline. These large monopolies, which depend on ongoing injections of capital from the government to survive, distort markets and hinder competition and innovation. [12]

In addition, the trade deficit grew to an all-time high of €6.9 billion in 2019 with imports at over €22.6 billion (TND [13] 63 billion) and exports at €15.6 billion (TND 43.9 billion). [14]

Given the low levels of intra-regional trade in the region, it is no surprise that almost 80% of Tunisia's exports go to the European Union (EU) rather than its neighbours. The lack of regional integration is a major constraint on development in Tunisia and North Africa.

Negotiations for a Deep and Comprehensive Free Trade Area (DCFTA) between the EU and Tunisia were launched on 13 October 2015 to include agriculture and services. [15] The negotiations are expected to create new trade and investment opportunities and ensure Tunisia is better integrated into the EU single market, but the domestic impact is contested. [16]

Tunisia has a significant informal and parallel economic sector that is substantially larger than the average for OLMICs when measured as a portion of the total economy or GDP. A World Bank study notes that 60% of Tunisia's graduates end up in the informal sector or unemployed. [17] This high level of informality constrains growth, as informal sectors are generally less productive than formal sectors and make a smaller contribution to taxes.

Many Tunisians are forced to engage in the informal sector in spite of their high levels of education; a situation that contributed to the overwhelming frustration that underpinned the revolution. [18]

Although some economists believe that the government relies on the informal sector to reduce unemployment, [19] labour absorption in the informal sector is actually about a third below the average for OLMICs. In spite of its large informal sector (as a per cent of GDP), informal labour as a portion of total labour in Tunisia is more than 30 percentage points below the OLMICs average.

The theory that Tunisia's large informal and parallel economy (estimated at 38% of GDP in 2013) is more than survivalist and involves considerable illicit activity is borne out by a World Bank estimate that about 25% of fuel consumed in Tunisia is smuggled from Algeria, where fuel is cheaper. [20] Much of the informal sector in Tunisia could therefore more appropriately be described as being part of the shadow economy, consisting of black market transactions such as smuggling and undeclared work. This is generally the case because formal sector opportunities are unavailable.

Tunisia's high import taxes, outdated regulations and corrupt customs officials are some of the issues that deter business people from complying with official trade and currency exchange laws. They also contribute to the extremely low level of formal trade between countries in the Maghreb. In 2017, a former trade minister estimated that the share of small enterprises in the parallel economy amounted to an annual loss of €1.2 billion for the state just from value-added tax alone. [21]

A study of the prevalence of the informal sector and the challenges to its formalisation shows that a third of informal workers and entrepreneurs listed bureaucracy, nepotism and corruption as major impediments to formalisation. [22]

Nonetheless, IFs forecasts that the informal economy will decline by about four percentage points of GDP by 2040 from roughly 23% in 2019, but it remains around six percentage points larger than the average for OLMICs across the forecast horizon. From a structural point of view, more rapid formalisation of the informal sector would boost government revenues, accelerate economic growth and expand regional trade.

To examine the other reasons for slow growth beyond the large size of Tunisia's shadow economy, we turn to analysis of the three standard contributors to economic growth, namely labour, capital and technology (or multifactor productivity [MFP] — see Chart 5).

#### Chart 5: Measuring productivity in IFs

The IFs system assesses the stock (e.g. labour force size) and flow (e.g. investment) dynamics between capital, labour and technology as a means to assess and model countries' long-term growth prospects.

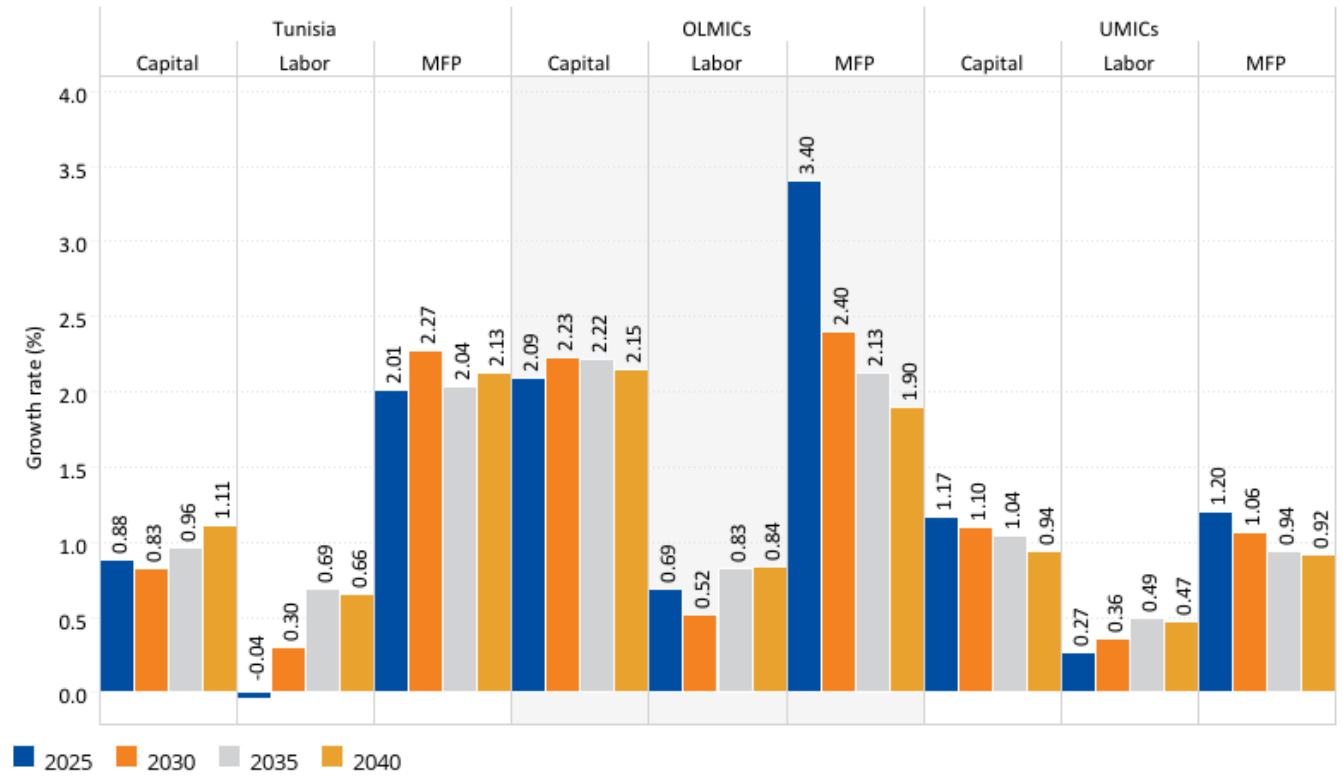
Technology is measured as multifactor productivity (MFP) and is further divided into four components — human capital, knowledge capital, social capital and physical capital. Additions to the initial MFP are computed within the IFs system using inputs from other sub-models, such as education.

The growth forecast therefore represents the expected economic output from financial interaction between households, firms and government on the basis of both direct economic inputs such as labour and domestic/foreign investment, and deeper drivers such as the level of human development, quality of governance, and physical infrastructure that augment the quality and/or quantity of the direct inputs. In this way, IFs integrates longer-term issues, whereas most economic models focus on shorter-term equilibration and deal with the long run exogenously.

Compared to OLMICs, labour and capital contribute the least to Tunisia's growth, although, by 2035, the contribution from labour reaches the current mean of OLMICs. Of the three primary factors, MFP makes the greatest contribution to economic growth in Tunisia compared to OLMICs and UMICs, as shown in Chart 6 at five-year intervals.

The reason for labour's low contribution is that Tunisia's labour participation rate has steadily diverged from the OLMICs' mean since 1985, and is currently about 12 percentage points lower, with rates for females significantly below that of males.

Chart 6: Growth accounting for Tunisia, OLMICs and UMICs



Source: IFs version 7.45

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The poor contribution from capital is because investment in Tunisia’s economy is around six percentage points below that for OLMICs at around 20% of GDP. Since the 2011 revolution, foreign direct investment (FDI) has declined sharply. In 2017, for example, FDI inflows amounted to €894 million, a 45% decrease from 2012. The result is that Tunisia’s stock of FDI declined to €29 billion in 2017 compared to €29.8 billion in 2016. [23]

The Tunisian government has taken a number of measures to attract FDI to industries such as energy, tourism, construction material, telecommunications, finance and electronics. In 2018, for example, the government passed legislation to simplify the procedures required to work and do business as a foreigner. [24]

Furthermore, in 2017 remittance inflows came to roughly €1.9 billion while outflows were approximately €29.5 million. In 2018 inflows were estimated to be over €2 billion. While remittances have contributed significantly to livelihoods (consumption) in Tunisia, only a small portion is allocated to investment. [25]

Although MFP performs well, according to the World Bank’s human capital index, Tunisia scores lower than expected in terms of its education and income levels. [26] It is one of the few countries where a higher level of education decreases employability, particularly for women. [27]

In addition to the opportunities offered in the shadow economy and barriers to entry into the formal economy, one of the reasons for this is the lack of fringe benefits like maternity leave in the private sector. [28]

The World Bank estimated that unemployment was approximately 15% in 2018, and disproportionately affects the youth

and women. The unemployment rate for graduates and women hovers at roughly 30% and 25%, respectively. [29]

Theoretically, the country has an ambitious legislative reform agenda and a progressive constitution, and indices on governance quality closely track the averages for ULMICs rather than OLMICs. But it is also evident that the post-2011 economic environment is characterised by a deteriorating business climate, a decline in investment and a shift away from capital investment. Instead of declining, cronyism seems to have survived the Freedom and Dignity Revolution. [30]

#### **Chart 7: Governance measures**

IFs draws the measures of government effectiveness and regulatory quality from the World Bank's Worldwide Governance Indicators (WGI) project. Government effectiveness 'captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.' Regulatory quality reflects perceptions of the government's ability to create and implement policies and regulations that promote the development of the private sector. Greater government effectiveness and regulatory quality link forward to improved ICT and enhanced social capital.

These dynamics highlight the extent to which economic growth and opportunity has not matched political progress in Tunisia. In the short- to medium-term, Tunisia will have to reduce the size of the parallel economy, contain unemployment, reduce public debt, improve public spending efficiency and address the social and regional disparities in the country.

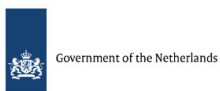
These challenges require a reassessment of the country's governance model and the introduction of substantive competition that will take time to have an impact. Lowering taxes and barriers to participation in the formal sector and reviewing tariff differentials with neighbours, among other things, could gradually lead to greater investment and formalisation.

## Endnotes

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Jakkie Cilliers and Stellah Kwasi (2024) The Rebirth: Tunisia's potential development pathways to 2040. Published online at [futures.issafrica.org](https://futures.issafrica.org). Retrieved from <https://futures.issafrica.org/special-reports/country/tunisia/> [Online Resource] Updated 12 May 2023.

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Dr Jakkie Cilliers is the ISS's founder and former executive director of the ISS. He currently serves as chair of the ISS Board of Trustees and head of the African Futures and Innovation (AFI) programme at the Pretoria office of the ISS. His 2017 best-seller *Fate of the Nation* addresses South Africa's futures from political, economic and social perspectives. His three most recent books, *Africa First! Igniting a Growth Revolution* (March 2020), *The Future of Africa: Challenges and Opportunities* (April 2021), and *Africa Tomorrow: Pathways to Prosperity* (June 2022) take a rigorous look at the continent as a whole.

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