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Tunisia

Advancing Tunisia's Global Integration

Reforms options in the context of deeper integration with the EU

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Currency Equivalents

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Currency Unit = Tunisian Dinar (TND)

1 TND = 0.594 USD

1 USD = 1.68 TND

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Abbreviations and Acronyms

AA	Association Agreement	LAC	Latin American Countries
AfDB	African Development Bank	MAD	Moroccan Dirham
AMU	Arab Maghreb Union	MENA	Middle East and North Africa
ASEAN	Association of Southeast Asian Nations	MERCOSUR	<i>Mercado Común del Cono Sur</i> (Southern Cone Common Market)
ATI	<i>Agence Tunisienne d'Internet</i>	MFN	Most Favored Nation
BITs	Bilateral Investment Treaties	NAFTA	North-American Free-Trade Agreement
BPO	Business Process Outsourcing	NTM	Non-tariff measures
CARIFORUM	Caribbean Group of African, Caribbean and Pacific (ACP) States	OECD	Organization for Economic Co-operation and Development
CEPEX	Centre for the Promotion of Exportations	ONTT	<i>Office National du Tourisme Tunisien</i>
CGE	Computable General Equilibrium	PAFTA	Pan-Arab Free-Trade Agreement
DCFTA	Deep and Comprehensive Free Trade Agreement	PPP	Public Private Partnerships
E&Y	Ernst & Young	PTA	Preferential Trade Agreement
EFTA	European Free Trade Association	PwC	PricewaterhouseCoopers
ENP	European Neighborhood Policy	R&D	Research and Development
EU	European Union	SCET	<i>Société Centrale pour l'Équipement du Territoire</i>
FDI	Foreign Direct Investment	SMEs	Small and Medium Enterprises
FIPA	Foreign Investment Promotion Agency	SOE	State-Owned Enterprises
FTA	Foreign Trade Agreement	STUDI	<i>Société Tunisienne d'Ingénierie</i>
GAFTA	Greater Arab Free Trade Agreement	SWOT	Strengths, Weaknesses, Opportunities, and Threats
GATS	General Agreement on Trade in Services	TIFA	Trade and Investment Framework Agreements
GCB	General Compensation Unit	TIVA	Trade in Value Added
GCC	Gulf Cooperation Council	TND	Tunisian Dinar
GDP	Gross Domestic Product	TRAINS	Trade Analysis and Information System
GPA	General Agreement on Government Procurement	UNCTAD	United Nations Conference on Trade and Development
IMF	International Monetary Fund	USD	United States Dollar
KPO	Knowledge Process Outsourcing	WBG	West Bank and Gaza
		WTO	World Trade Organization

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Table of Contents

ABBREVIATIONS AND ACRONYMS.....	I
EXECUTIVE SUMMARY	VI
1. OVERVIEW	1
1.1 Motivation.....	1
1.2 Reforms options for deepening integration with the EU	3
1.3 Benchmarking Tunisia’s global integration.....	5
1.4 Estimating the effects of deeper integration for Tunisia.....	10
2. SERVICES LIBERALIZATION AND DEEPER INTEGRATION WITH THE EU: REFORMS OPTIONS.....	13
2.1 Key regulatory reforms to remove barriers to trade and investment in services in Tunisia.....	13
2.2 From Rents to Competition: Unleashing Tunisia’s Services Trade Potential in a Context of Deeper Regional Integration.....	14
2.2.1 Tunisia’s structural underperformance in services trade	16
2.2.2 The role of services and services trade in Tunisia’s overall economic performance.....	20
2.3 The Role for Unilateral Reforms and Regional Trade Integration	28
2.3.1 Using regional trade integration to achieve Tunisia’s services “revolution”	31
2.3.2 A focus on the negotiations with the EU: challenges and prospects.....	32
2.4 Reforming the Services Sector: What Has Been Done, What Remains to Be Done, and How it Should Be Done.....	36
a. Putting in place an institutional framework for services trade promotion	37
b. Improving business environment	38
c. Increasing the benefits from the movement of services providers.....	39
2.5 Conclusions	41
3. COMPETITION POLICY AND REFORMS OPTIONS IN THE CONTEXT OF DEEPER INTEGRATION WITH THE EU	43
3.1 Background	45
3.2 Status of the competition in the Tunisia market: an overview	46
3.3 The EU – Tunisia relationship on competition matters	52
3.4 Shortcomings of the competition policy framework: the competition law	55
3.4.1 Competition law contains broad exclusion and exceptions to its application	56
3.4.2 Shortcomings of the institutional set up.....	59
3.4.3 Enforcement weaknesses	60
3.4.4 Due Process and parties’ guarantees.....	65

3.4.5	Lack of competitive neutrality between state-owned enterprises (SOEs) and private companies.....	68
3.4.6	Lack of State Aid framework.....	69
3.5	A Roadmap for reforms options in the context of deeper integration with the EU.....	70
4.	THE LEGAL FRAMEWORK FOR OPENING TUNISIA PUBLIC PROCUREMENT TO INTERNATIONAL MARKETS IN THE CONTEXT OF REGIONAL TRADE AGREEMENTS.	73
4.1	International Framework on Access to Public Procurement.....	73
4.2	Tunisian Policy for Providing Foreign Companies Access to Tunisian Procurements.....	76
4.3	Importance of Access to Procurement in the Agreements Signed by Tunisia.....	78
4.4	Procurement Provisions in the Agreements Signed by the EU.....	80
4.5	Procurement Policies in the Agreements Signed by the United States.....	84
4.6	The simultaneous Negotiations between the European Union and the United States May Drive the Adoption of Dissimilar Policies	86
4.7	Conclusions	86
5.	CONCLUSIONS.....	88
6.	REFERENCES	90

List of Figures

Figure 1.1A	Bilateral trade costs for Tunisian products.....	6
Figure 1.1B	Bilateral trade costs for Tunisian products.....	6
Figure 1.2	Bilateral trade costs to the world (manufactures)	7
Figure 1.3	Bilateral trade costs to the world (agriculture products).....	7
Figure 2.1	A trade in services net surplus.....	16
Figure 2.2	Tunisia Net Trade in Commercial Services (million USD), 2004-13	16
Figure 2.3	Trade in Services as % of GDP, 2012.....	16
Figure 2.4	A high dependency on travel and transport services	17
Figure 2.5	A relatively poor performance in other services	17
Figure 2.6	Relative sizes of MENA services exporters	17
Figure 2.7	The double shock and the risk of Tunisia’s stall	18
Figure 2.8	The impact of the revolution on FDI inflows	19
Figure 2.9	Distribution by sector of FDI inflows and job creations in Tunisia	20
Figure 2.10	Services value-added embodied in goods exports, Tunisia, 2009.....	21
Figure 2.11	Services value-added in total gross exports, Tunisia and comparative countries, 2009.....	22
Figure 2.12	The European Union remains a prime target market.....	24
Figure 2.13	Traditional Tunisian services exports markets are less dynamic.....	24
Figure 2.14	Other MENA countries are the main investors in Tunisian services	26
Figure 2.15	Trade in tasks specialization and upgrading	27

List of Tables

Table 1.1	Tunisia Non-Tariff Measures by category (10-digit tariff line), 2011	8
Table 1.2	Ad Valorem Equivalents (AVEs) of Barriers to Trade in Services in Tunisia	9
Table 1.3	Scenarios for goods and services liberalization	12
Table 2.1	An improving performance in logistics and trade facilitation services	23
Table 2.2	Distribution by sector of projects with foreign participation in Tunisia	25
Table 4.1	Public Procurements Provisions in Tunisia Trade Agreements	80
Table 4.2	FTA concluded by the European Union in the MENA region	82

List of Boxes

Box 2.1	Taking stock of existing regional trade agreements and negotiations involving Tunisia.....	31
Box 2.2	Regional integration should include both hard and soft networks.....	36
Box 2.3	Innovation and education: matching supply and demand.....	38
Box 2.4	Measuring the importance of trade under mode 4 of the GATS	40
Box 3.1	Scope of Competition Frameworks	46
Box 3.2	Price Cost Margins (PCMs) as a Measure of Competitive Pressure in Markets.....	49
Box 3.3	Competition policy	53
Box 3.4	Development of the Competition Council activity	60

Executive Summary

i. **Tunisia’s past integration policies brought important economic benefits to the country. However, significant challenges remain.** Thanks to a policy of gradual opening to the global economy, Tunisia’s exports, particularly manufactures, have become more competitive in global markets, and trade costs have been falling steadily towards all partners since 1995. The country saw also a significant increase in FDI flows in the manufacturing sector, including substantial rise of the textiles/clothing and mechanical/electrical components through participation to EU production networks. Increased exports and FDI inflows were the main drivers¹ of economic growth, which averaged over 5 percent following the opening of the country to international trade². These changes, however, have remained limited. 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 Italy³. This highly skewed trade pattern reflects the duality of the Tunisian economy, which has become increasingly concentrated towards low value added activities⁴. Geographic diversification of exports has also been very limited, with the EU absorbing nearly 80 percent of Tunisia’s exports and, within the EU, France and Italy accounting for more than 55 percent of total exports.

ii. **Policy related obstacles to competitive trade in both goods and services persist.** Heavy and pervasive intervention by the State in the economy continues to limit competition in the onshore sector and trade integration, particularly in services sectors. Widespread restrictions to the number of firms allowed to operate in the market have been coupled with many legal (public) monopolies and undue regulatory constraints, 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 legislation⁵. Many of these sectors at present remain de facto closed to competition⁶. In this context, the onshore sector is operating at a low-efficiency/productivity levels and is preventing other sectors and the economy as a whole from increasing productivity and value added⁷.

iii. **These challenges put the country at risk of gradually losing ground vis-à-vis its competitors.** The framework for international trade has changed dramatically in the past decade. Traditional trade implied the exchange of goods produced in one country that were to be sold in another. Today the world is rapidly moving towards global supply-chain trade, where goods are produced globally. This type of trade, which involves strong complementarities at the international

¹ Together with large public investments and private consumption

² Real GDP growth from 1995 to 2008 (source: WDI)

³ Tunisia DPR, WB 2013

⁴ 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 extremely difficult to move beyond assembly tasks and low value added processes.

⁵ See Chapters two and three of this report

⁶ Tunisia DPR, WB 2013

⁷ A forthcoming study (Weak links in Tunisia 2014) shows the role of low productivity sectors, mostly located onshore and characterized by lack of market access and consequent distorted market power, as a constrain to the overall productivity of the economy. This is particularly the case for downstream sectors that provide intermediate inputs to final production, which then act as a drag on increasing productivity of the upstream sectors and hurt also prospects to climb up the value added chain.

level (with production processes split across countries), has rendered obsolete the old model of “exchange of market access” between FTA partners (which has largely driven Tunisia’s opening to the world). The political economy of regionalism has changed and the new ‘trade-investment-service’ nexus made possible by the IT revolution has ushered a new bargain, one of “foreign factories for domestic reforms” (Baldwin 2011). In this context, protection in goods and services markets leads to exclusion from partaking in the growing supply-chain trade. Behind-the-border reforms and institutions are more than ever necessary to attract FDI to obtain the ‘backbone’ services necessary to participate effectively in the world trading system. Openness in services is therefore key to benefit from openness in goods markets since these services are bundled in goods trade. Countries that have realized this have progressed much faster than Tunisia and have become more competitive in global markets⁸.

iv. **Tunisia needs to re-assess its global integration strategy.** While the perception in Tunisia is that economic growth has been characterized by trade integration and strong export performance, in fact trade integration remains highly limited and export performance has been deteriorating. Tunisian export growth during 2000 to 2010 was positive (3.3 percent) but slower than export growth in many other countries and also slower than Tunisian GDP growth. In fact Tunisia’s share of goods exports in world trade has been declining over the past decade. As shown in this report, Tunisia’s trade costs have declined regularly over the past two decades, but the trade costs of competitors have generally fallen faster so that Tunisia has not increased its competitiveness vis-à-vis comparator groups and, if anything, it might have lost ground over the period. As a small economy of just over 10 million people, greater integration in the global economy remains critical to Tunisia’s economic success. Hence, the need to re-assess its global integration: the ultimate objective is for Tunisia to strategically use its preferential partners to break into global markets, particularly in a context where production takes place increasingly through global value chains.

v. **With the neighboring European Single Market accounting for a quarter of world trade and outward investment, deeper integration with the EU should remain a core element of Tunisia’s integration strategy.** The European Neighborhood Policy (2004) offers the EU’s neighbors the prospect of a significant measure of economic integration through gradual integration in the internal market and deepening of political, cultural and social cooperation. Beyond the on-going negotiations, or preparations for negotiations in the areas of trade in agriculture and trade in services, the EU formally opened discussion on a Deep and Comprehensive Free Trade Agreements (DCFTA) with Tunisia. The DCFTA will be a comprehensive agreement on trade and economic relations covering a full range of regulatory areas, such as trade facilitation, technical barriers to trade, sanitary and phytosanitary measures, investment protection, public procurement and competition policy. The main objective will be the progressive integration of the economy of Tunisia into the EU single market. This constitutes an opportunity to further open Tunisia and make it more competitive in global markets. Further integration with the EU would require the implementation of comprehensive policy reforms to improve the investment climate, raise productivity, and eliminate a host of trade barriers.

Main Findings

Gains from deep and multilateral trade liberalization are estimated to be substantial for Tunisia, considerably above those from shallow liberalization. Estimates from an economy-wide

⁸ These countries, considered as a benchmark to Tunisia based on either the economic structure, similar factor endowments or the range of income level, include Chile, Slovak Republic, Poland, Turkey, Malaysia and Korea.

simulation model for this report- that takes into account the linkages between goods trade and services trade- show that deep integration (i.e. including the removal of non-tariff barriers) and multilateral goods trade liberalization would generate a significant increase in output and in household welfare (respectively 10 and 12 percent). The greatest benefits are likely to come from deep (in contrast with shallow) liberalization of both goods and services. The EU remains the preferred partner for Tunisia and the EU market likely to generate the largest gains from deeper integration⁹. More specifically:

- **Significant benefits would accrue from the reduction in non-tariff measures (NTMs).** NTMs are a drag on trade in commodities and do not result in government revenues. Thus, eliminating NTMs substantially improves the outcomes of either MFN or preferential trade agreements. For instance, while shallow MFN liberalization was found to improve welfare from 1 to 5 percent, deep MFN liberalization that includes NTMs improves welfare between 8 and 9 percent.
- **Services trade magnifies the gains from deep goods trade liberalization and is particularly beneficial for wage and salary earners.** Welfare gains from liberalization in services are in the range of 2-3 percent but could reach 11-14 percent in the case of joint MFN in goods and services trade. Foreign investment into services would result in increased local demand for labor, pushing up wages and salaries significantly, by about 18 percent¹⁰;

vi. **The cost of non-reform is therefore very high.** The background papers prepared for this report assess the main regulatory and institutional bottlenecks that still prevent the country from reaping the benefits from greater and deeper integration with regional partners, primarily the EU. In the case of services, this report identifies both horizontal and sectoral policies to move towards a more competitive environment and identifies the potential costs (in terms of lost benefits) of not moving forward with this agenda. A number of reform options to the current competition policy framework have also been identified that would broaden the country's engagement with the global economy. Most of the reforms to remove these bottlenecks are domestic ones and the key ones could be undertaken unilaterally. However, international and regional trade integration would strengthen this process by helping to build consensus and locking in these necessary reforms.

vii. **The sequencing of reforms is very important: trade liberalization should be preceded by reforms of the business environment and competition at large.** Opening a services sector to

⁹ In all liberalization scenarios, the greatest gains would come either from multilateral liberalization or from regional integration with the EU

¹⁰ Positive welfare implications of services liberalization are even larger if competition can be allowed and guaranteed between providers. It is important to note though that these scenarios do not take into account the specific nature of services trade liberalization. Studies by Konan and Maskus (2003a) and Konan and van Assche (2007) indicate market structure and regulations play a significant role in the liberalization of services, particularly for Mode 3. For instance simulation of welfare implication of allowing foreign providers to enter Tunisia's key services sectors (in this case telecommunication) shows that the welfare implications are clearly positive if competition can be guaranteed between providers. Welfare gains can be up to 0.65 percent if the foreign provider is 15 percent more efficient than the domestic incumbent and does not shift its profits abroad. In contrast, services liberalization would be welfare deteriorating if the foreign provider colludes with the domestic incumbent. These findings highlight the importance of implementing services liberalization in a suitable regulatory (competition enhancing) framework.

domestic (e.g. privatization or suppression of a public monopoly) and/or foreign competition without paying attention to the domestic regulatory and competition environment could have negative effects, allowing for example anti-competitive behaviors and price increases. Transitioning from a rent system, the government needs to ensure that regulatory reforms are effective to guarantee greater competition and remedy market failures. The scope of the reforms goes beyond negotiations in preferential trade agreements and should be on the agenda of the government at large, and include all line Ministries involved in the reform process, with the Ministry of Trade playing a pivotal role.

viii. **It is essential to coordinate reforms under multiple ongoing agreements and negotiations. Multilateral concessions (engagements) are seen as a first best, topped up by some “open regionalism”.** Tunisia is under pressure to carry out reforms in multiple spheres: domestic reform agenda; bilateral/ regional trade negotiations; WTO negotiations, etc. Sometime, the concessions asked from individual countries could be conflicting – for instance if market access is granted on a preferential basis. There is a risk that the multiplication of Preferential Trade Agreements (PTAs) will generate conflicting rules or add to the complexity of trade (e.g. administrative burden attached to conflicting rules of origin across PTAs). Greater transparency and information sharing should help the prevention of such conflicts. It is however recommended to favor multilateral concessions (i.e. in the GATS) that could be topped-up by some “open regionalism” and avoid discrimination.

ix. **The international dimension of market access must be reflected also in the ongoing reform of the national public procurement system.** Public procurement plays an increasingly important role in the global economy. Each year, it can be estimated that approximately US\$4,000 billion is devoted to purchases through public procurement, including 2,288 billion Euros in 2009 for the countries of the European Union and US\$535 billion in 2010 for the U.S Federal Government. The stakes are thus quite sizeable, as on average public procurement represents 15 percent of the GDP in these countries. The figures are even higher in developing countries where public investment remains the key driver of national growth. Public procurement bears economic leverage through targeted social and economic actions, offers market prospects to the private sector, can help to generate budget savings through adequate reforms, and has a key role in development and in the fight against corruption. For these reasons it has been given increasing international attention during the recent years, and several countries have launched national reform programs.

x. **For Tunisia, the negotiations for access to its public procurement and of its own companies’ access to public procurement in other countries clearly show these stakes.** The preliminary discussions with the European Union and the United States have shown the same to be true for its partners. Therefore the topic requires all the more attention, especially as the assessment of Tunisia’s public procurement system that launched in 2011, after regulations of public procurement had been revised to boost public investment, is currently at the recommendation phase for comprehensive reforms in national procedures, while the introduction of e-signature procedures for procurements are also being planned. At this stage, it is important to include an international component into the public procurement reform in Tunisia. At the moment, however, there is no international or regional dimension in terms of access to public procurement. The US and EU currently rely on an international model (the UN General Agreement on Public Procurement, or GPA) which could also inspire future bilateral negotiations. To the extent some countries in the region are also in bilateral negotiations with the EU or the US, the regional dimension will inevitably emerge.

xi. **Tunisia might ensure the consistency of the conditions to access its public procurement system to avoid the stacking of different rules that would be specific to specific agreements.** It is also recommended to reduce any risk of misinterpretation due to lack of clarity in the legal texts and regulations of the country in this field. The current regulatory framework does in fact hesitate between openness and protectionism. It is important to reduce any uncertainty and spell out the conditions for access of foreign companies.

Conclusion

xii. **The political and economic events since January 2011 have contributed to change the context in which Tunisia is shaping its own global integration agenda.** This changing landscape presents new challenges but also opportunities to advance integration in a rapidly globalizing world trade environment. On one side, Tunisia has a great deal to gain from deepening trade and economic integration with its regional and global partners: trade and investment are in fact a key engine of sustainable growth and employment creation. On the other side, this report argues that Tunisia won't be in the position to fully gain from deeper integration if trade and investment restrictions, a legacy from the old economic and political model, persist and continue to prevent a more efficient allocation of resources. Firms and economic agents, and by extensions Tunisians households, cannot benefit from increased market opening if competition remains stifled and market opportunities limited by an uneven domestic regulatory environment.

1. Overview

1.1 Motivation

Tunisia's past integration policies have brought important economic benefits to the country but significant challenges remain¹¹. Thanks to a policy of gradual opening¹² to the global economy, Tunisia's exports, particularly manufactures, have become more competitive in global markets, and trade costs have been falling steadily towards all partners since 1995 (see section 1.2 below). The country saw also a significant increase in FDI flows¹³ in the manufacturing sector in the recent years, including substantial rise of the textiles/clothing and mechanical/electrical components through participation to EU production networks. Increased exports and FDI inflows were the main drivers (together with large public investments and private consumption) of economic growth¹⁴. However, these changes have remained limited. Policy related obstacles to competitive trade in both goods and services persists Heavy and pervasive intervention by the State in the economy continue to limit competition in the onshore sector and trade integration in services sectors. Widespread restrictions to the number of firms allowed to operate in the market have been coupled with many legal (public) monopolies and undue regulatory constraints, 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 (see Chapter two). Many of these sectors at present remain de facto closed to competition¹⁵. Tunisia's integration with the global economy remains superficial, both in quantities and sophistication of exports. Geographic diversification of exports has also been very limited, with the EU absorbing nearly 80 percent of Tunisia's exports and, within the EU, France and Italy accounting for more than 55 percent of total exports¹⁶.

These challenges put the country at risk of gradually losing ground vis-à-vis its competitors. While traditional trade is about goods produced in one country that are sold in another, supply-chain trade-towards which the world is moving rapidly- is mostly about producing goods internationally. It involves hi-tech firms combining their know-how with low-wage labor in developing countries. Supply chains apply mostly for manufactures, but also for agricultural products. In this new world, the old model of "exchange of market access" between FTA partners, which has largely driven Tunisia's opening to the world (with the EU and with North African countries) no longer applies. As Baldwin (2011) puts, the political economy of regionalism has changed and the new "trade-investment-service" nexus made possible by the IT revolution has ushered a new bargain, one of "foreign factories for domestic reforms. In this context, protection in goods markets leads to exclusion from partaking in the growing supply-chain trade. Behind-the-border reforms and institutions are more than ever necessary to attract FDI and obtaining the 'backbone' services necessary to participate effectively in the world trading system implies that openness in services is necessary to benefit from openness in goods markets since these services are bundled in goods trade. Countries that have realized this, such as the ones in Asia, have progressed much faster than Tunisia and become more competitive in global markets.

¹¹ For a detailed discussion on the benefits and limitations of Tunisia past integration policies please refer to World Bank "Tunisia Global Integration Study" (2009)

¹² Since the mid-1990s, the country has accelerated its openness to trade and today goods trade with the EU, the Greater Arab Free Trade Area partners and a large number of bilateral partners is duty-free

¹³ FDI increased steadily from an average 2.2 percent of GDP in 1996–2000 to a record 6 percent of GDP in 2008.

¹⁴ Growth reached an average of 5 percent during 1997-2007 before the effect of the global slowdown

¹⁵ Tunisia DPR, WB 2013

¹⁶ This highly skewed trade pattern reflects the nature of the Tunisian economy. Companies in these countries 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. (DPR 2013)

Tunisia needs to re-assess its global integration strategy. Recent political and economic events have begun to shape the context in which its new strategy will operate. The Jasmine Revolution for Tunisia, the Libyan war and the continued Eurozone slowdown and debt crisis are contributing to change the context in which previous economic strategies were conceptualized. First, the democratic revolution Tunisia experienced in January 2011 and the following free elections in October 2011 have contributed to close the democratic gap vis-à-vis the EU (previously an obstacle to Tunisia's "Statut avancé" with the EU) and presents a window of opportunity for the country to accelerate its economic integration with its biggest trade partners. This process could also strengthen the domestic reform agenda by anchoring the progress under the ENP to essential domestic reforms. Second, the conclusion of the Libyan war will also open new opportunities to strengthen trade and investment links with another important partner for Tunisia, on a bilateral or unilateral basis. And third, the economic slowdown in the EU zone suggests the importance of analyzing different options within the liberalization strategy and assess the relevance of pre-existing regional FTAs, deepen ties with other key partners in the region, or consider agreements with potential new partners whose markets have so far remained unexploited.

With the neighboring European Single Market accounting for a quarter of world trade and outward investment, deeper integration with the EU should remain a core element of Tunisia's integration strategy. The European Neighborhood Policy (ENP) launched in 2004 offers the EU's Southern and Eastern neighbors the prospect of a significant extent of economic integration through gradual integration in the internal market and deepening of political, cultural and social cooperation.¹⁷ Beyond the on-going negotiations, or preparations for negotiations in the areas of trade in agriculture and trade in services, the EU formally opened discussion on a Deep and Comprehensive Free Trade Agreements (DCFTA) with Tunisia¹⁸. The DCFTA will be a comprehensive agreement on trade and economic relations covering a full range of regulatory areas, such as trade facilitation, technical barriers to trade, sanitary and phytosanitary measures, investment protection, public procurement and competition policy. The main objective will be the progressive integration of the Tunisian economy into the EU single market. This constitutes a unique opportunity to further open Tunisia and make it more competitive in global markets. However, further integration with the EU would require the implementation of comprehensive policy reforms to improve the investment climate, raise productivity, and eliminate a host of trade barriers.¹⁹

¹⁷ The *acquis communautaire* provides the benchmark for the laws, regulations and institutions which will be conducive to the creation of the conditions for investment and growth: (a) stable, progressive and predictable laws and institutions (including well-established property and creditor rights, a well-functioning judiciary and adequate law enforcement); (b) efficient factor markets (flexible labor markets, adequate skills for innovation driven growth, and deep financial markets); (c) macroeconomic and financial stability; (d) social and environmental sustainability; (e) effective integration into European infrastructure networks; and (f) a dynamic business-oriented environment which facilitates the production of high value added goods and promotes the adoption of efficient processes and innovative technologies.

¹⁸ The intention to move on a DCFTA has been confirmed in a joint declaration UE-Tunisia following the official visit of the head of Tunisian government, Mr Jebali, to Brussels (Feb 2, 2012) and by a scoping mission from the EU that happened in early February 2012

¹⁹ Beyond the EU, Tunisia has a lot to gain from deepening integration with the rest of the world, in particular the regional market. Such a strategy calls for strengthening of the trade and economic integration with other key trading partners (i.e., the new Libya, other Maghreb and Agadir countries, and even the US, particularly now given the launch of the negotiations of the transatlantic FTA between US and EU). The ultimate objective is for Tunisia to strategically use its preferential partners to break into global markets, particularly in a context where production takes increasingly place in global value chains. All these options call for a sound analytical basis to spell out the potential costs and benefits of selecting each option separately or in a complementary fashion.

The objectives of this report are: (i) to assess the key constraints to Tunisia’s past integration policies, particularly in the context of services liberalization and benchmarking Tunisia’s past global integration; (ii) to analyze the options of an integration strategy looking forward, and (iii) to provide recommendations and options for the new authorities to consider. The ultimate objective is to provide the authorities with relevant information to assess the impact of different options of trade integration by providing a thorough analysis of the key regulatory and institutional bottlenecks to deeper integration. This analysis aims to support the authorities in their decisions as to which reforms to prioritize and address in the short and medium term.

1.2 Reforms options for deepening integration with the EU

In the aftermath of the “Arab Spring” in 2011 the EU has re-assessed the ENP to strengthen its partnership with the countries and societies of the neighborhood²⁰. This includes strengthening the regional dimensions of the European Neighborhood Policy (covering respectively the Eastern Partnership and the Southern Mediterranean) with consistent regional initiatives in areas such as trade, energy, transport or migration and mobility complementing and strengthening the bilateral co-operation. In the area of trade, the EU will negotiate Deep and Comprehensive Free Trade Agreements (DCFTA) with a view to progressively integrate the most advanced partners with the EU Internal Market. The G7 sponsored Deauville partnership has also recognized regional and global integration as key to the economic development of the Partnership Countries and committed to support acceleration of on-going trade negotiations and efforts to achieve better integration²¹.

The main question for Tunisia is how to prioritize and sequence the planned reforms. To that effect, it is crucial to determine in which sector/area the gradual approximation/ harmonization with the EU *acquis* could be most beneficial, mindful of the country’s implementation capacity and development objectives. As experience from the new member states illustrates, convergence and catching-up are not automatic outcomes of alignment with the *acquis*. A “proforma” transposition of EU regulations (due to weak implementation) would likely deprive Tunisia of the economic and social benefits that such policies would bring about if they were effectively implemented. Similarly, fiscal and economic costs can outweigh the benefits from the harmonization with the relevant *acquis* if reforms are not strategically prioritized and adjustment costs properly weighted.

Key questions to be addressed and objectives of the study

This study attempts to present a sequence of reforms to prioritize in the context of the ENP²², focusing on areas in which legal and regulatory reforms can be achieved with contained costs and, together with institutional reforms, can significantly contribute to improve Tunisia’s

²⁰ Tunisia prepared and officially adopted the first ENP Action Plan (AP) in 2005. The AP has a wide coverage spanning both economic and non-economic fronts. From an economic perspective, it foresees, inter alia, negotiation of an agreement in services, development of a favorable investment climate, and participation of Tunisia in selected areas of the internal market (e.g., EU transport network). The progress on the implementation of the Action Plan is documented in yearly updates, the latest of which is for 2010.

²¹ See “From Political to Economic Awakening in the Arab World: The Path of Economic Integration.”

²² The ENP does not prescribe specific measures and regulations that the Mediterranean Partners (MPs) might need to adopt to achieve its objective. Unlike the EU accession process, which requires the accession candidates to harmonize their regulations with the EU by adopting the entire *acquis communautaire*—containing 80,000 pages of regulations—countries without accession prospects can implement only those regulatory changes that are expected to result in large benefits and have low costs. In other words, these countries can adopt part of the *acquis*, “a la carte”, and, through this harmonization, share the benefits associated with the relevant elements of the EU’s internal market. Partner countries must determine whether they want to pursue such integration and if so, in what areas and how to do so.

competitiveness and accelerate growth and job creation. To reach this objective, this study provides: (i) a diagnostic of the legal and regulatory framework and institutional capacity in some of the most relevant areas of interest for Tunisia, namely in services liberalization, competition policy and procurement; (ii) a qualitative assessment of the “distance” of the Tunisian framework from the EU’s and the impact of some of the reforms covered by the DCFTA; (iii) a quantitative assessment of selected key integration options.

The report then presents a roadmap of the necessary steps to be taken to fill such gaps²³, by focusing specifically on:

- a) ***Key regulatory reforms to remove barriers to trade and investment in services in Tunisia.*** The objective of chapter 2 is to: (i) take stock of the reforms engaged by the government, (ii) re-assess the priorities in the light of recent domestic and international economic and political changes, (iii) explore the potential role of deeper integration with the EU to achieve these objectives and (iv) identify the key national regulatory reforms that should accompany this process. The aim is to suggest a few practical steps towards reforms that could serve as a basis for discussion with the authorities: it includes a diagnostic, a definition of priorities, and a list of recommendations on how to use deeper integration with the EU (or alternative options) to best serve those priorities.
- b) ***Competition policy and reforms options in the context of deeper integration with the EU.*** The *acquis communautaire* covers both anti-trust and State aid control policies. It includes rules and procedures to combat anti-competitive behavior by companies (restrictive agreements and practices between undertakings and abuse of dominant position), and to prevent governments from granting state aid that distorts competition in the Internal Market. Tunisia is among the countries that have spontaneously adopted domestic legislation that shares common characteristics with EC competition law, but without transposing EC rules to their full extent. Whether deeper harmonization is desirable at this stage is an issue that needs to be explored, carefully balancing the benefits with the costs that would be generated by such a process (significant costs could come, for instance, from strengthening institutions to ensure an effective enforcement of competition rules). Chapter 3 focuses on identifying the main bottlenecks to remove anti-competitive practices in line with the competition *acquis* and provide a preliminary analysis of the choice to converge with the *acquis* in this field. A more detailed cost-benefit analysis is beyond the scope of this work and would require a thorough and detailed assessment of every single action involved in the convergence process or simply in the reform process at large.
- c) ***An analysis of the current context and perspectives for opening Tunisian Public Procurement to International Markets.*** Public procurement bears economic leverage through targeted social and economic actions, offers market prospects to the private sector, can help to generate budget savings through adequate reforms, and has a key role in development and in the fight against corruption. For these reasons public procurement has been given increasing international attention during the recent years, and several countries have launched national reform programs. For Tunisia, the negotiations for access to its public procurement and of its own companies’ access to public procurement in other countries clearly show these stakes. The preliminary discussions with the European Union and the United States have shown the same to be true for its partners. Therefore the topic requires all the more attention, especially as the assessment of Tunisia’s public procurement system that was launched in 2011, after regulations of public procurement had been revised to boost public investment, is currently at the recommendation phase for

²³ The quantitative analysis will also compare this integration option with the other scenarios/options of integration which include multilateral liberalization.

comprehensive reforms in national procedures, while the introduction of e-signature procedures for procurements are also being planned. At this stage, it is important to include an international component into the public procurement reform in Tunisia. Chapter 4 will focus on: (i) presenting the challenges related to the international framework on public procurement, (ii) analyzing the current Tunisian policy related to the participation of foreign companies, the current international agreements effective in Tunisia that focus on public procurements, and the public procurement policies contained in the agreements by the European Union and by the United States with other countries.

1.3 Benchmarking Tunisia's global integration

Tunisia has gradually moved toward trade liberalization, particularly in a regional context. Tunisia joined the WTO in 1990, with liberalization entering into force in 1995. In that same year, Tunisia entered into an association with the European Union (EU) with an agreement to gradually eliminate all trade barriers (with the exception of agriculture) by 2008. By 1997, the Republic of Tunisia also joined the Greater Arab Free Trade Agreement (GAFTA), which provided for the elimination of tariffs by 2008. The 2004 Agadir Agreement between Tunisia, Morocco, Egypt, and Jordan provide common rules of origin for trade with the EU and members.

To assess Tunisia's competitiveness in world market, and its evolution over time since 1995, we estimated the trends in its trade costs, drawing from a new database of bilateral trade costs for manufactures and agriculture (WB 2013²⁴). In the first set of estimates (Figure 1.1A and Figure 1.1B), Tunisia's trade costs are estimated for different destination groups (where the trade cost for each group is the simple average of each country's bilateral trade cost in the group with Tunisia²⁵). This measure shows that average trade costs are very high (about 200 percent) but have declined consistently over time. The second set of measures (Figures 2a and 2b) describes Tunisia's performance in world markets²⁶, again relative to averages for selected groups of countries²⁷.

Tunisia's trade costs for manufactures (Figure 1.1A) and agriculture (figure 1b) have been falling towards all partners. When exporting to the world, the ad-valorem of trade costs for manufactures is 225 percent in 1995 falling by 14 percentage points to 195 percent by 2010. While in 1995 the lowest costs were with respect to GAFTA partners, the biggest reduction in costs was toward the EU²⁸. The pattern for agriculture is not as regular. As in the larger sample in Arvis et al., trade costs for agriculture (Figure

²⁴ Arvis, J-F, Y Duval, B Shepherd, and C Utoktham (2013), "Trade Costs in the Developing World: 1995-2010", Policy Research Working Paper 6309, World Bank.

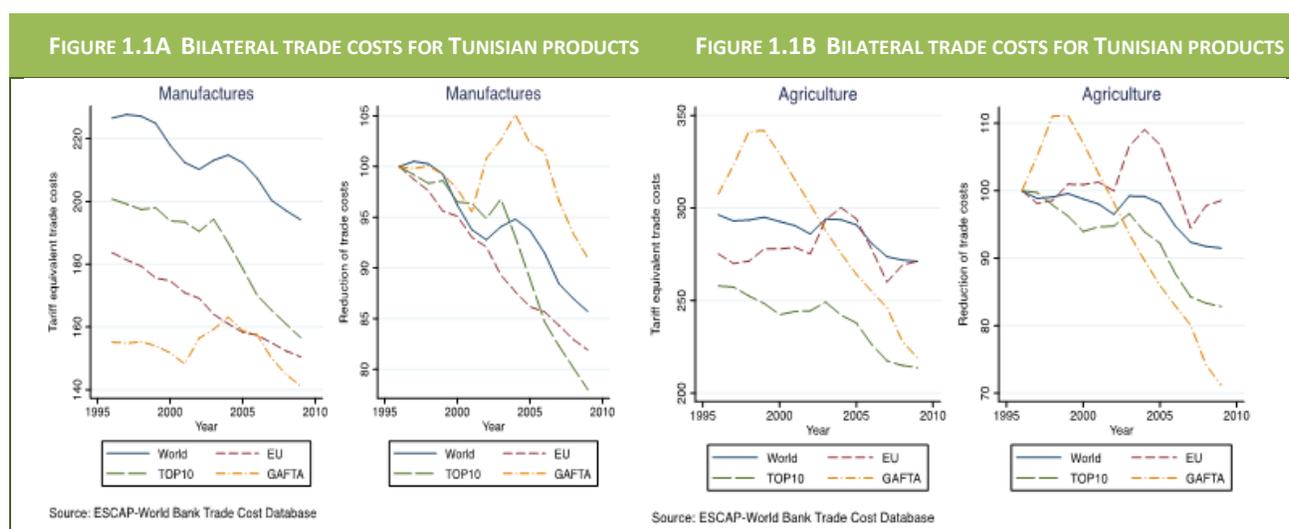
²⁵ The gravity model of trade embodies two strong features observed in all trade data, namely that relative country size and relative trade costs determine bilateral patterns of trade. As explained in the annex, one can solve the model for the bilateral trade costs implied by the observed production and trade data on an annual basis. The resulting annual trade cost measures capture all trade costs, observable and unobservable thus including all factors that account for a price wedge between the producer price in the exporting country and the consumer price in the importing country. Thus one can observe changes in international trade costs relative to domestic costs and how Tunisia's trade costs are evolving relative to partners. The trade costs' estimates are built from Arvis et al. (2013).

²⁶ WORLD are all partners with which Tunisia had positive bilateral exports throughout 1995-2010. EU included the 27 members of the European Union. GAFTA (proxy) includes Algeria, Egypt, Jordan, Morocco, and Oman. TOP 10 importers in the world (USA, China, Germany, France, Japan, the UK, Italy, Korea, and Mexico).

²⁷ For each set of figures, the left-hand figure gives the absolute value of bilateral trade costs, and the right-hand figure gives the costs normalized to 100 in 1996 so it represents the proportional change in trade costs during the period. For each group, bilateral trade costs are averages of bilateral trade costs to all partners in the group.

²⁸ Unfortunately, since the trade cost measure is an average of both partners' trade costs, one cannot attribute the evolution to origin or destination partners. A plausible explanation is that a greater reduction in trade and behind-the-border barriers took place with Europe than with GAFTA partners.

1.1B) are higher than for manufactures, often twice as high. Since the geographical and other natural factors driving trade costs in agriculture are broadly the same as those for manufactures, this probably reflects the more restrictive policies in agriculture than in manufactures once one takes into account tariff and non-tariff protection (Kee et al. 2009). As for manufactures, trade costs for agriculture are also falling towards all partners and are lower for GAFTA than for other partners. As reference, the level of protection in Tunisia is the highest in MNA (50 percent in agriculture and 17 percent in manufacturing --- Minot et al. 2010, table 2.7) and it ranks among the countries that protect their agriculture---defined as ratio of agricultural to industry protection above 1.4. Interestingly, the fall in agriculture trade costs is small for trade with the EU which is higher than with other high-income countries. While the data do not allow one to attribute this evolution to Tunisian trade costs in agriculture or to those in the EU, the pattern is probably indicative that trade costs for agricultural trade has fallen less rapidly in the EU than for any of the other comparator groups.

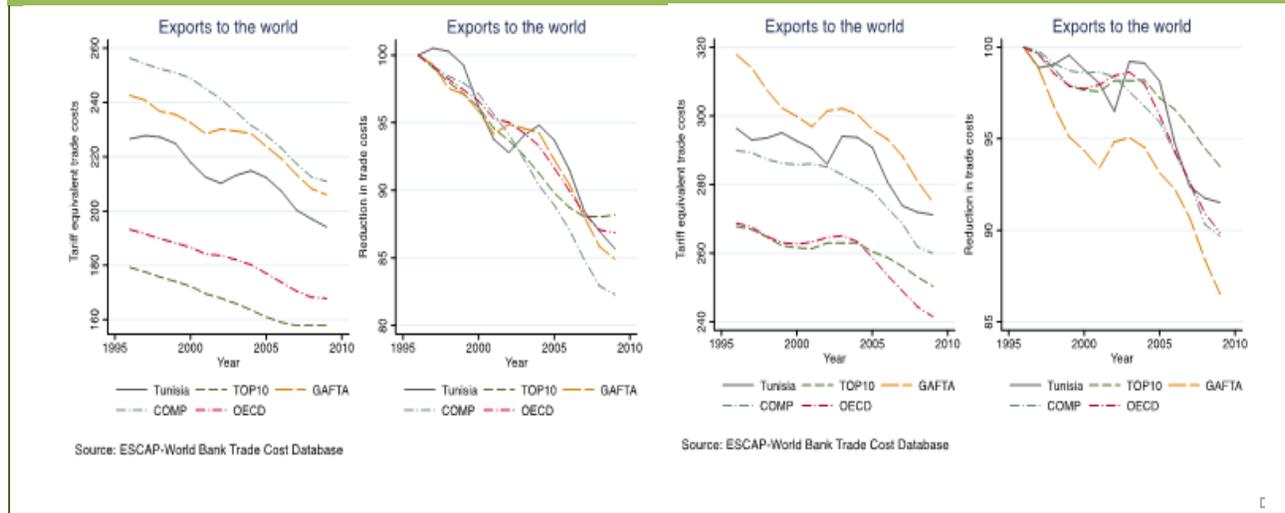


The evolution of trade costs and their regular decline for all the main regional groups show how Tunisia has not increased its competitiveness vis-à-vis comparators groups and, if anything, it might have lost ground over the period. The second set of trade cost profiles shows the evolution of trade costs towards the world for Tunisia and for each one of four comparator groups²⁹. Trade costs are a third higher for the far-away comparator (COMP) group, and trade costs for all groups have fallen by about 15 percentage points, or about 1 percent per year on average. Tunisia’s trade costs are lower than for GAFTA and the gap has remained constant. The regular decline in trade costs for all groups shows that Tunisia has not been catching up and, if anything, there is a catching up by the COMP group. The same pattern hold for trade cost in agriculture (Figure 1.3) where trade costs are higher than for manufactures and are also falling less rapidly.

²⁹ The composition of all groups are self-explanatory except for the COMP group made up of all countries with GDP per capita at PPP is between one-half and twice that of Tunisia in 2002 and whose population is between 5 million and 20 million. The resulting group is Bulgaria, Bolivia, Chile, Dominican Republic, Ecuador, Guatemala, Hungary, Jordan, Paraguay, Slovak Republic, and Slovenia. This heterogeneous group drawn from the simplest specification of the gravity model does not take into account endowments (e.g. human and physical capital, natural resources, etc...) as it builds only on the robust relation between a country’s size (GDP per capita and population) and its trade pattern. Almost half of this group includes Latin American countries that are far from high-income markets.

FIGURE 1.2 BILATERAL TRADE COSTS TO THE WORLD
(MANUFACTURES)

FIGURE 1.3 BILATERAL TRADE COSTS TO THE WORLD
(AGRICULTURE PRODUCTS)



High trade costs, particularly in agriculture, persist due to policies in place both in the origin and destination countries. Bilateral trade costs reported here capture all factors that account for a price wedge between unit export price and unit import price. Differences in the costs of communication and transport technologies will be part of these wedges, but in many cases, the most important contributors will be policies in the origin and destination countries. Tunisia exports currently face relatively low barriers in their destination markets, reflecting mostly the fact the EU represents the biggest (76 percent in 2011) share. This is true mainly for manufactures, where agriculture and food products are instead facing diverse restrictions related to specific arrangements in all multilateral and bilateral arrangements³⁰ On its side, over the last forty years, Tunisia has progressively reduced its protection on goods, mostly on manufactures through an exchange of market access with its partners on a bilateral and regional basis.³¹ Tunisia also presents the highest level of protection for agriculture, fishing and for food in the

³⁰ Tunisia's exports face a very favorable trading environment, especially when compared to its MNA or lower-middle-income comparators. Tunisia's Market Access restriction index TTRI (including preferences) is 0.9 percent which is below the MNA and lower-middle-income averages of 2.1 and 2.3 percent, respectively. The weighted simple average of the overall rest-of-the-world tariff (including preferences) faced by Tunisia's exports is 0.5 percent for non-agricultural products and a high 30.0 percent for agricultural products (authors calculations). However, the overall weighted rest of the world tariff is 2.6 percent, since Tunisia mainly exports manufactured goods. This low level of tariff faced by Tunisian exports reflects, among others its high export share to the EU (76.4 percent in 2011) and to the fact that the latter had in place virtually free trade on their imports from Tunisia under the GSP system being in force even prior to the entry into force of the current Association Agreement

³¹ A first turning point occurred with Tunisia's agreements with the EC, first in 1969 and later expanded in 1976. These agreements gave duty-free access to the European market of all non-agricultural products while Tunisia was not faced with reciprocity, only having to accord MFN treatment to European exports to its market. A second was Tunisia's accession to the GATT in 1990 and its WTO membership in 1995, the year it signed an Association Agreement with the European Community, this time on a reciprocal leading to reciprocity and free trade for industrial products by 2008. Tunisia also joined the Greater Arab Free Trade Area (GAFTA) leading to the elimination of most tariffs by January 2005 even though each country could exclude 10 agricultural products from the agreement during the harvest season. With WTO membership, Tunisia bound 58 percent of its tariff lines with tariffs bindings of 116 percent for agriculture and 40 percent for non-agriculture, resulting in a tariff overhang of 30 percent--typical of developing country WTO members. The evolution of the average MFN applied tariffs are shown in Figure 4—with the spike around 2000 for agriculture resulting from the conversion of non-tariff barriers in agriculture at the Uruguay round.

manufacturing sector. Minot et al. document the extensive intervention in the Tunisian agriculture and food sectors that include, tariffs, taxes, subsidies in the politically sensitive cereal sub-sector, ranking Tunisian agriculture among the countries in the world with the highest duties (non-discriminatory duties average 35 percent against an average of 12.8 percent among middle income countries in 2002). As a result, they report effective rates of protection for agriculture and fishing were estimated at over 100 percent in 2003.

An important component of Tunisia’s high trade costs is the presence of high and frequent NTMs.

Non-tariff measures (NTMs), generally defined as non-price typically reduce international trade in goods, changing quantities traded, or prices or both (UNCTAD, 2010). NTMs in Tunisia remain high and non-transparent in key areas³². In 2011, 31 percent of tariff lines (10 digits) were subject to NTMs and 47 different NTMs were being administered. As shown in Table 1.1, technical barriers to trade represent the bulk of NTMs, including sanitary and phytosanitary (SPS) measures and technical barriers to trade (TBT), which combined account for about 70 percent of observations. A majority of these NTMs are in food manufacturing and agricultural product trade. For the purposes of this study, an attempt was made to identify ad valorem equivalent NTB rates. The authors’³³ best estimate is that streamlining trade-related non-tariff barriers through bilateral trade agreements would reduce net agriculture and manufacturing import prices by about 5 percent in general and 15 percent with Arab trading partners. Reflecting the technical nature of these barriers, it is assumed that these act as pure friction and are resource using constraints.

TABLE 1.1 TUNISIA NON-TARIFF MEASURES BY CATEGORY (10-DIGIT TARIFF LINE), 2011

NTMs’ categories	Number of NTMs	% of Total
Technical Measures	63114	92,2%
Non-Technical Measures	5364	7,8%
Total	68478	100,0%
A - Sanitary and phytosanitary measures	40409	54,1%
B - Technical barriers to trade	12313	16,5%
C - Pre-shipment inspection and other formalities	10392	13,9%
D - Contingent trade protective measures	212	0,3%
F - Price control measures, additional taxes and charges	4876	6,5%
H - Measures affecting competition	276	0,4%
P - Exports measures	6190	8,3%
Total	74668	100,0%

Source: Authors estimates using data extracted from TRAINS

³² Augier (2011), Feki (2013, background paper for this report), Basu et al (2012) Basu et al. (2012) report the results from questionnaires administered to 395 Tunisian firms. The large majority (74 percent) reported TBTs followed by SPS measures (4 percent). The majority of TBTs were reported by importing firms while for SPS, the majority was for exporting firms with 5 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.

³³ Konan (2013) et al

The barriers to trade in services are generally quite different from those involved in goods trade. As many cross-border services transactions do not involve tangible products, customs and port clearance procedures are generally not relevant. For many services there is a need for proximity between the producer and client. Hence, barriers to the movement of factors, commercial presence, and consumers become relevant. Of concern are foreign investment measures, capital controls, competition policies, product specifications, labor movement restrictions, and other domestic regulatory and administrative restrictions. These barriers may not only raise transactions costs but they may be entirely prohibitive to some or all modes of international services transactions. Data on services trade and the barriers have been under development for nearly 20 years in response to increased negotiation on services barrier liberalization. An early survey effort includes Findley and Warren (2000). In Tunisia, early reviews of services barriers were originated by Zarrouk (2000) and Maskus and Lahouel (1999). In Tunisia, exclusive commercial agency laws in distribution services limit foreign entry in distribution and sales, protect domestic monopolists, and prevent parallel imports.

Barriers to trade in services remain high. A recently commissioned review of services barriers for Tunisia, prepared for this report, provides a detailed analysis of barriers in services based largely on survey analysis. Transportation (air, maritime, ground, and rail), banking, insurance, telephone, retail, accounting and other business services are considered. Table 1.2 summarizes the findings distinguishing barriers that are non-discriminatory as they affect equally domestic and foreign entrants and those that discriminate only against foreign firms. According to Table 1.2 estimates, transport services face the most restrictive barriers with all firms facing ad valorem equivalent trade barriers ranging from 62 to 72 percent and foreign firms facing additional barriers over 81 percent. Financial services and telecommunications sectors face lower barriers. These estimates are corroborated by the estimates of barriers to trade in Services of Gootiz et al. (2012) that show that Tunisia has the 16th most restrictive overall index (out of 104 countries) and the 28th most restrictive Financial index (out of 100 countries)

TABLE 1.2 AD VALOREM EQUIVALENTS (AVES) OF BARRIERS TO TRADE IN SERVICES IN TUNISIA

Service Sector	Trade	% Ad Valorem	Trade	% Ad Valorem
	restrictiveness Index (TRI) using Regulatory Barriers Index (non-discrim)	Equivalent based on Regulatory Barriers Index (non-discrim)	Restrictiveness Index (TRI) using Foreign Discriminatory Regulation index	Equivalent based on Foreign Discriminatory Regulation index
Maritime services sector	0.325	62.29	0.5647	79.27
Air transportation sector	.	.	0.5147	77.51
Rail transportation sector	0.4125	71.97	0.6375	81.21
Road transportation sector	0.3250	62.29	0.550	78.79
Banking sector	0.2325	15.61	0.2597	17.27
Insurance sector	0.4000	25.32	0.4272	26.79
Mobile services sector	0.3750	23.83	0.4022	26.10
Fixed line services sector	0.4000	5.65	0.4272	6.06
Accounting sector	0.2000	4.57	0.6686	20.63
Auditing sector	0.2375	4.57	0.7816	23.53
Legal sector	0.2250	5.15	0.7566	22.91
Retailing sector	0.2050	10.35	0.4275	6.80

Source: authors calculations, background paper for this report

When estimating the costs of barriers in services, ideally, services barriers would be distinguished depending on ‘mode of delivery’ since the effects of removing barriers will be different according to mode of delivery.³⁴ The mechanisms by which liberalization across these trade modes have an effect on efficiency and welfare will differ depending on interplay of market structure, imperfect competition, and entry barriers. Chapter 2 of this report presents a detailed assessment of the barriers to trade and investment in services sectors and of the key regulatory reforms needed to remove them and increase competition.

1.4 Estimating the effects of deeper integration for Tunisia

An innovative model has been developed as part of this report³⁵ to estimate potential benefits for Tunisia of reducing (tariff and non-tariff) barriers to trade in goods and services vis-à-vis different partners (EU, USA and GAFTA) and under several integration scenarios of policy reforms. The scenarios considered include a gradual and shallow approach to barriers removal whereby tariffs are reduced unilaterally by 50 percent and then fully on an MFN basis. Then the following scenario considers Deep and Comprehensive FTA involving NTB liberalization on goods trade with main trading partners (EU, GAFTA, US). Finally, services liberalization is considered. Services liberalization gives rise to two sources of welfare gains: (a) the removal of mark-ups between price and marginal costs resulting from cartels that would disappear if commercial presence (i.e. FDI) were allowed; (b) the adoption of best-practice marginal costs as resource-using barriers (which usually lead to waste of resources) are removed. A summary of the main results is presented below while the description of the model and a comprehensive presentation of the model’s results is presented in Vol II Annex 7.

Gains from deep and multilateral goods trade liberalization are estimated to be substantial, considerably above those from shallow liberalization. The greatest benefits would come from opening trade to both goods and services. Estimates from the CGE model show that deep and multilateral goods trade liberalization have the potential to generate a 10 percent increase in output and a 12 percent improvement in household welfare. In the more realistic case of compensation for government revenues via adjustment of the VAT, the gains of deep liberalization would be around 8 percent.

Significant benefits³⁶ accrue from deep liberalization of goods, and specifically the reduction in non-tariff measures that are resource-using, raising marginal costs above best-practice marginal costs. Eliminating NTMs substantially improves the outcomes of either MFN or preferential trade agreements. For example, while shallow MFN liberalization was found to improve welfare from 1 to 5 percent, deep MFN liberalization that includes NTMs improves welfare between 8 and 9 percent.

Services trade magnifies the gains from deep goods trade liberalization and is particularly beneficial for wage and salary earners. Welfare gains from liberalization in services are in the range of 2-3 percent but could reach 11-14 percent in the case of joint MFN in goods and services trade. Foreign

³⁴ Within the context of WTO negotiations, services trade includes the following modes: (1) Cross border supply; (2).Consumption abroad (e.g. tourism); (3) Commercial presence (e.g. foreign direct investment) and (4) Presence of natural persons.

³⁵ The full background study presenting the model and simulation results is presented in Vol II Annex 7

³⁶ Tariff liberalization interacts critically with the domestic tax system. Reducing tariffs with no change in domestic taxes is estimated to contract government revenues substantially. Simulations show that requires up to a 43 percent increase in VAT rates would be needed to maintain government revenue neutrality. These results give preliminary indication that domestic tax policies are quite important and must be calibrated with international liberalization efforts. In all cases, attempting to recoup lost tariff revenues through VAT increases will dampen the gains from trade liberalization particularly for households. Further study is needed on public goods, government revenues, and the domestic tax architecture

investment into services results in increased local demand for labor, pushing up wages and salaries significantly, by about 18 percent.

In all liberalization scenarios, the greatest gains would come either from multilateral liberalization or from regional integration with the EU. The EU remains the preferred partner for Tunisia and the market that is likely to generate the largest gains from deeper integration. Scenarios of integration with GAFTA partners or with the US are likely to generate smaller gains.

Positive welfare implications of services liberalization are even larger if competition can be allowed and guaranteed between providers. It is important to note though that these scenarios do not take into account the specific nature of services trade liberalization. Studies by Konan and Maskus (2003a) and Konan and van Assche (2007) indicate market structure and regulations play a significant role in the liberalization of services, particularly for Mode 3.³⁷ For instance simulation of welfare implication of allowing foreign providers to enter Tunisia's key services sectors (in this case telecommunication) shows that the welfare implications are clearly positive if competition can be guaranteed between providers. Welfare gains can be up to 0.65 percent if the foreign provider is 15 percent more efficient than the domestic incumbent and does not shift its profits abroad. In contrast, services liberalization would be welfare deteriorating if the foreign provider colludes with the domestic incumbent and shifts. These findings highlight the importance of implementing services liberalization in a suitable regulatory and competition framework (see Chapter 2).

³⁷ Introducing a method to incorporate a single imperfectly competitive service sector that can take on various market structures into a standard CGE model, Konan and van Assche (2007) identified several welfare effects induced by service trade liberalization: (i) a positive *love-of-variety* effect if services provided by domestic and foreign providers are considered to be imperfect substitutes; (ii) a positive pro-competitive effect if the two providers decide to compete in quantities instead of colluding; (iii) a positive efficiency effect if the foreign providers are more efficient than the domestic provider; and (iv) a negative profit-shifting effect if the foreign providers shift their profits abroad. The fact that the welfare effects have different signs corresponds to policy concerns that the welfare impact of service trade liberalization is ambiguous and depends on the adopted market structure and country characteristics.

TABLE 1.3 SCENARIOS FOR GOODS AND SERVICES LIBERALIZATION

	Baseline values	50% MFN Tariff Reduction	Full MFN Tariff Elimination	FTA with US	FTA with EU	GAFTA	Cross-border services (Mode 1)	Cross Border and Domestic Presence (Mode 1 & 3)	Deep MFN Goods and Services
	(1)	(2) (CNPF-50%)	(3) (CNPF-100%)	(4) ALE-EU	(5) ALE-UE	(6) ALE-GAFTA	(7) MODE-1	(8) MODE-1 + MODE3	(9) B&S(CNPF)
Indices									
Welfare index	1.00	1.01 <i>(1.08)</i>	1.01 <i>(1.08)</i>	1.00 <i>(1.00)</i>	1.02 <i>(1.04)</i>	1.00 <i>(1.01)</i>	1.02 <i>(1.02)</i>	1.07 <i>(1.03)</i>	1.14 <i>(1.11)</i>
VAT adjustment		18.25 <i>(6.78)</i>	43.17 <i>(33.05)</i>	7.93 <i>(8.34)</i>	15.28 <i>(13.80)</i>	0.65 <i>(0.75)</i>	<i>(-0.41)</i>	<i>(41.21)</i>	<i>(31.74)</i>
HH expenses	42.5	42.75 <i>(45.94)</i>	42.91 <i>(46.14)</i>	42.50 <i>(42.61)</i>	43.22 <i>(44.41)</i>	42.54 <i>(42.77)</i>	48.7 <i>(43.61)</i>	49.2 <i>(43.98)</i>	49.7 <i>(47.12)</i>
GDP	65.4	65.42 <i>(65.44)</i>	65.43 <i>(65.45)</i>	65.41 <i>(65.41)</i>	65.43 <i>(65.43)</i>	65.41 <i>(65.41)</i>	65.4 <i>(65.38)</i>	65.4 <i>(65.39)</i>	65.5 <i>(65.41)</i>
Production	163.7	163.79 <i>(176.29)</i>	163.74 <i>(176.53)</i>	163.19 <i>(163.26)</i>	169.22 <i>(172.50)</i>	163.91 <i>(164.20)</i>	158.5 <i>(158.47)</i>	161.2 <i>(158.13)</i>	173.1 <i>(169.96)</i>
Variation en %									
Welfare		0.59 <i>(8.01)</i>	0.95 <i>(8.45)</i>	0.02 <i>(0.28)</i>	1.69 <i>(4.46)</i>	0.12 <i>(0.64)</i>	2.13 <i>(2.16)</i>	6.82 <i>(3.11)</i>	13.76 <i>(10.62)</i>
Wages and Salaries		0.81 <i>(5.82)</i>	1.61 <i>(6.80)</i>	0.23 <i>(0.43)</i>	1.76 <i>(3.58)</i>	0.07 <i>(0.39)</i>	11.21 <i>(11.21)</i>	12.15 <i>(13.03)</i>	17.95 <i>(18.56)</i>

Source: Tables A.7.1, A.7.2 and A.7.3, Volume II. Values at 2010 prices (real value)

Notes: In columns 2 to 6, tax revenues are kept constant by adjusting VAT and the values between brackets in italics correspond to results obtained with a deep liberalization that takes into account the removal of costs associated with NTMs. In columns 7 to 9, the values between brackets in italics correspond to the results under constant tax revenues by adjustment of VAT. Welfare indices measure the equivalent variation (the monetary cost estimated at the reference price for the consumer to get the level of utility after the change)

2. Services liberalization and deeper integration with the EU: reforms options

2.1 Key regulatory reforms to remove barriers to trade and investment in services in Tunisia

Service reforms and liberalization are crucial to respond to the country's specific needs in the post-revolution context. Achieving economic growth is not enough. Tunisia is facing additional challenges inherent to the post-revolutionary context. With a view to appease social unrest, growth should be balanced and inclusive. Priorities of the government include the fight against unemployment (of the youth and women in particular) and the reduction of social and regional inequalities. The following argues that services reform and trade integration are essential elements of the government's success.

Fighting unemployment, in particular for the youth and women

Unemployment in Tunisia has surged from 13 percent in 2010 to 19 percent in 2011 with important disparities among age groups, women/men, and regions. Unemployment of the youth reached 44 percent, and 72 percent of the unemployed are under 30. In Western (Center) provinces, unemployment rates average more than 28 percent, i.e. more than twice the average rates observed in the North-East. The rebound of the economy in the first quarter of 2012 (+4.8 percent compared to the same period in 2011) helped reducing the unemployment rate to 18 percent in 2012 and 16.5 percent in 2013, but structural problems remain (all data from INS, 2013).

New jobs created by trade are prominently in the services sector and benefit both women and the youth that are most affected by unemployment in Tunisia. Services represent half of the jobs in Tunisia, compared to 75 percent in OECD countries like France (with the highest level of employment in the services sector for the 15-29 age group) (INS et INSEE, 2012). The hospitality sector is the main source of "first jobs" for low-skilled workers (that represent 67 percent of total unemployment in Tunisia). Call centers employ 11,000 persons in Tunisia, mostly young graduates, and this sector has been the first one to rebound in 2012, representing 6 percent of the FDI-related jobs created in the first four months of the year (with an additional 2 percent for telecoms, 1 percent for IT, and 1 percent for consultancy). The development of ICT services is a common factor of increase of youth employment. Greater economic integration increases the demand for skilled workers and could benefit young graduates. Upgrading within global services value chains – e.g. from BPO to KPO – could also serve the same objective, justifying an emphasis in the services trade negotiations not only on low but also high-skilled labor movements and a further liberalization of trade in professional services. A better regulation of services sectors could also help address the issue of informality that affects those sectors (and women in particular) more than manufacturing.

Despite recent advances in female labor force participation, only 25 percent of women have a job in Tunisia (the participation rate for men reaches 70 percent), compared to 52 percent for the world average. At the same time, unemployment among women reached 46 percent. There is significant margin for improvement and, as a result, for increasing the income of households. The development of services trade could contribute to this objective: two services sectors alone (communication services and retail/hotels/restaurants) represent more than half of the jobs held by women (52 percent compared to 33 percent of jobs held by men)(World Bank, 2011a). The 2012 World Development Report (World Bank, 2011a) suggested that increases in female employment levels (but not male) between 1995 and 2005 were correlated with increases in international trade and new opportunities in the services sector. In particular, the report stressed that new ICT-enabled jobs in services (e.g. information processing in banking, insurance, printing and publishing, and call-centers) were mainly taken up by women, and that

teleworking offered new opportunities for men and women to better combine family and professional lives.

Fighting social and regional inequalities

Important wealth and development disparities between sub-national regions in Partner countries are a source of economic distress and social unrest, as illustrated by the outburst of the Tunisian revolution in the least privileged central part of the country (Gafsa, Sidi Bouzid). Tunisia suffers from these regional inequalities: unemployment rates in the Center-West of the country are more than twice the level of those in the North and Center-East, reaching 28 percent of the active population (INS, 2012); poverty affected 29 percent of the population in the Center-West, compared to 5-7 percent in the Center-East and the grand Tunis area (INS, 2011).

Services trade integration strategies could include spatial (regional) planning as a legitimate domestic policy objective. In Morocco, for instance, the Atlantic coast with the economic and administrative capitals has traditionally been the economic driver of the country; it is the objective of an ambitious spatial planning policy – backed by services trade integration projects – to develop new growth poles: Tanger-Tétouan and Fès-Meknès as trade platforms respectively with Europe and the Maghreb, Marrakesh and Agadir for tourism, Ouarzazate for solar power (Ministère des Affaires Etrangères, 2006). Larger scale projects (such as cross-border transport, energy and telecommunications networks) could allow the construction of adequate infrastructure and the development of efficient and competitive services available to a larger share of the population. Services trade, under all four modes, could be used to serve spatial planning objectives. As suggested below, regional integration could adequately serve such objectives to the extent it includes both soft and hard network-building dimensions.

2.2 From Rents to Competition: Unleashing Tunisia’s Services Trade Potential in a Context of Deeper Regional Integration

For over a decade, Tunisia has been underperforming in services trade. Despite sometime important growth rates, Tunisia’s performance gap with its main competitors has been widening, and the succession of two shocks aggravated this trend: the 2008 global economic crisis and the 2011 Jasmine Revolution. While the 2008 crisis has affected all economies, the 2011 shock was country/region specific, and some of Tunisia’s competitors spared by the political turmoil of the Arab Spring have benefited from trade diversion effects. At a time other economies were bouncing back in the aftermath of the 2008 crisis, Tunisia continued its decline, postponing critical reforms, and putting the country literally at risk of “stalling”. To avoid this scenario, and harness the opportunities unlocked by the revolution, Tunisia urgently needs to engage a number of reforms to both increase the competitiveness of the country and restore its attractiveness for foreign investors. The dual shock Tunisia recently faced only accelerated a trend that preceded the crisis: in 2007, Tunisia was already underperforming and in need of reform. A number of sectoral strategies had been drafted to boost the country’s competitiveness and growth, but put on hold. Six years later, the performance gap to fill in is much wider and the ambition of reforms to be engaged, including the strength of the signals to be sent to foreign investors, is significantly higher. At the same time, due to social unrest and high unemployment rates, the government has little room for maneuver.

The problems to be addressed are structural. For instance, Tunisia remains highly dependent on tourism receipts, suggesting a failure of its services trade diversification efforts. Since tourism is particularly sensitive to political (among others) shocks, the impact of the revolution on Tunisia’s trade performance has been higher. However, tourism in Tunisia was already declining and in need of reform prior to 2008. Looking at the causes of the country’s structural underperformance, it appears that Tunisia

has been functioning as a rent-economy: a number of regulations and administrative burdens have been put in place over years to allow the creation and preservation of rents subsequently captured by a small fringe of the population through nepotism and corruption. A recent World Bank study (2014) shows that 77 percent of the firms owned by the Ben Ali family were in the services sector, mainly in real estate, trade/distribution/retail, personal services, construction, hospitality, financial services and telecommunications. This means that the country remained largely closed to foreign competition, but also that the functioning of the domestic market was distorted to the benefit of a few privileged insiders. After 2008, coincidentally with the deterioration of prospects on global markets, the rent system reached its apogee, and the flagrance of its excesses in a context of economic downturn probably contributed to the outburst of the revolution.

In light of the priority to fight unemployment and inequalities, the leading thread of the new government's action should be to move from a rent- to a competition-driven economy to the benefit of the Tunisian population at large. This means increasing transparency, predictability and security of the services regulatory framework.

This agenda is primarily a domestic one, and key reforms could be undertaken on a unilateral basis. However, international and regional trade integration could help achieving this objective by fostering competition and locking in reforms that are necessary to prevent old rents from being captured by new individuals. It is also a source of technical assistance and capacity building resources that are extremely valuable in light of the number of challenges facing the new government and its tight budget constraints.

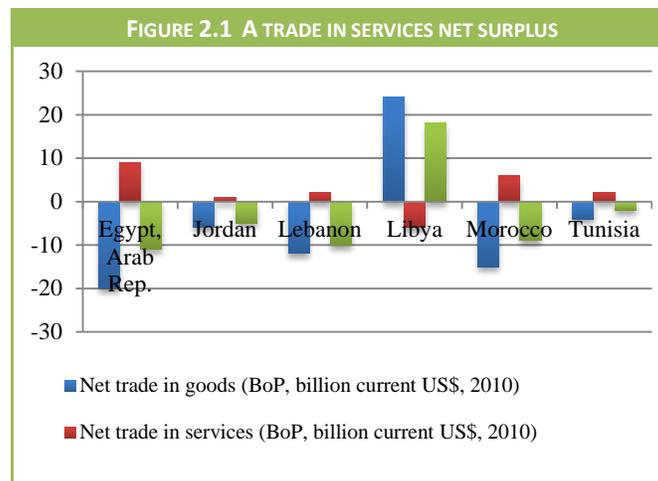
Necessary reforms have long been identified, but have been postponed in the first place by insiders with vested interests and then by exceptional circumstances associated with the revolution. A number of sectoral strategies, regulatory and institutional reforms have been prepared that could still guide the government. For six years, the reforms have been on hold, and the country never moved from the reflection stage to the implementation stage. The revolution, at the same time, has made action more challenging, but also possible, more necessary and pressing. Moreover, the international context has significantly changed since the 2008 crisis: the global economy has witnessed important shifts in demand and supply, and a re-organization of production along global value chains. Economic solidarities have changed accordingly, and remaining outside the main trade and production networks is a recipe for economic collapse. Allowing further delays for reflection reduces rather than increases the number of options available to Tunisia: for instance, with regard regional trade integration, first movers have a significant advantage by setting the standard for negotiations and benefiting from later concessions through the most-favored nation clause contained in most trade agreements. Hopefully, the pressure of the regional integration agenda can help building consensus and accelerating the pace of reforms that are in the country's best interest. Thus, the main benefits of integration will probably rest in the convergence process that should precede the implementation of the agreements themselves. Moving from rents to competition is not easy, however.

The government is facing two main challenges with this regard: (i) in a context of high unemployment and remaining social tensions, it will be very difficult to implement reforms that suppress jobs, even if these jobs were created and remain dependent on rents. The government will have to make clear how this short term loss will translate in medium terms gains in terms of jobs creation (thanks to increased competition and market efficiency); (ii) to avoid that rents are captured by new vested interests, either domestic or foreign. Sequencing of the reforms will be essential to ensure that opening will result in more competition and a better distribution of wealth among Tunisians. The government will need to be bold and strategic at the same time. Giving in to vested interests and preserving the rent-system would deny the country's chances of filling in its performance gap. The temptation to go down that path remains strong; however, as illustrated by current debates and hesitations on the opening of key sectors such as air

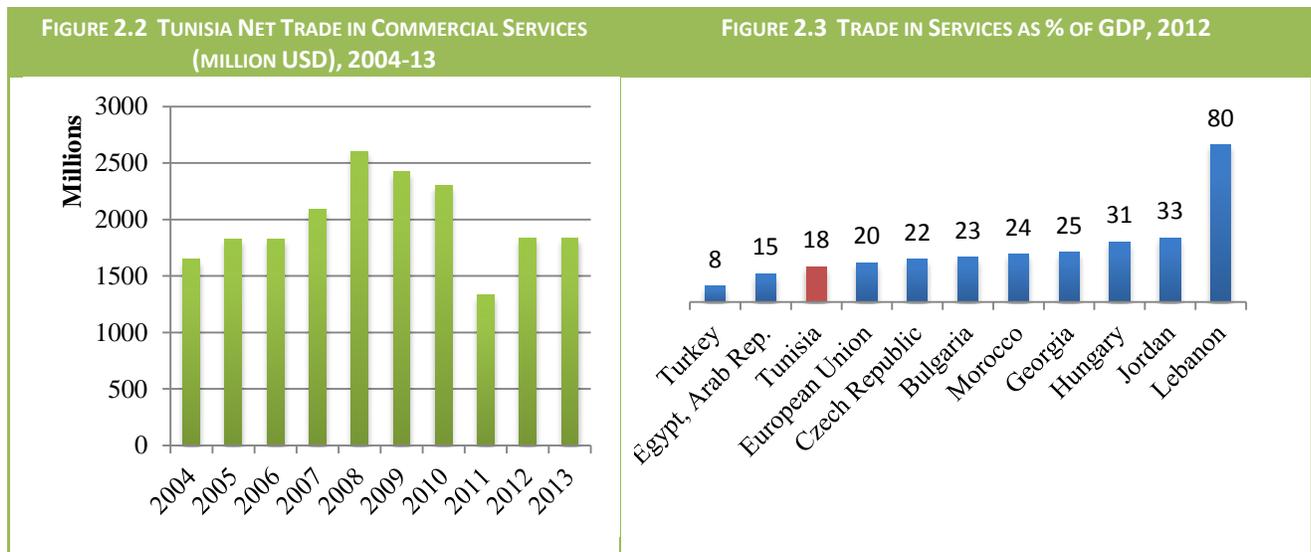
transport and telecommunications. At the same time Tunisia's trade partners should also resist the temptation to capture existing rents or press the country to engage reforms that are not sustainable in the current fragile socio-economic context. In addition, they should increase their assistance efforts to make the transition as smooth as possible.

2.2.1 Tunisia's structural underperformance in services trade

For the past decade, Tunisia has run a services trade surplus, which has contributed to partially offset the country's current account deficit in merchandise trade. Prior to the revolution (2010), this situation was common to most countries in the region, with the exception of oil-exporting countries (GCC, Libya), which continued to run a net services trade deficit in absence of diversification of their exports. In addition, 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.



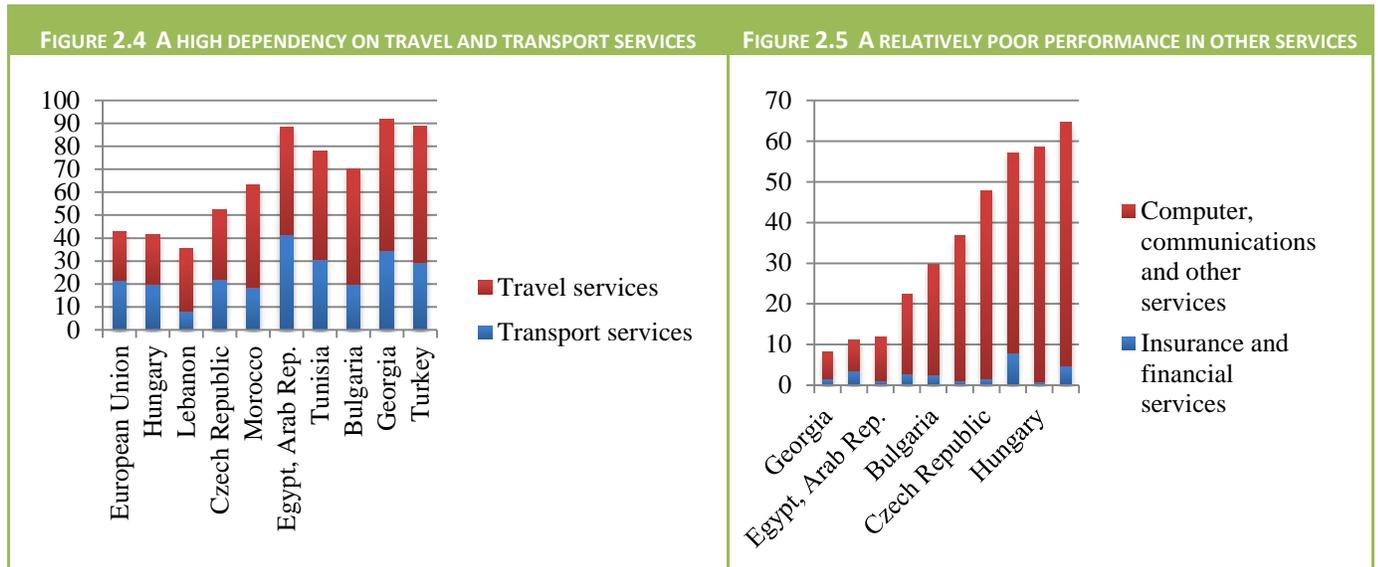
Source: World Development Indicators, World Bank, 2011



Source: World Development Indicators, World Bank, 2014

Source: World Development Indicators, World Bank, 2014

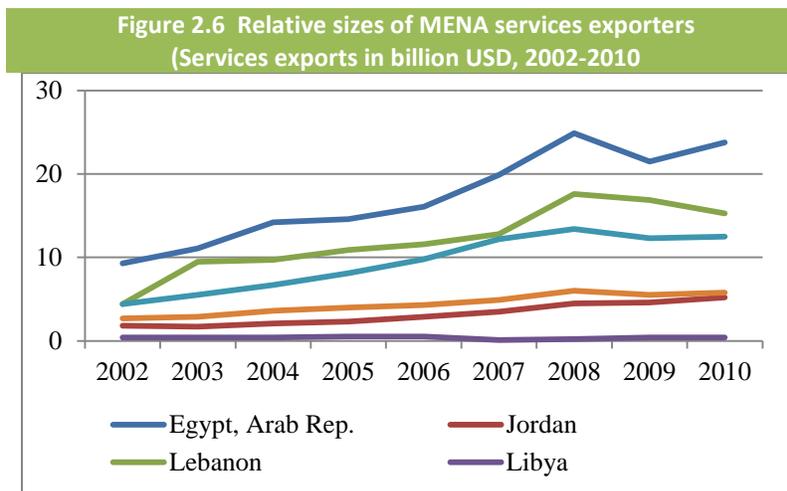
However, a closer analysis of the country's services exports reveals a high dependence on transport and travel, i.e. tourism. Travel alone represents close to 50 percent of Tunisia's services exports, compared to 25 percent or less, on average, for the rest of the world and the OECD. Cumulatively, travel 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/insurance and communications/computer services remains well below the world average. This suggests a need for further diversification and a low capacity to innovate.



Source: World Development Indicators, World Bank, 2014

Source: World Development Indicators, World Bank, 2014

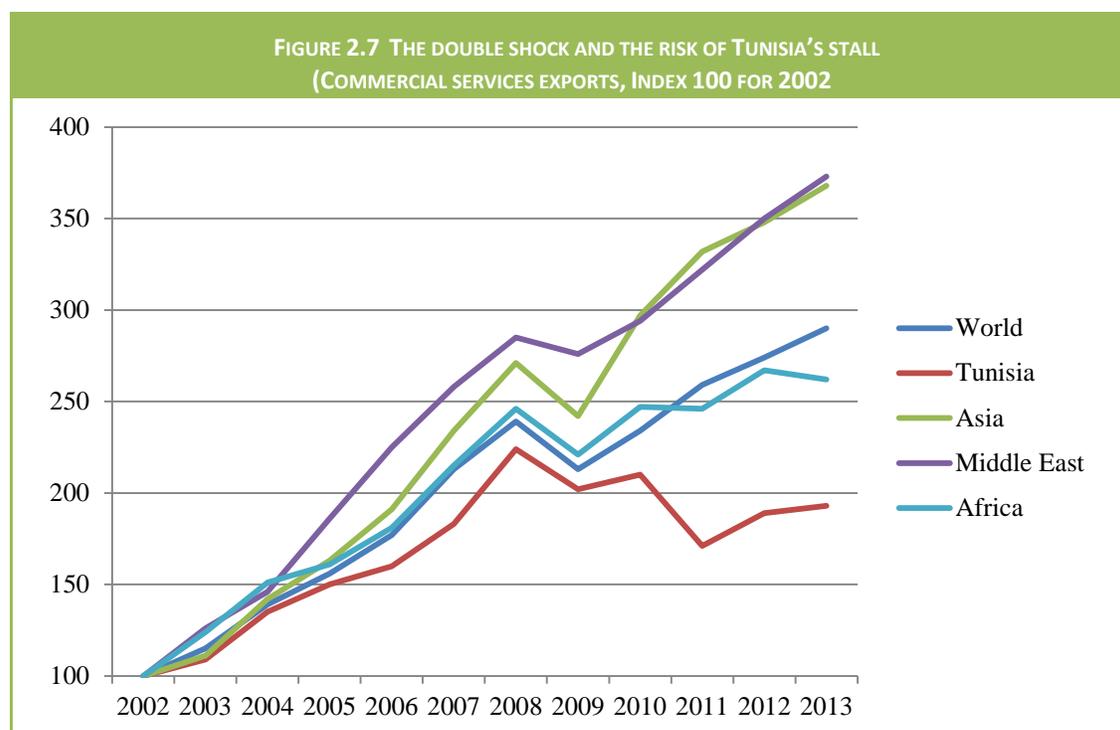
While these trade patterns seem to be common to most countries in the region, the example of Lebanon suggests that a specialization in more innovative services (such as finance or communications/computer services) could be successful and reduce the dependence on tourism receipts. Also, looking at the value of Tunisian services exports, the country remains a small player in the region, principally due to the scale of the country and its population (per inhabitant, Tunisia exports twice as much as Egypt, but four times less than Lebanon). Over the last decade, Tunisia's exports also grew much more slowly than the exports of its main competitors in the region.



Source: World Development Indicators, World Bank, 2011

The double shock (2008 and 2011) and the effects on services trade and FDI

In 2008 and 2011, exports dropped as a result of the crises. In between, recovery had been slower in Tunisia than in the rest of the world, due to the postponing of reforms and an increase in corruption and rent seeking behaviors. As a result of these exogenous and endogenous, as well as economic and governance factors, between 2002 and 2011, the level of services exports more than tripled in Asia and the Middle East when it grew by a mere 70 percent in Tunisia, widening the original performance gap. The 2012-13 recovery was not sufficient to fill in the gap since growth of services exports in Tunisia (+12.8 percent over two years) remained slower than in competing economies (+15.8 percent in the Middle East and +14.3 percent in Asia for the same period).

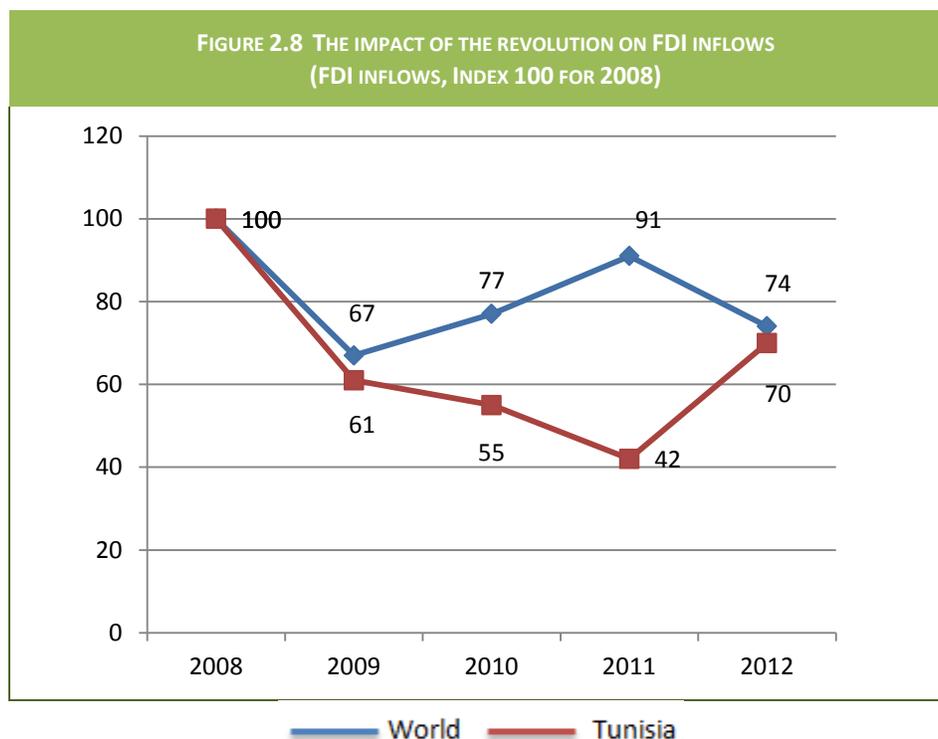


Source: WTO online statistics (accessed in June 2014)

FDI also dropped as a result of the crises. The level of FDI in Tunisia has continuously declined between its historic high of 2008 (second best year for FDI in Tunisia after 2006 – year of privatization of Tunisie Telecom) and 2011. Worldwide, FDI inflows have dropped from close to 1,800 billion USD in 2008 to 1,200 billion USD in 2009 (-33 percent); in Tunisia, FDI inflows dropped in comparable proportions (-39 percent) from 2.8 billion USD to 1.7 billion USD. However, world FDI bounced back with a 15 percent increase in 2011 (to reach 1,400 billion USD), and an 18 percent increase in 2011 (to reach 1,650 billion USD). In 2012, world FDI dropped again by 19 percent to 1,350 billion USD. In total, world FDI inflows level stood in 2012 at 74 percent of the 2008 level. By contrast, Tunisia FDI inflows continued to drop by 10 percent and 24 percent respectively in 2010 and 2011 (to reach 1.5 and 1.1 billion USD). In total, Tunisia FDI inflows level stood in 2011 at less than 40 percent of the 2008 level. In 2012, FDI in Tunisia rebounded to catch up with world level with a two-year delay.³⁸ Other countries most affected by the Arab Spring uprisings had similar concerns: in 2011, the number of FDI projects in Libya and Yemen declined by 80 percent, in Egypt by 29 percent, in Syria by 26 percent, and in Tunisia by 14

³⁸ UNCTAD statistics online, retrieved in July 2013.

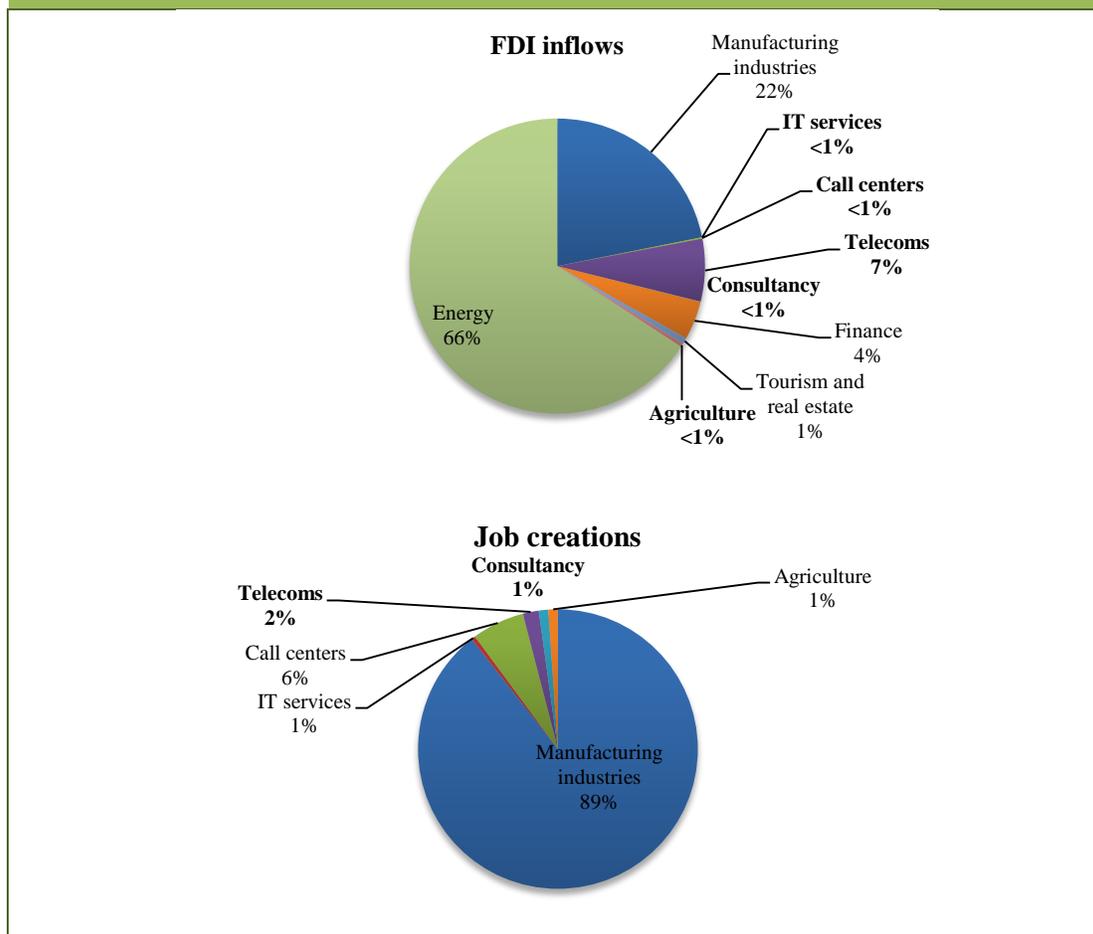
percent. By contrast, countries in the region that remained politically stable benefited from the diversion of FDI inflows, and attracted a large number of additional projects: for example, the same year, the number of FDI projects surged by 40 percent in Morocco (FDI Intelligence, 2012).



Source: UNCTAD statistics online, 2013

In 2012, FDI bounced back (FIPA, 2013): in Tunisia FDI flows grew by 55 percent between 2011 and 2012 to reach a level comparable to the one observed before the revolution (+15,7 percent compared to 2010). However, this performance is mainly attributable to two major operations: the acquisition of 13 percent of Banque de Tunisie (MTND 218) by Crédit Mutuel Français, and the acquisition of 15 percent of the Tunisiana stocks (MTND 636,9) by Qatar Telecom. In the tourism and real estate sector, FDI grew by over 300 percent between 2011 and 2012, however this rebound was not sufficient to compensate for the effects of the revolution, and the level of FDI in 2012 remained lower than in 2010 (by about 20 percent). This could be explained by the factors that drive services trade: while services trade is more resilient than merchandise trade to economic downturns (see Borchert and Mattoo, 2009), it is more sensitive to reputational risks (e.g. malpractice in professional services, or insecurity in tourism). Thus, FDI/trade in services should bounce back later than in the manufacturing sector. It also suggests that even more efforts should be made to restore the attractiveness of Tunisia as a destination for services providers (investors) and consumers (including tourists).

**FIGURE 2.9 DISTRIBUTION BY SECTOR OF FDI INFLOWS AND JOB CREATIONS IN TUNISIA
(FIRST QUARTER 2012, 100%=592.8 MTND=2,440 JOBS)**



Source: FIPA, 2012

2.2.2 The role of services and services trade in Tunisia's overall economic performance

The efficiency of services inputs is a key determinant of Tunisia's competitiveness and growth

Services are inputs into any kind of economic activity and production, representing generally between 10 and 20 percent of the industrial production costs (Hodge, 2002). Ease and cost of access to finance, for example, are essential to economic initiative and growth: according to Doing Business, Tunisia ranks only 98th (out of 183 surveyed countries) regarding the ease of getting to credit. Similarly, as pointed out in the sectoral analyses below, Tunisia has high telecommunications, Internet access, and transport costs, which affect the competitiveness of Tunisian firms, as well as the attractiveness of the country for foreign investors.

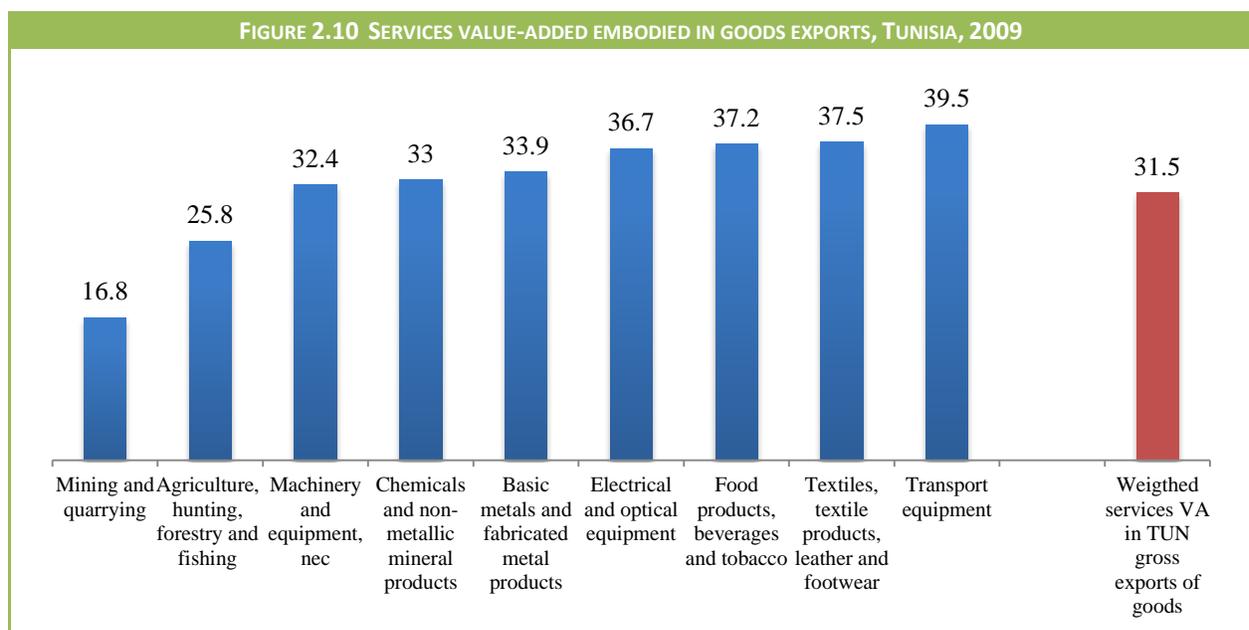
Services trade liberalization, if implemented in a proper regulatory and competition framework, could remedy supply-side constraints and increase competition on the domestic market, resulting in a more diversified and competitive local supply of services. Gains expected from trade also include knowledge spillovers and FDI inflows. Benefactors are the local consumers of services, including firms that use services in their production. In turn, productivity gains allow growth and job creations in all sectors. A recent study by Arnold et al. (2012) found that banking, telecommunications, insurance and transport reforms in India all had significant, positive effects on the productivity of manufacturing firms:

A one-standard-deviation increase in the aggregate index of services liberalization resulted in a productivity increase of 11.7 percent for domestic firms and 13.2 percent for foreign enterprises.

The efficiency of services “links” is a key determinant of Tunisia’s level of trade integration and its ability to participate to global production networks

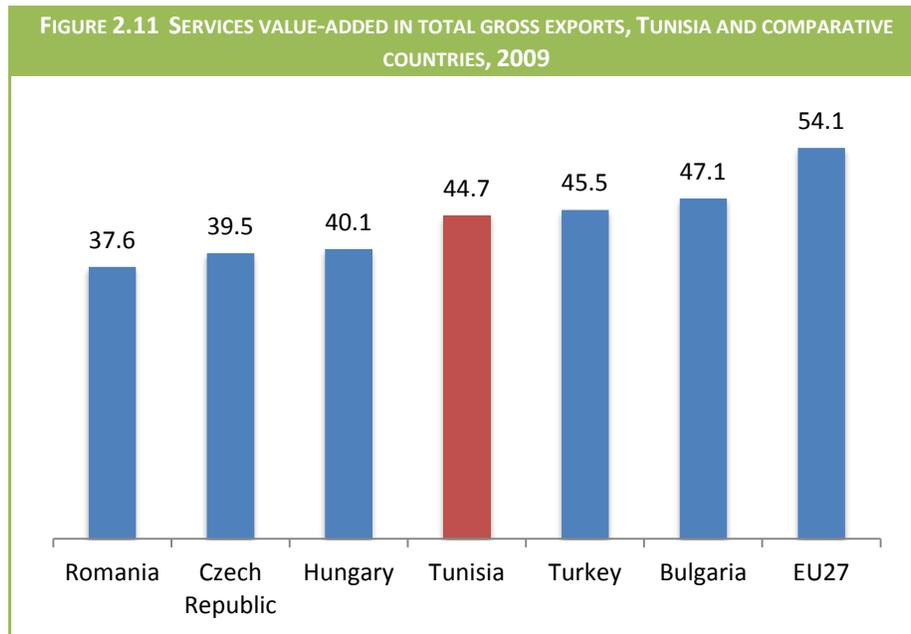
Improving the efficiency of services is important to any trade integration (or export-led growth) strategy and is necessary to compete with cost-efficient emerging countries. Due to the “servicification” of the economy and the increase in the services content of traded goods, ease of access to quality, efficient and moderately priced services all along the production chain (including abroad) has become a key determinant of competitiveness and participation to global production networks in traditional sectors such as agriculture and industry. About 75 percent of services trade is in intermediate services, suggesting that services trade primarily takes place in global value chains (Miroudot et al. 2009). A recent study by the Swedish National Board of Trade (2010) revealed that 40 different services tasks are involved when a manufacturing firm internationalizes its production. Participation to global production networks will depend on the country’s ability to efficiently supply those services (either onshore or offshore): vis-à-vis the EU, Tunisia’s geographical proximity and just-in-time production are a major comparative advantage that relies on sophisticated supply chain management.

The most recent data on trade in value-added reveals the importance of services embedded in traditional goods exports. While Tunisia does not appear in the OECD-WTO database on trade in value-added it is possible to make some estimates of the services content of its exports by looking at the structure of Tunisian exports and observed services content of exports by sector. First, it appears that the average services content of Tunisian goods (manufacture and agriculture) is relatively low: less than one third of the value-added (31.5 percent). This suggests that Tunisia remains specialized in sectors where little value can be added. Second, once services exports are taken into account, the share of services value-added in total exports is close to 45 percent. This is much more than the nominal share of services in total trade (22.5 percent), and puts Tunisia at a level of services value-added in trade comparable to countries in the EU’s sphere.



Note: Services value-added per sector are for the EU, average for Tunisia is an estimate based on the relative value of exports per sector

Source: OECD-WTO Trade in Value-Added Database, 2014



Note: Estimation based on EU averages per sector, using the structure of Tunisian exports.
Source: OECD-WTO Trade in Value-Added Database, 2014

Despite recent improvements, trade in intermediate goods remained relatively modest in the MENA region, suggesting that the region is not part of the main global production networks. This could be explained in part by a high level of protection in the services sector, including in key sectors like transport/logistics and telecommunications. Major obstacles to trade in services and poor services efficiency could contribute to leaving the region aside from major global value chains. For example, barriers to establishment (such as the equity limits imposed in many sectors in Tunisia – see Vol II Annex 2A) and movement of persons (such as Tunisian nationality requirement to work in professional services) could constrain production relocation decisions (FDI) in some industries; barriers to trade in retailing and distribution (such as the discrimination against foreign franchises that require, unlike Tunisian franchises, administrative authorizations) could be an impediment to backward linkages in the industry and agriculture sectors (when the lead firm is a global retailer – see for instance the problems met by big retailers to establish in Tunisia); absence of adequate protection of data could be an obstacle to services off-shoring.

As part of the integration negotiations, services trade liberalization – as well as aid for trade in services provided by major donors or transfers by the private sector – could help increasing the competitiveness of Tunisia and its participation to global production networks, hence boost its exports in both goods and services. In a globalized economy, where global value chains prevail in business strategies, and where final and intermediate goods cross borders a number of times before reaching the final consumer, services “links” (e.g. transportation and logistics, telecommunications) will enable trade to take place and dictate production relocation and trade routes. According to recent OECD/WTO work on global trade in value-added, it appears that services trade has been largely underestimated: accounting for the value-added by services in the production of goods shows that services contribute over 50 percent of total exports in most OECD countries, and nearly a third of exports in emerging countries (OECD/WTO TIVA database, 2013).

As part of the integration package, liberalization of key transport and ancillary services, aid for trade facilitation, harmonization and simplification of procedures with adequate technical assistance could contribute to reducing the trade costs of Tunisia, and help its participation to global production networks. Recent analysis suggests that progress on trade facilitation could generate more gains for developing countries than anything else emerging from the Doha negotiations (Hoekman and Nicita, 2010). Reducing supply chain barriers to trade (border administration and transport and communications infrastructure and related services) could increase GDP by nearly 5 percent and trade by 15 percent (World Economic Forum, *Enabling Trade. Valuing Growth Opportunities*, 2013). Tunisia has engaged a number of reforms as part of development programs sponsored by the donors: as a result, its logistics performance has significantly increased, and Tunisia has gained 20 positions (from 61 to 41 out of 155) between the 2010 and 2012 World Bank LPI rankings (see Table 2.1 below). Tunisia is now in the first third of best performing countries in the world, and the second best performing country in the region. However, there is still substantial room for improvement and regional integration with major trading partners could be a way to justify and reinforce reforms in this sense.

TABLE 2.1 AN IMPROVING PERFORMANCE IN LOGISTICS AND TRADE FACILITATION SERVICES

Country	LPI Score	Customs	Infrastructure	International shipments	Logistics competence	Tracking & tracing	Timeliness
Turkey	3.51 (rank:27)	3.16	3.62	3.38	3.52	3.54	3.87
Tunisia	3.17 (rank:41)	3.12	2.88	2.88	3.12	3.25	3.75
Morocco	3.03 (rank:50)	2.64	3.14	3.01	2.89	3.01	3.51
Egypt, Arab Rep.	2.98 (rank:57)	2.6	3.07	3	2.95	2.86	3.39
Lebanon	2.58 (rank:96)	2.21	2.41	2.71	2.38	2.61	3.11
Jordan	2.56 (rank:102)	2.27	2.48	2.88	2.17	2.55	2.92
Algeria	2.41 (rank:125)	2.26	2.02	2.68	2.13	2.46	2.85
Libya	2.28 (rank:137)	2.08	1.75	2.62	2.25	2.38	2.51

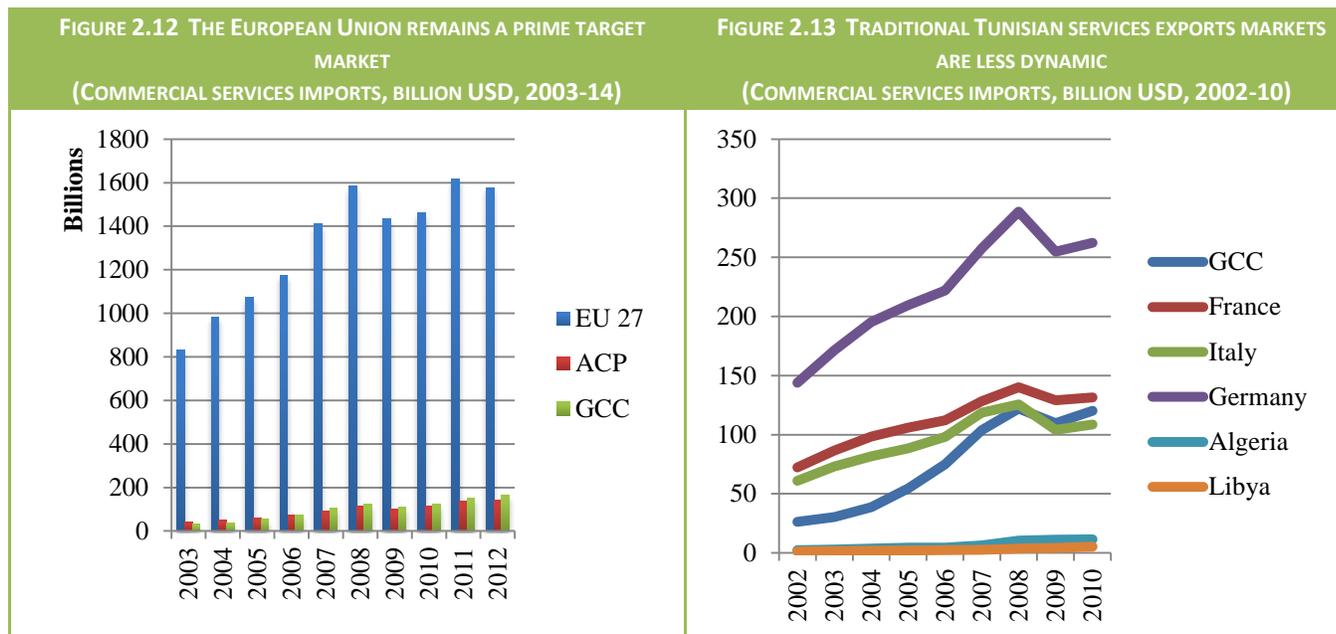
Source: Logistics Performance Index, World Bank, 2012.

Increasing and diversifying Tunisia's services exports and foreign investment inflows would allow to exploit largely untapped resources

MENA countries have long been too dependent on the export of raw materials and low value-added industrial goods, confined at the bottom of the productivity chain when emerging countries moved up the value chain (Müller-Jentsch, 2005). Services trade, whether embedded in goods or stand-alone, represents an important diversification, upgrading and growth potential that has remained largely untapped. Over the last decade, Tunisian services exports have increased by 70 percent in value, which is significant but way under growth rates observed in the rest of the world. As mentioned earlier, the share

of services exports in Tunisia's GDP is relatively important (twice as large as the share observed on average in OECD countries), but largely due to a high dependence on tourism. Thus, Tunisia needs to boost its services exports and diversify their content.

The need for diversification extends to the geography of export markets. In 2010, the European Union still absorbed more than three quarters of the Tunisian services exports (France and Italy alone represented more than half of the exports); Algeria and the US, coming next, each absorbed 3 percent of the Tunisian services exports (WTO statistics online, 2012). Figure 2.12 shows that the EU remains a prime target market for Tunisian services exports, e.g. by comparison to the Gulf or ACP countries. However, figure 10 suggests that the dynamic of the French and Italian markets has been fading over years, with growth rates much lower than GCC countries (or Germany in the EU) – at the same time, GCC countries have boosted their services exports and threaten to become major competitors for Tunisia, e.g. in the off-shoring sector where the UAE moved to the 15th position in terms of attractiveness ahead of Tunisia (23rd) (AT Kearney, 2012). With the current budget and debt crises in France and Italy, prospects for a quick rebound are limited. Therefore, a strategy of diversification remains wise for Tunisia. The objective would be to reduce dependence on declining markets, and avoid that the Euro-zone crisis adds to the series of shocks Tunisia faced in recent years.



Source: WTO statistics online, 2014

Source: WTO statistics online, 2012

Services trade is extremely relevant in terms of human capital and knowledge transfers usually associated with FDI. The ratio of FDI to services trade is significantly higher than for merchandise trade: about 250 percent compared to 50 percent (Miroudot et al., 2009). At the beginning of the 2000's, the World Bank and the European Commission pointed at the failure of the MENA region to use trade and FDI as an engine for growth (Müller-Jentsch, 2005); starting with a low baseline, between 2000 and 2008, MENA has multiplied its FDI inflows 17-fold, compared to a mere increase of 86 percent in LAC or 68 percent in China; the 2009 crisis has resulted in a brief drop in FDI (-19 percent) that was caught up in 2010 (+12 percent) (O'Sullivan, 2010). This performance is primarily due, however, to investments in the energy sector, with fuel exporting countries receiving three-quarters of the FDI inflows. In Tunisia, the energy sector received 62.5 percent of FDI inflows in 2011 (FIPA, 2013; see Table 2.2). The services

sector represented only 13.5 percent of FDI inflows to Tunisia in 2011, and 16 percent in the first quarter 2012 – generating 10 percent of the FDI-related job creations (see figure 8). In 2012, two major operations in the financial and telecoms sectors boosted Tunisian FDI inflows and masked an otherwise flat growth of FDI.

**TABLE 2.2 DISTRIBUTION BY SECTOR OF PROJECTS WITH FOREIGN PARTICIPATION IN TUNISIA
(MILLION TND)**

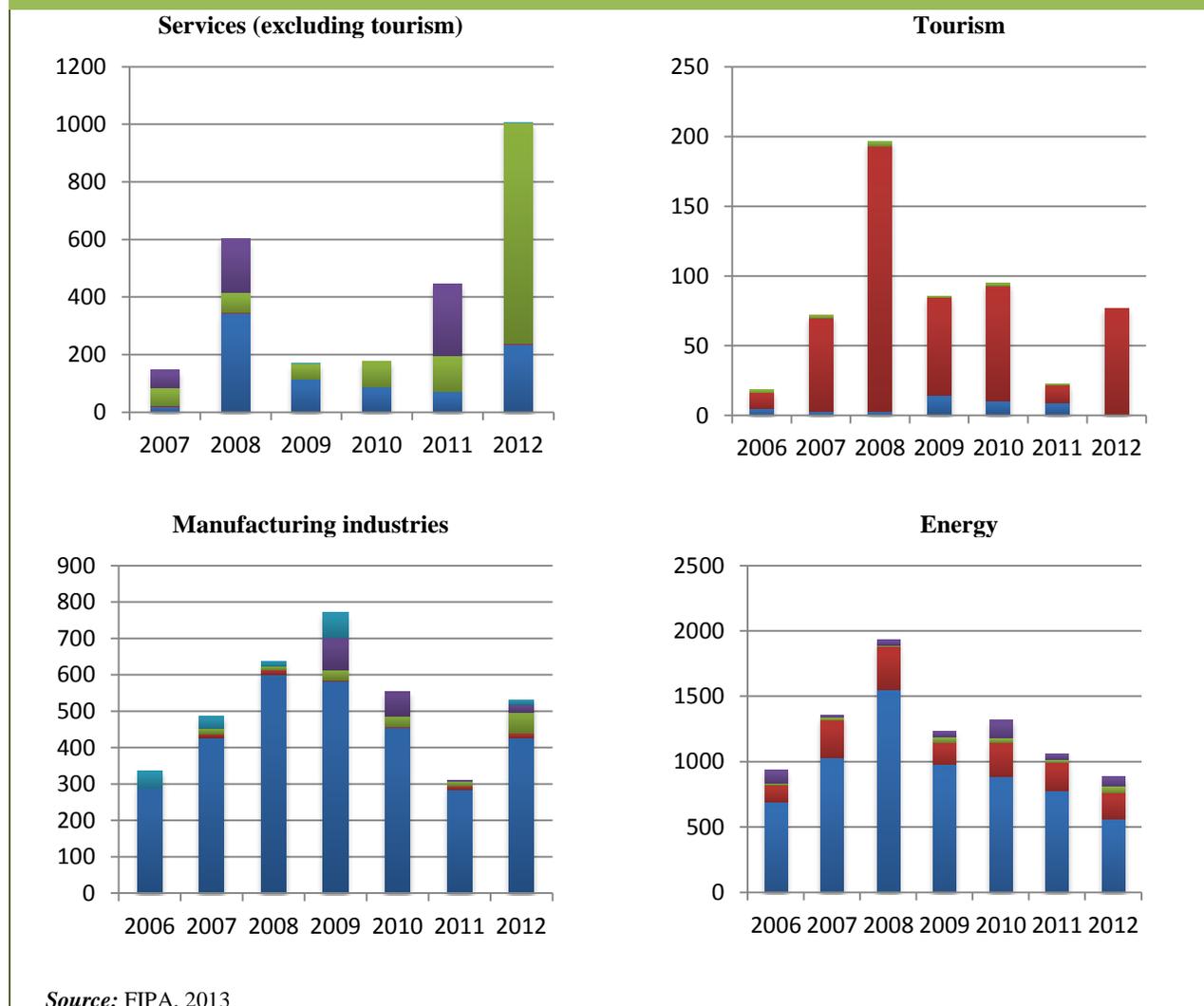
	Manufacturing industries	Energy	Tourism and real estate	Agriculture	Services and others	Total FDI
2006	347.4	940.3	18.3	14.1	3,082.8	4,402.9
2007	485.7	1,359.0	72.0	7.7	146.4	2,070.9
2008	641.6	1,933.9	198.6	20.1	604.5	3,398.7
2009	771.6	1,233.5	85.5	16.9	171.2	2,278.7
2010	573.6	1,317.1	95.0	2.8	176.5	2,165.0
2011	330.6	1,063.41	22.9	2.3	196.7	1,615.9
2012	531.7	886	77	4.6	1,004.8	2,504.1

Note: Services FDI for 2006 includes 2,972 million TND for the partial privatization of Tunisie Télécom, and Services FDI for 2012 includes 2,180 million TND for partial foreign acquisition of BT and 636.9 million TND for partial foreign acquisition of Tunisiana.

Source: FIPA, 2013

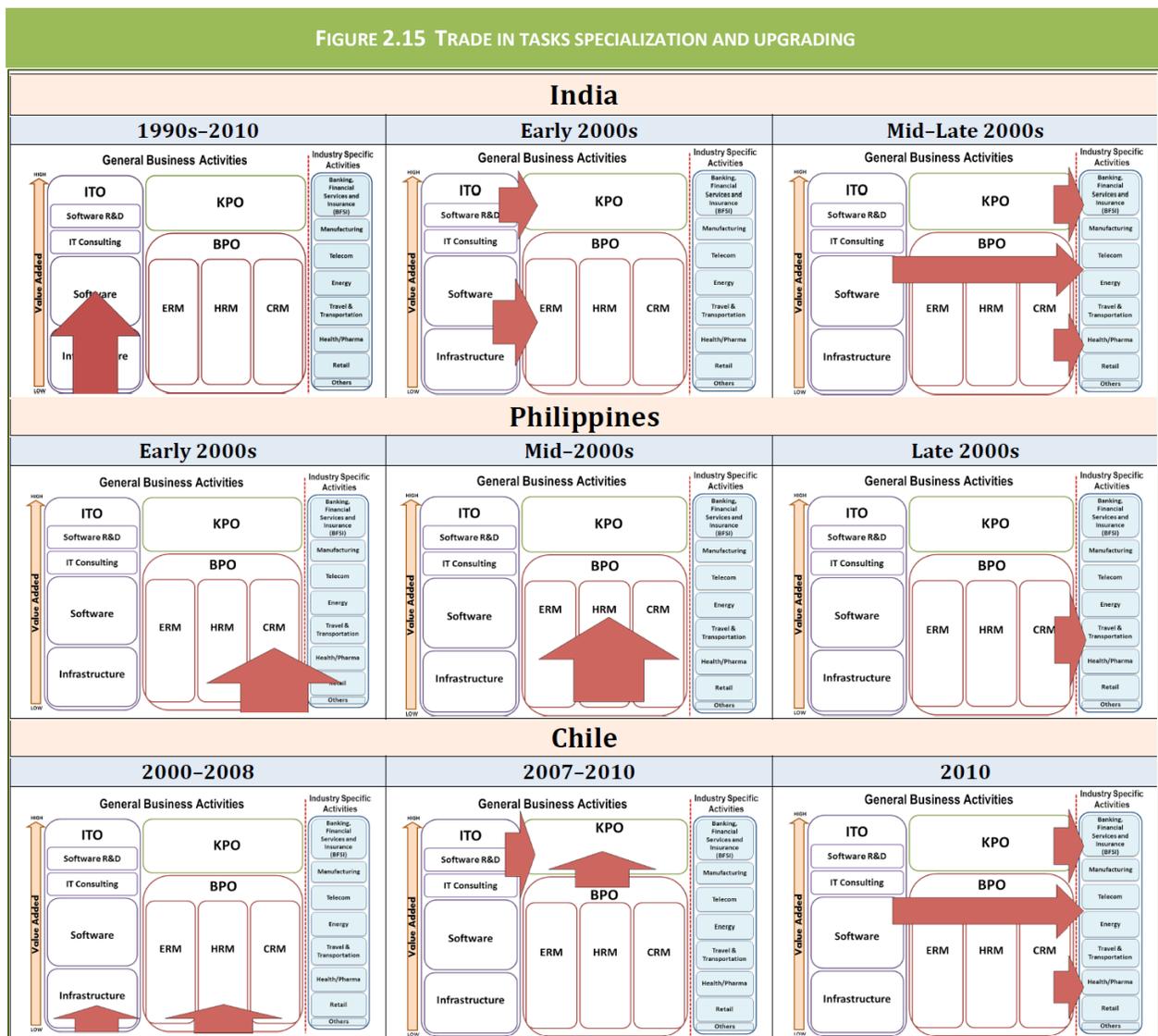
About 78 percent of total investments in the services sector (including tourism) originate in the MENA region. In 2012, the EU represented less than a quarter of the foreign investment in services (tourism and other services) – by contrast, the EU represented 80 percent of the foreign investment in the manufacturing sector and 63 percent in the energy sector (with the US and Canada another 23 percent). Put differently, it seems that the EU primarily invests in the manufacturing and energy sector, and the US/Canada essentially in the energy sector. This trend has been increased after the revolution. This raises questions about the potential impact of services trade liberalization (including mode 3 – foreign establishment) in the context of an FTA: considering that other Arab countries and Turkey already do invest in Tunisia, is the limited attractiveness of the country for EU/US investors only the result of existing regulatory barriers? Figure 11 would suggest otherwise: cultural proximity (including language) probably plays a major role in investment decisions in the services sector. On the other hand, EU/US investors might be more sensitive than their MENA counterparts to the security and predictability of the legal investment framework. Also, the example of the US-Morocco FTA shows that such agreement could give a significant impetus to investment decisions: between the conclusion of the negotiations (2004) and the entry into force of the agreement (2006), FDI inflows to Morocco multiplied three-fold and jumped from USD 800 million to 2.4 billion – the signal sent to investors by the conclusion of the agreement should not be underestimated.

FIGURE 2.14 OTHER MENA COUNTRIES ARE THE MAIN INVESTORS IN TUNISIAN SERVICES
(INVESTMENT BREAKDOWN, BY COUNTRY OF ORIGIN, IN MILLION TND)



Tunisia will not become a major exporter of services unless it opens its market to imports. Services have become increasingly complex, and intra-firm trade and trade in intermediate services have surged – country specialization (and trade) can be at the task level, although recent trends towards global value chain consolidation suggest that countries able to supply a bundle tasks will be more attractive to lead multinational firms. Tunisia cannot become a major services exporter unless it is open to services imports. As noted above, services trade is 75 percent trade in intermediate services: this includes trade in services inputs to agriculture, manufacture, and services. With regard to the latter, two phenomena are noticeable: first, services exports include about 15 percent of imported services inputs (Miroudot and Ragoussis, 2009); second, about a quarter of cross-border services trade is intra-firm (Lanz and Miroudot, 2010). Thus, a country not open to trade in services automatically excludes itself from a significant part of world services trade, significantly increasing its trade costs to the detriment of its competitiveness, and staying aside from major global value chains and intra-firm trade. This is the case, for example, in professional services where the “big four” in accounting/auditing or large US or UK law firms capture a large share of top multinational firms: if such firms cannot establish in Tunisia, the Tunisian files will be treated from abroad, with no spillover effects on the local economy.

When negotiating FTAs, Tunisia should have holistic services trade and reform strategies, or it will never be able to move up the value chain and become part of the main global production networks. Trade in intermediate services and tasks has created new prospects for international division of labor and productivity growth. A country can specialize in different tasks and progressively move-up the value chain, for instance from business process outsourcing (BPO) to knowledge process outsourcing (KPO) (Gereffi and Fernandez-Stark, 2011- see Figure 2.15). Starting with call-centers, Tunisia could move to exporting knowledge if market access were granted by key trading partners. Recent studies suggest, however, that not all tasks can be performed independently/off-shore (Lans, Miroudot and Nordas, 2011), and that only countries able to offer a “bundle of tasks” to lead firms will remain part of the main global value chains that have consolidated their activities after the crisis (Staritz, Gereffi and Cattaneo, 2011). Thus, it is not enough to liberalize the performance of one specific task when it is bundled to other tasks.



Source: Fernandez-Stark et al. (2011)

The driver of the regional trade integration negotiations between Tunisia (and its neighbors) with the EU could be the creation of a production platform with intermediate goods and services traded within the zone and a competitive services/industrial/agricultural offer vis-à-vis the rest of the world. It is not about competing with China and other emerging countries, but offering a bundle of tasks with high value-added content at key points of global value chains. This will require more freedom of trade in services and an increased efficiency of services links to allow a new division of labor, as well as important technology and knowledge transfers for Tunisia and its neighbors to move up the value chain.

2.3 The Role for Unilateral Reforms and Regional Trade Integration

The revolution has provided Tunisia with a unique opportunity to restore good governance by moving from rents to competition, and implement long overdue reforms. When social tensions are still vivid, with resurgent protests and strikes, it is important to send strong signals to investors and restore faith in good governance. Paradoxically, reforms need to be taken at a time the costs of adjustment are the least acceptable (short term job losses, even with prospects of longer term job creations, come with a high political cost), but delaying the reforms any further just threatens to increase the risk of stalling for the country. In a highly integrated world, the absence of action does not mean stagnation, but regression. For example, if Morocco concludes its Deep and Comprehensive Free-Trade Agreement (DCTFA) with the EU before Tunisia, the risk is that – within the most-favored nation (MFN) clauses – Tunisia will just have to abide the rules set by its neighbor. The opening of the negotiations, in July 2013, of the US-EU FTA also changed the rules of the game at several levels. Specifically: (i) the Transatlantic agreement will capture many of the EU Commission’s negotiation resources; (ii), it will set a new level of concessions that are likely to be asked from trading partners, the EU and US FTAs with South Korea serving as a basis for the negotiations; (iii) it will provide simultaneous access to the US and EU market for those countries having concluded with either of the parties a separate FTA with an MFN clause. In that respect, Morocco, Jordan and other countries that already have an FTA with the US are more advanced, and it is even more important to conclude an agreement between Tunisia and the EU before the US-EU FTA is negotiated.

Reforms should be taken in Tunisia’s best interest, and most of them unilaterally. Nonetheless, regional trade integration could provide an impetus and help building consensus for the reforms as part of the convergence process. Linking reforms with regional trade integration and convergence could also help Tunisia benefit from technical assistance and capacity building programs that are likely to reduce adjustment costs.

In 2009, the World Bank called for a move “from privilege to competition” with a view to unlocking private-led growth in the MENA region (World Bank, 2009). The Tunisian services sector remains one of privileges, with a frequent absence of competition that facilitates the capture of rents by services providers (to the detriment of the consumers). Such rent-system encourages corruption and either the capture of the rents by the power itself (e.g. if the ruler takes stocks in a business) or the distribution of rents in return for bribes (e.g. if administrative authorizations are given in return for bribes or hiring of individuals close to the power). In Tunisia, nepotism and corruption reached their apogee in the last few years of the old regime. The number of granted administrative authorizations and implemented reforms just shrunk. Between 2005 and the revolution, Tunisia dropped from the 43rd to the 73rd rank in the *Transparency International Corruption Perception Index*.³⁹ In the spirit of the revolution, the Tunisian government should attempt to suppress existing privileges and aim at a better distribution of the provider’s surplus to the benefit of both a larger number of providers and the consumers. Moving from rents to competition comes with a number of challenges, however, that are exacerbated by the post-revolution context.

³⁹ See <http://www.transparency.org>.

A services regulatory framework tailored to rent seeking and capturing

The liberalization of the services sector, therefore, has two dimensions: one domestic (increasing competition among domestic providers) and one international (increasing the openness of the economy). A number of regulations apply in the services sectors that serve legitimate objectives, such as the protection of the consumers against malpractice or universal access to essential services. These equally affect domestic and foreign competition. Some other regulations, however, discriminate against foreigners (market access and/or national treatment) and aim to protect domestic providers against foreign competition (under one or more modes of services supply: cross-border, consumption abroad, foreign establishment, and temporary movement of services providers).

The international dimension

Restrictive regulations on all four modes of services supply constitute a major obstacle to regional integration and to the participation of the region to the new division of labor allowed by the globalization of production networks and value chains. Services trade restrictiveness indexes (STRIs) that have been recently developed measure the degree of openness of services sectors to foreign competition. In 2009, a first assessment of the barriers to trade in services in the MENA region (Marouani and Munro, 2009) highlighted that significant regulatory reforms had taken place, but a broad range of restrictions remained. The World Bank reached similar conclusions: while the GCC is the most restrictive area of the world in terms of services trade, the MENA region at large is poorly performing on the openness front. All the countries in the Maghreb, with the exception of Morocco, appear relatively more restrictive than the world average, with Egypt and Tunisia being the most restrictive of the sample (Borchert, DeMartino and Mattoo, 2010). According to this index, Tunisia is the most restrictive country of MENA for retail and professional services⁴⁰, and second most restrictive country for transportation. Annex 2A provides a list of exceptions to the national treatment principle.

The Tunisian government has retained a considerable degree of regulatory discretion in the implementation of its policies. Thus, *de jure* openness did not always translate into *de facto* openness, and a key reform issue will be to reconcile regulatory discretion – to the extent it serves legitimate domestic policy objectives – with the need for foreign and domestic service providers to have clear and predictable rules (Borchert et al., 2010). A number of companies that attempted to enter the Tunisian market in the last years of the old regime faced problems with corruption and nepotism, and were refused administrative authorizations to establish or even open franchises in strategic sectors (e.g. retail, real estate, hospitality). The restoration of the country's attractiveness will therefore depend not only on a *de jure* but also *de facto* opening, i.e. a greater transparency, predictability and security of the rules and their implementation.

The domestic dimension

A number of services sectors have suffered from excessive administrative burdens and controls. In the last years of the old regime, nepotism prevailed and distorted competition on the markets; tax audits could also be used to capture rents. Foreign companies that benefited from the offshore status could avoid some of these issues faced by their Tunisian counterparts. The main objective of the reforms should be to restore transparency, security and predictability.⁴¹ Moving from rents to competition is not an easy task due to adjustment costs and the likely resistance of incumbent actors. In some sectors where entry and operational costs are high, the introduction of competition might also challenge the profitability of

⁴⁰ After correction of the index regarding the openness of legal services.

⁴¹ The second Report on the "Action Plan" analyzes in further details the reforms that need to be engaged to remove unnecessary barriers to domestic and international competition in selected strategic sectors.

existing firms. In a post-revolutionary context, those problems become even more acute. Below, some of the main challenges the government might face when moving from rent to competition:

(i) Recovering stolen assets

Under the old regime, the ruling family acquired stakes in a number of strategic services sectors, such as transportation, telecommunications, distribution/retail, media, real estate, hospitality, etc. Preserving rents in those sectors was thus of interest to the power in place. Since the revolution, these assets have been seized by an *ad hoc* commission. A number of Tunisian entrepreneurs are also under investigation for corruption. These assets represent an important stake in Tunisian services, and the restoration of competition in those sectors will be complex and time consuming. It is important that services sectors where competition was distorted due to rent seeking behaviors of the former rulers are now open to competition and the rents are suppressed to the benefit of the Tunisian people at large.

(ii) Dealing with incumbent actors

Suppressing rents triggers important adjustment costs for incumbent actors. This is particularly the case in sectors where entry or operational costs are high, e.g. in telecommunications or transports. A sudden move to competition without proper restructuration plans could threaten the profitability of major companies and result in massive job losses. This is the case, for example, in air transportation, telecommunications, and tourism. These sectors also constituted important lobbies that are difficult to deal with in a context of social stress.

(iii) Sequencing of reforms

It is important that a proper competition legal framework is in place when rents are suppressed. For instance, moving from a public monopoly to a private monopoly is not synonymous of progress and improvement of the consumers' situation. In a context of international trade integration, it is equally important to make sure that all recovered assets are not transferred to foreign investors – or if they are, that basic competition and concentration rules are respected. At the same time, regulatory convergence (to include competition rules) might help the transition process.

(iv) Level of reforms

As stressed above, a major tenant of the Tunisian rent-system has been the regulatory discretion in the implementation of government policies. For instance, the existence of administrative authorizations allowed the creation and the preservation of rents as well as the development of nepotism and corruption. In a context of improved governance, should those administrative burdens be completely removed? Or is the improvement of the governance sufficient to guarantee that authorizations will now be granted and not help further discrimination? The reform of the services sector and the removal of administrative burdens should therefore be part of a larger program targeted at improving transparency and good governance. Relevant chapters of such program would include: the simplification and reduction of the discretion, cronyism and arbitrariness of the regulatory and administrative environment (e.g. guillotine reform); and the revision of the legal framework for public procurement. The government is currently undertaking such reforms with the assistance of its development partners.

(v) Restoring foreign investors' confidence in the security of the market

A number of services companies that attempted and failed to enter the Tunisian market in past (due to the above described system) are now considering investing in the country again. Changes in administrative practice might not suffice to restore full confidence in the stability of the market. It is necessary to send a strong signal that change in governance and administrative practice towards more transparency and less arbitrariness is structural: the law (or regulation) should leave as little room for arbitrariness as possible, and unnecessary administrative burdens should be removed.

2.3.1 Using regional trade integration to achieve Tunisia's services "revolution"

Almost all the necessary services reforms could be decided and implemented unilaterally. For most sectors, the government also has reform strategies already at hand (e.g. for tourism or off-shoring). In the particular context of the post-revolution era, however, the Tunisian government could use regional integration as a framework for reforms with a view to help building consensus, accelerating the adoption and implementation of reforms, and locking the reforms in. Such strategy was followed, for example, by the Zedillo administration in Mexico that secured the democratic transition of the country, and used the regional trade integration with the US and Canada in the North-American Free-Trade Agreement (NAFTA) to lock in the reforms engaged by the new administration.

Regional integration could also help reducing/sharing the cost of adjustment if the country benefits from technical assistance and capacity building transfers. Thus, regional integration could be conceived as tool of promotion of good governance, and its main benefits would reside in the convergence process that would help restoring a transparent, secure and predictable regulatory environment as well as sending a strong signal to potential investors. Taking a strictly economic standpoint, it also appears that regional trade integration is not all about market access anymore: it is about facilitating trade flows (imports as well as exports) to allow Tunisia's participation in global production networks, and to strategically position the country on high value-added segments of global value chains. In that sense, it is a framework for dialogue and convergence that should lead to a better distribution of production resources according to comparative advantages.

BOX 2.1 TAKING STOCK OF EXISTING REGIONAL TRADE AGREEMENTS AND NEGOTIATIONS INVOLVING TUNISIA

Most economic studies point at services and trade facilitation as the main sources of gains from regional trade integration. For example, looking at the potential impact of a DCFTA for Armenia, Jensen & Tarr revealed that, in order of importance, the sources of the gains would be: (i) trade facilitation and reduction in border costs; (ii) services liberalization; and (iii) standards harmonization. The integration of services markets in the region lags far behind the progress that has been achieved for goods, for instance within the Pan-Arab Free-Trade Agreement (PAFTA), where most tariffs and duties on intra-regional trade have been removed. Similarly, Tunisia has already concluded the goods chapter of the DCFTA negotiations with the EU, when the discussions on services are still lagging. Thus, most of the gains expected from further integration and a removal of the barriers to trade still lie ahead. This prevails for both horizontal (South-South) and vertical (North-South) integration.

(i) The major plurilateral agreements to which Tunisia is a member are the following:

⇒ The **Agadir Agreement** (Egypt, Jordan, Tunisia, Morocco) (2004): Article 5 pertaining to trade in Services does not require further liberalization of services trade from its members: "Member Countries undertake to respect the commitments as regards liberalization of trade in services defined in the schedules of the World Trade Organization Agreement on Services, and will seek to expand the scale of trade in services between them, in accordance with the applicable laws and structures existing in each Member Country. The Foreign trade Ministers' Committee will continuously monitor developments in trade in services between the Member Countries after the entry into effect of the agreement."

⇒ The **Arab Maghreb Union** (Tunisia, Morocco, Libya + Algeria, Mauritania) (1989): Article 2 of the Treaty of Marrakesh only provides for a progressive liberalization of services trade, without further details. This group of countries has nonetheless undertaken a number of infrastructure projects and coordination efforts that pertain to services (e.g. telecommunications).

⇒ The **Pan-Arab Free-Trade Agreement** (Agadir members, Libya, Lebanon + GCC, WBG, Yemen, Iraq, Sudan, Syria) (1997): PAFTA does not cover trade in services, but a separate framework agreement for regional liberalization of services that is based on a GATS+ approach was concluded in 2003 (Regional Agreement on

Liberalizing Trade in services). Between 2004 and 2011, four rounds of negotiations based on a requests/offers approach have been completed, but no agreement has been reached yet. Egypt and Jordan suggested a new approach aimed at fully liberalizing selected sectors (e.g. education, computer services, and telecommunications), but nothing concrete has materialized yet (Ghoneim, 2011).

- (ii) Tunisia also signed or is in the process of discussing a number of bilateral free-trade agreements that contain provisions on services trade liberalization:

⇒ In 2003, the US launched the **Middle-East Free-Trade Area Initiative** to expand and deepen economic ties through Trade and Investment Framework Agreements (TIFAs), Bilateral Investment Treaties (BITs), comprehensive Free Trade Agreements (FTAs), and other measures as appropriate. Tunisia (2002), along with Lebanon (2005), Libya (2010) and Egypt (1999) signed a TIFA with the US whose aim was to strengthen bilateral trade and support economic reforms of its partners as part of a graduated step-by-step approach to creating a free trade area with countries interested and willing to open their economies and liberalize their trade regimes. A number of Tunisian neighbors have, however, already moved to the stage of an FTA: the US agreements with Israel, Jordan, Morocco, Bahrain, and Oman have already entered into effect.

⇒ Tunisia is part, along with Morocco, Egypt, Jordan, and Lebanon, of the **Euro-Med process with the EU and EFTA**. The objective of the Euro-Mediterranean trade partnership (launched in 1995 with the Barcelona Declaration and boosted in 2004 with the European Neighborhood Policy) is the creation of a deep Euro-Mediterranean Free Trade Area, which aims at substantially liberalizing trade between both the EU and Southern Mediterranean countries (North-South), and Southern Mediterranean countries themselves (South-South). As part of this process, all the Partnership countries have concluded an Association Agreement with the EU. While these agreements essentially cover trade in goods, negotiations have been opened to liberalize trade in services. In 2012, the European Commission started negotiations with Tunisia (as well as Egypt, Jordan, Morocco) to establish deep and comprehensive free-trade areas (DFTAs) that should go well beyond the Association Agreements and supplement a GATS-Art.V-compatible agreement on services with key disciplines on competition, government procurement, investment protection, etc. Mobility agreements will also be negotiated to deal with the movement of people.

⇒ Finally, Tunisia has concluded a number of other bilateral agreements, in addition to its agreements with the EFTA and EU, with Morocco, Jordan, Egypt, Libya, Senegal, Mauritania, Algeria and Turkey. However, these include no other commitment but to further cooperate on services trade.

(iii) Bilateral investment treaties could also have an incidence on service trade and overlap with some commitments made in the GATS or PTAs (mode 3). According to the ICSID database on bilateral investment treaties (June 2012), Tunisia concluded 54 of such treaties.

2.3.2 A focus on the negotiations with the EU: challenges and prospects

The EU has already concluded a number of DCFTAs. However, each process is tailored to the country's specific conditions and needs. When negotiating its agreement, Tunisia should take four aspects into account: the sequencing, the coherence, and the level of the reforms, as well as the state of negotiations with main competitors.

The sequencing of the reforms:

Trade liberalization should be preceded by reforms of the business environment and competition at large. Opening a services sector to domestic (e.g. privatization or suppression of a public monopoly) and/or foreign competition without paying attention to the domestic regulatory and competition environment could have negative effects, allowing for example anti-competitive behaviors and price increases. The government needs to ensure that regulatory reforms are effective to guarantee greater

competition and remedy market failures. Thus, reforms are not all about trade, but also about competition and business environment at large (see dedicated report on competition). Assessments of the state of competition on markets should be made accordingly, sector by sector, as was done for instance in the telecommunications sector.

It is particularly important in a country in democratic transition like Tunisia where part of the economic assets could have been captured by a few, to make sure that trade services liberalization and economic growth benefit the population at large – including the consumers – and not only a few domestic or foreign investors. While Tunisia has adopted competition rules and set up a competition authority, there is still room for improvement of the competition framework (World Bank, 2012).

International cooperation could help, and technical assistance/capacity building provided by the major donors could play a crucial role in improving the country's competition framework, notably through peer review and the exchange of best practices. Cooperation could also extend to the exchange of information needed for the investigations. The EU Association Agreements (and the future deep and comprehensive free-trade agreements) with the Mediterranean countries include a competition chapter to supplement trade integration. When negotiating the DCFTAs with the EU, Tunisia should favor a gradual approach to convergence and pursue harmonization only to the extent necessary.

The coherence of the reforms:

It is essential to coordinate reforms under multiple ongoing agreements and negotiations. Multilateral concessions are seen as a first best, topped up by some “open regionalism”. Tunisia is under pressure to make reforms in multiple instances: domestic reform agenda, bilateral or regional trade negotiations, WTO negotiations, etc. Sometime, the concessions asked from individual countries could be conflicting – for instance if market access is granted on a preferential basis. There is a risk that the multiplication of PTAs generates conflicting rules or adds to the complexity of trade (e.g. administrative burden attached to the rules of origin). The same risk prevails when commitments made in bilateral investment treaties (BITs) overlap with mode 3 commitments under the GATS.

Greater transparency and information sharing should help the prevention of such conflicts. It is however recommended to favor multilateral concessions (i.e. in the GATS) that could be topped-up by some “open regionalism” and avoid discrimination. It is also the responsibility of the EU to ensure the coherence of the commitments and the proper sequencing of the reforms. For example, the EU has launched the DCFTA negotiations without having previously concluded the AA negotiations on agriculture and services; and the DCFTA contains important chapters that could directly impact services trade (e.g. competition, investment protection, government procurement); the EU also plans to soon launch negotiations of a Mobility Partnership, which could also overlap with the mode 4 chapter of the services negotiations (visas for temporary movement of highly-skilled, revolving migration, etc.). The government of Tunisia should seek clarification from its negotiating counterparts and ensure that concessions made in one agreement does not affect the balance of power of other negotiations: for example, services and agriculture could be ruled into the DCFTA negotiations, together with the mode 4 services discussions- which are currently conducted in parallel with the negotiations of the Mobility Partnership- to ensure they are complementary.

The optimal level of regulation and cooperation and the respective roles of the unilateral, regional and multilateral approaches:

Regulatory reforms should primarily be driven by domestic agendas. Nonetheless, it appears that multinational disciplines, as well as regional cooperation and integration, could help promoting and anchoring these reforms, releasing some of the pressure exerted by domestic interest groups. Deeper integration with major trading partners is therefore desirable, although there is unfortunately no “one size fits all” solution, and regional approaches should be tailored to countries’ needs. For each individual services sector, the right mix of multilateral, regional and unilateral reforms should be identified and implemented (see Annex in Vol II that presents the respective roles for unilateral and regional opening).

It should be noted that required regulatory changes are easier to achieve on a non-preferential basis, and services markets are ideally opened on an MFN basis (Mattoo and Stern, 2008). *De facto*, most reforms prompted by FTAs benefit all partners without discrimination. Where feasible, the introduction of preferences might not be desirable, since it would require the design and implementation of rules of origin, which might be costly and add another layer of bureaucratic burdens (Fink, 2008).

It appears that the main benefits from services trade FTAs are usually captured during years preceding the conclusion of the agreement, when regulatory reforms are adopted by the parties in anticipation of the agreement (Miroudot and Shepherd, 2011). The benefits lie in the reforms themselves, i.e. in the convergence process. Ghoneim (2011) reviewed some of the studies that attempted to measure the impact of the US-Morocco FTA on bilateral services trade, and concluded that the results were mixed: US presence in Morocco increased in some sectors (e.g. architecture, design) and not in others where commitments made were more significant (e.g. telecommunications); moreover, European and Arab firms seem to have benefited more from the reforms prompted by the US FTA than US firms in key sectors like financial services; changes in the transport sector failed to attract new investors.

Market access alone is not enough: accompanying regulatory reforms, sometime non-trade related, will decide on the impact of liberalization (e.g. business environment, competition rules).

The optimal degree of regulatory convergence across countries that decide to go down the regionalism path is hard to assess. Tunisia should not seek full convergence with the EU: it should only pursue regulatory harmonization where it will effectively facilitate trade and help anchoring domestic reforms (Müller-Jentsch, 2005). For example, Messerlin et al. (2011) contested the benefits for Georgia to be derived from a DCFTA with the EU that required the adoption of the EU *acquis* in a number of areas. The authors also pointed at the absence of concessions in services and agriculture that created an imbalance in the outcome of the negotiations. Müller-Jentsch (2005) similarly concluded that the complete adoption of the *acquis* by the countries participating in the ENP would be an unrealistic and possibly dangerous strategy. This should serve as a lesson for Tunisia: since the negotiations of EU DCFTAs started in 2012, it is essential that the services negotiations engaged in the context of the Association Agreements are swiftly concluded or linked to the conclusion of the DCFTA, otherwise the global outcome of deeper integration would certainly be imbalanced. As suggested above, it is important to avoid that, by multiplying the number of agreements, the EU does not pick and choose commitments, and some agreements remain unbalanced (see Messerlin et al. (2011) on Georgia).

Regulatory convergence is a gradual and lengthy process, which requires important efforts and resources. The EU itself still struggles with the harmonization of its members’ services regulations, as illustrated by the implementation of the Services Directive (so-called “Bolkenstein Directive”). Mutual recognition agreements sometime represent a less costly first step towards integration. The proximity of the regulations, the scale of operation of services providers, economies of scale for infrastructure and regulation are just a few of the factors that could decide of the optimal degree of convergence. With this regard, horizontal (South-South) integration is often easier to achieve from a technical standpoint and

would bear the highest benefits. In any event, the identification of the right level of convergence should be done on a case-by-case basis, and technical assistance will be needed both to assess the optimal degree of integration and to implement the reforms necessary toward convergence. Annex 2C in Vol II provides a correspondence chart between the negotiation chapters and the *acquis communautaire*.

The state of negotiations with other partners:

Tunisia should be wary of risks related to potential trade diversion as well as lock-in conditions that might arise from the conclusion of negotiations between the EU and other partners, such as Morocco. The EU has started DCFTA negotiations simultaneously with Tunisia, Morocco, Egypt and Jordan. Morocco and Jordan have already concluded an FTA with the US that contained GATS+ provisions, although these agreements contained the least ambitious services commitments among all US FTAs signed in the region. As noted above, the impact of the US-Morocco agreement has been so far limited. Thus, the diversion effects to the detriment of US-Tunisia trade have probably remained limited as well – helped by the fact that the US represented only 1.5 percent of the Tunisian exports in 2011. By contrast, the EU represents 80 percent of Tunisia’s exports, and the risks of trade diversion, were Morocco to conclude the agreement first, should not be overlooked.

In addition, the US-Morocco agreement (Art. 11.3), and most likely the future DCFTAs with the EU do/will contain an MFN clause. As a result, any concession made by Morocco with either the US or the EU will be systematically extended to the other party. Practically, this means that the US-Morocco FTA will serve as a minimum basis for negotiations of the AA+DCFTA agreement with the EU. It also means that, were Morocco to conclude first with the EU, this EU-Morocco agreement would serve as a basis for negotiations with Tunisia. Despite the fact that the EU deliberately started the negotiations with Tunisia first, the risk of an early conclusion of an agreement with Morocco is high: after successfully concluding an FTA with the US, Morocco is better prepared for the negotiations and has a solid basis for the negotiations. It remains that the advantage of the first mover is important, and delays in the conclusion of the agreement with Tunisia would not help the conclusion of a better deal: on the contrary, the deal would be dictated by the EU’s commitments with Morocco.

The launch of the US-EU FTA negotiations in July 2013 has also increased the risk of trade diversion and changed the balance of power in the ENP. Concluding an FTA with either the US or the EU has become a priority and should take place before the conclusion of the US-EU FTA. Here again, Morocco and Jordan are in a better position than Tunisia to conclude an FTA with the EU since they have already concluded one with the US.

Box 2.2 REGIONAL INTEGRATION SHOULD INCLUDE BOTH HARD AND SOFT NETWORKS

The negotiation of further trade integration should be an opportunity to increase cooperation between Tunisia and the EU. This cooperation should include both a “hard” (e.g. regional infrastructure for telecommunications, energy, transports, etc.) and a “soft” (e.g. strengthen the cooperation among services regulatory agencies and potentially create joint agencies) dimension. At least two reasons for such cooperation could be put forward: first, the scale of operation of services providers is often regional or global – the market of reference is therefore broader than the domestic market, and it would make sense to issue regional licenses or reach conclusions on competition litigations with a larger market of reference; second, beyond the economies of scale allowed by regional networks, cooperation allows information sharing and helps liberalization through approximation of rules and practices.

Cooperation should extend beyond the public sphere to include professional bodies and other entities that contribute to the regulation of services. For instance, professional orders have a key role to play in the development of mutual recognition agreements. Cooperation should also include education that is the basis of any professional qualification. South-South cooperation should also be supplemented by North-South cooperation, for example to develop joint educational or professional training programs.

With regard “hard” networks, a recent collection of World Bank studies (2010a, b, c) explored the integration of the MENA region through the lens of infrastructure. In the Maghreb, it concluded that most countries had made good progress in investing in and reforming infrastructure, but more investment and reforms were needed to better integrate the region. This confirms the initial diagnostic of a lack of openness and integration in key backbone services such as transports and telecommunications. The Maghreb performs relatively well, however, in terms of integration in the fields of energy, water supply, and sanitation services.

The development of efficient hard networks will require significant public (including development aid) and private investment. Regional projects should be promoted among the donors community. Also, the soft dimension of regional cooperation should not be neglected, and assistance should be provided to develop regional regulations and agencies to increase the efficiency of backbone and other services. For example, the Arab Maghreb Union (AMU) finalized a project of broadband telecommunication network in 2011 (hard), and the African Development Bank offered support for a study on the coordination of regulations on telecommunications and information technologies (soft).

2.4 Reforming the Services Sector: What Has Been Done, What Remains to Be Done, and How it Should Be Done

Trade negotiations deal with both sectoral and horizontal barriers to trade. The rent-system developed by the old regime has heavily relied on such horizontal barriers that added to the complexity of the regulatory framework and the lack of transparency of the system. For example, the Tunisian investment code contains twenty times more pages than regular investment codes. For years, the revision of the code has been planned but postponed due to the complexity of the task. Tunisia has also been a precursor in terms of competition law, but the adaptation of the system to new requirements is taking time. Laws regulating the professions date back from several decades. The multiplication of administrative authorizations and other arbitrary restrictions on entry contributed to the deterioration of the business and investment climates in Tunisia. The government should focus on restoring legal security and predictability, and take the opportunity of the regional trade negotiations to remove unnecessary horizontal barriers to trade, such as limits on foreign equity or employment of foreign nationals.

Next chapter presents an in-depth analysis of the business and competition environments. Here, a few reforms pertaining to business environment are nonetheless put forward, along with suggestions pertaining to the reform of the services trade promotion institutional framework and the question of the temporary movement of services providers (mode 4 of the GATS) that remains a contentious issue in multilateral and regional trade negotiations. A more detailed analysis of sectoral reforms is presented in Annex 2.

a. Putting in place an institutional framework for services trade promotion

Designing a strategy for negotiations and services trade promotion

Compared to Morocco or Jordan, which have already negotiated an FTA with the US, Tunisia could have appeared unprepared to negotiate the AA and DCFTA with the EU. However, in recent years, budget support programs have contributed to the reform of the institutional framework necessary to the identification of Tunisia's offensive and defensive trade interests and the elaboration of a domestic reform and trade integration strategy. Below we present some of the actions that were undertaken to strengthen Tunisia's position in the context of regional trade agreements and negotiations:

- (i) To solve the absence of coordination among ministries, regulatory agencies, and other public entities, as well as of dialogue between public and private sector (e.g. with professional orders that control access to the professions), the National Services Council (Conseil National des Services, CNS) was created. The CNS brings together representatives of all the relevant ministries, the professions, and civil society, to discuss key topics pertaining to services reform and trade integration. An information system was also developed by the Ministry of Commerce.
- (ii) To fill the lack of statistics on services, and services trade in particular, the services nomenclature was revised and coordination efforts between the INS and the Central Bank were increased, including under the auspices of the National Statistical Council. Technical assistance was also provided for the implementation of the new system.
- (iii) To move away from an excessive focus on "traditional" exports such as agriculture and low value added manufacture (e.g. textiles) despite a declining importance, the Tunisian Center for the Promotion of Exportations (CEPEX) has progressively included services trade promotion in its agenda and recruited services experts.
- (iv) With a view to prepare reforms and trade negotiations, a regulatory diagnostic of all the strategic services sectors was prepared along with sectoral action plans for reform. It was also suggested to prepare a report of the state of competition on the telecommunications market and an audit of the functioning, with regard competition, of the professional orders.

As a result, the government should now be in a position to negotiate deeper integration agreements, and identify, for each individual services sector as well as across sectors (horizontal measures), rules that need to be removed, rules that need to be adapted, and new rules that need to be introduced. Nonetheless, the resources of the Ministry of Commerce remain limited, and the extension of the negotiations to new areas that exceed its prerogatives could make the inter-ministerial coordination and the negotiations even more complex.

Adjustment and upgrading in the services sector

It is not enough to negotiate market access: Tunisian services providers should be competitive enough to enjoy the benefits to be expected from further integration. As suggested above, companies that benefited from the rent-system will need to be restructured to survive the opening of markets to competition. All the Tunisian services companies would benefit, however, from upgrading.

As part of the budget support programs developed with the Tunisian government in recent years, a unit dedicated to the upgrading of services firms was put in place in the Ministry of Commerce. The European Union also developed a dedicated program that will supplement the resources already engaged.

Other reforms that exceed the scope of this paper but are necessary to Tunisia's deeper integration with global or regional markets include the matching of the skills and the services offered to the needs of the markets. Education and training are particularly important to the promotion of services activities that are skill-intensive. It is necessary to adapt education and training to the needs of export-oriented services sectors, for example by developing new fields of study in technologies or promoting the teaching of foreign languages. A number of workforce development initiatives in competing developing countries have, for example, allowed and accelerated upgrading in services offshoring (from BPO to KPO) (Gereffi and Frederick, 2012). Reforms of the education/training in strategic services sectors have already been engaged, e.g. for nurses or lawyers. Studies pertaining to innovation in the services sector have also been conducted to identify needed reforms (see World Bank, 2010).

b. Improving business environment

Illustrative list of measures to develop services efficiency

The improvement of the business and investment environments is a large and long-term agenda. Multiple reviews have been recently performed, including in the context of Tunisia's recent adhesion (May 2012) to the OECD Declaration on International Investment and Multinational Enterprises. **Key measures that would help the development and efficiency of services include:**

- i. ***The simplification of the regime of administrative authorizations.*** A “guillotine” reform of administrative procedures is planned and should be implemented shortly. The offshore strategy also suggests concrete measures such as the tacit authorization in case of absence of answer from the administration.
- ii. ***The suppression of discriminatory barriers to entry based on nationality.*** These primarily affect professional services (see above) and should be replaced, in such case by objective qualification criteria. They also constitute a major barrier in key sectors of the economy that still benefit from rents: for example, in the distribution/retail sector, the “carte de commerçant” remains an obstacle to certain types of establishment by foreigners; the acquisition of certain lands also remains forbidden for foreigners, affecting investment prospects in hospitality among others.
- iii. ***The suppression of the 49 percent limit on foreign equity in strategic sectors in need of foreign investment.*** The objective would be to authorize a foreign investor to hold a majority of the shares, even if limits on equity are maintained. A number of multinational companies would like to invest in the country but have trouble identifying the right partner, e.g. in the cosmetics.
- iv. ***The suppression of the discrimination between Tunisian and foreign franchises.*** Franchises are a predominant business model in a number of services sectors. The Tunisian law submits foreign franchises to burdensome administrative authorizations, which, in the recent past, had been attributed only in counterpart for rents. Franchises represent an important source of investment, jobs, and knowledge transfers.
- v. ***The reform of the competition legal framework*** (see dedicated section in chapter 3). It is important that efficient competition laws and enforcement mechanisms are in place to avoid that the opening of the Tunisian market results into new rents captured by foreign companies.
- vi. ***The reinforcement of the protection of intellectual property and personal data.*** Moving up the value chain in the services sector requires the improvement of the protection of high value-added

activities. For instance, better personal data protection is necessary to allow the movement from BPO to KPO.

- vii. ***The revision of the rules on government procurement would benefit a number of services sectors, including engineering and construction.*** Reforms should aim at increasing the efficiency, transparency, and accountability of procurement.
- viii. ***The suppression of the limits on the employment of expatriates*** (at present, 4 per company). Skills required for performing certain tasks or providing certain types of services have become increasingly specialized. Temporary movement of key personnel should be allowed at critical stages of a firm's life – it could be accompanied by obligations of training local staff if the objective of the government is to build local capacities. In an economy where global value chains prevail, key personnel should be able to move up and down the value chain to ensure the good functioning of the global network.

Relevant chapters of regional trade agreements

Here again, it is in the interest of Tunisia to improve business environment, in particular in the post-revolution context, to increase the competitiveness of its firms and attract foreign investment. Reforms could be adopted unilaterally. However, there is an overlap between these reforms and areas of negotiations under the DCFTA, such as competition, government procurement, investment protection, intellectual property rights. This could be seen as an opportunity to build consensus, conform to best international practice, and benefit from technical assistance and capacity building.

A number of horizontal measures will also be subject to negotiations in the services negotiations of the AA. This is the case, for example, of limits on foreign equity or nationality conditions. These should be used as bargaining chips to obtain more concessions from Tunisia's trade partners.

c. Increasing the benefits from the movement of services providers

The movement of services providers in regional trade negotiations

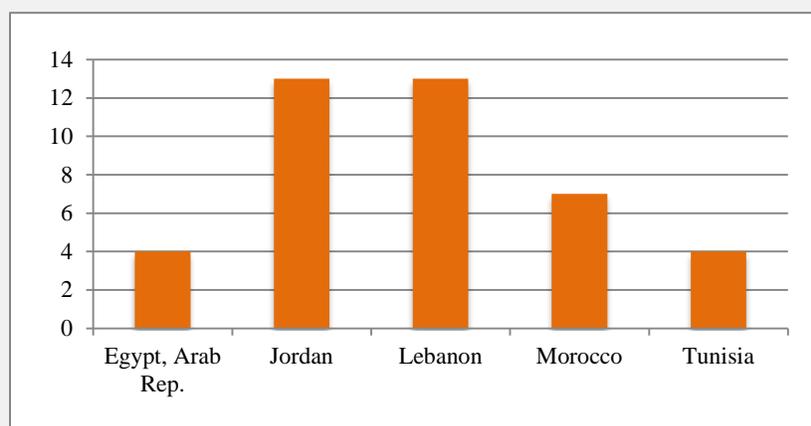
The temporary movement of physical persons to deliver services (mode 4) is a key component of services trade. Any regional trade integration effort should aim at facilitating such movement although, due to the political sensitiveness of the issue, FTAs often contain very limited commitments on mode 4. For example, the US-Morocco FTA contained no chapter on temporary entry. Hufbauer and Stephenson (2011) reviewed the provisions pertaining to the temporary movement of people (Mode 4 of the GATS) in a number of plurilateral trade agreements (PTAs). For the essential, those provisions cover skilled professionals, and only recently have some PTAs started to move beyond.

So far, the most ambitious provisions on labor mobility included in a trade agreement concluded by the EU has been the Economic Partnership Agreement (EPA) with the CARIFORUM. Even in this case, however, a number of locks have limited the impact of the agreement and the agreement could not serve as a model for future negotiations. The temporary movement of services providers is part of the AA negotiations with Tunisia. However, the EU will also begin negotiations of mobility partnerships – starting with Tunisia – that should improve opportunities for people in the region to work, study, and travel in the EU. Thus, there is a risk that labor mobility falls outside the scope of the FTAs, even if the objectives assigned to the mobility partnerships (e.g. easing procedures to issue short-stay visas, promoting circular migration, etc.) overlap with some of the commitments that could be made under mode 4.

BOX 2.4 MEASURING THE IMPORTANCE OF TRADE UNDER MODE 4 OF THE GATS

There is no precise measure of trade in services taking place under Mode 4 (i.e. the cross-border movement of physical persons to deliver services). Commonly used proxies are the balance of payments “workers’ remittances” and “compensation of employees”. According to the World Bank (2011b), Lebanon (USD 8.2 billion – 13th), Egypt (USD 7.7 billion – 14th), Morocco (USD 6.4 billion – 18th) and Jordan (USD 3.8 billion – 28th) are among the world top recipients of remittances in gross value. Looking as remittances as a percentage of the GDP, only Lebanon (6th) and Jordan (11th) appear in the top 30. Tunisia is far behind despite a proportionally important diaspora.

Figure A. 2. 1. A small contribution of remittances to the Tunisian GDP
(Workers' remittances and compensation of employees, received (% of GDP), 2010)



Source: World Development Indicators, World Bank, 2011

The choice to include mode 4 in FTAs rather than other types of bilateral agreements, such as labor agreements, is not obvious. Hoekman & Ozden (2010) have presented the virtue of trade agreements and a facilitated temporary movement of workers as an alternative to migration; however, there is also a case for dealing with mobility of workers in a more flexible framework than FTAs. It appears that FTAs are better tailored to high-skilled workers, and bilateral labor agreements provide more flexibility to deal with semi-skilled and low-skilled workers and target specific categories of workers (e.g. seasonal agricultural workers, health personnel) or countries (Hufbauer & Stephenson, 2011).

When it comes to trade agreements, Hoekman & Mattoo (2011) suggest having mode 4 source country obligations specified in the schedule to increase the predictability of visas: the host country could list the requirements that source countries need to fulfill in order to qualify for the program such as credible pre-movement screening and selection, accepting and facilitating return, and commitments to combat illegal migration. They also suggest to replace existing economic needs tests by more predictable and clearer rules on the variance of quotas associated with the state of the host economy or unemployment levels.

Progress could be achieved faster through horizontal integration, i.e. among Arab countries, as illustrated by the recent approval by GCC members of a waiver of visa requirements for expatriates with valid professional visas in other Gulf countries. The ability to move workers across the region is essential for services companies to realize economies of scale; it is also essential to allow intra-corporate transferees and professionals to move and accompany investments. The freedom of movement of these categories of workers is essential to a better insertion into world trade through global production networks. Considering

that trade in services prominently happens intra-firm, obstacles to the movement of key personnel is very detrimental. This prevails for South-South, North-South and South-North movements, since the movement is within value chains, independently of the direction of the movement.

Other dimensions of the issue could also be more readily addressed. For instance, a common annex to US FTAs that aims to promote the development of mutually acceptable standards and criteria for licensing and certification of professional services suppliers, on the basis of factors such as educational background, qualifying examinations and experience, potentially eases the movement of professionals, even if this provision imposes no obligation on parties regarding immigration procedures. Interesting pragmatic solutions could be adopted: for instance, a professional order could collect the short-term visa demands of its members and serve as an intermediate with consulate offices with a view to expedite the process (example of Tunisia accountants).

It is important for Tunisia to create opportunities for returning short-term migrants, and better tap into the resources of the diaspora. Movement of workers should be to the mutual benefit of the origin and destination countries: for example, if nurses are needed in France, the latter should contribute to offset the cost of education of Tunisian migrant nurses. Such schemes have already been put in place by certain European countries with the Philippines, and also exist for agriculture or other sectors.

2.5 Conclusions

The revolution has provided Tunisia with a unique opportunity to implement long overdue reforms. When social tensions are still vivid, with resurgent protests and strikes, it is important to send strong signals to investors and restore faith in good governance. Reforms need to be taken at a time the costs of adjustment (for instance potential short term job losses, even with prospects of longer term job creations) come with a high political cost. However, delaying reforms any further just threatens to increase the risk of stalling for the country. In a highly integrated world, the absence of action does not mean just stagnation, but rather loss of ground with respect to competitors. For example, if Morocco concludes its Deep and Comprehensive Free-Trade Agreement (DCTFA) with the EU before Tunisia, the risk is that – within the most-favored nation (MFN) clauses – Tunisia will just have to abide the rules set by its neighbor. The opening of the negotiations, in July 2013, of the US-EU FTA also changed the rules of the game at several levels. Specifically: (i) the Transatlantic agreement will capture many of the EU Commission's negotiation resources; (ii), it will set a new level of concessions that are likely to be asked from trading partners, the EU and US FTAs with South Korea serving as a basis for the negotiations; (iii) it will provide simultaneous access to the US and EU market for those countries having concluded with either of the parties a separate FTA with an MFN clause. In that respect, Morocco, Jordan and other countries that already have an FTA with the US are more advanced, and it is even more important to conclude an agreement between Tunisia and the EU before the US-EU FTA is negotiated.

The sequencing of reforms is key. Market access alone is not enough: accompanying regulatory reforms, sometimes non-trade related, will decide on the impact of services liberalization. Trade liberalization should be preceded by reforms of the business environment and competition at large. Opening a services sector to domestic (e.g. privatization or suppression of a public monopoly) and/or foreign competition without paying attention to the domestic regulatory and competition environment could have negative effects, allowing for example anti-competitive behaviors and price increases. The government needs to ensure that regulatory reforms are effective to guarantee greater competition and remedy market failures. It is particularly important in a country in democratic transition like Tunisia- where part of the economic assets could have been captured by a few- to make sure that trade services liberalization and economic growth benefit the population at large – including the consumers – and not only a few domestic or foreign investors.

Reforms should be taken in Tunisia’s best interest, and most of them unilaterally. Nonetheless, regional trade integration could provide an impetus and help building consensus for the reforms as part of the convergence process. Linking reforms with regional trade integration and convergence could also help Tunisia benefit from technical assistance and capacity building programs that are likely to reduce adjustment costs. Regional integration could be conceived as tool of promotion of good governance, and its main benefits would reside in the convergence process that would help restoring a transparent, secure and predictable regulatory environment as well as sending a strong signal to potential investors.

Trade negotiations should deal with both horizontal and sectoral barriers to trade. Annex 1 presents a detailed assessment of the most urgent reforms needed in key services sectors. Just as important are the cross-sectoral and horizontal barriers that continue to hamper competitiveness. The rent-system developed by the old regime has heavily relied on such horizontal barriers that added to the complexity of the regulatory framework and the lack of transparency of the system. The government should focus on restoring legal security and predictability, and take the opportunity of the regional trade negotiations to remove unnecessary horizontal barriers to trade. It is suggested that: (i) an institutional framework for services trade promotion is put in place, which would imply a strategy for negotiations and services trade promotion together with an upgrading of the sectors in preparation for the opening to regional and global markets; (ii) concrete measures (such as the simplification of administrative procedure and the suppressions of discriminatory barriers to entry for foreign nationals) are taken to develop services efficiency and (iii) benefits from the movement of services providers are increased by facilitating the implement of commitments under Mode 4.

3. Competition policy and reforms options in the context of deeper integration with the EU

This section⁴² analyzes Tunisia’s current competition policy framework and identifies its major shortcomings vis-à-vis recognized international best practices. For each specific shortcoming in the legal framework or its implementation, policy options are identified, and throughout, the purpose is to suggest how Tunisia can better align its competition practices with international best practices.

Tunisia is among the countries that spontaneously adopted domestic legislation in the early 1990s that share common characteristics with EU competition law, but, notably, without transposing EU rules to their complete extent. Furthermore, Tunisia’ implementation lags behind and, two decades after the enactment of the Competition Law, major market foreclosures remain at both economy-wide and sector specific levels, and markets remain closed to new entrants. Moreover there is an unnecessary duplication of administrative costs and a general lack of efficacy and prioritization characterizes the application of the legal framework; and therefore weak implementation burdens the effectiveness of the competition framework.

Notwithstanding previous efforts to improve the competition framework and its implementation, the Tunisia counterpart acknowledges some of the legal and implementation shortcomings that have been identified and has already committed time and effort to improve the effectiveness of its competition policy proactively identifying areas of possible intervention. The Government deserves credit for giving attention to technical cooperation programs in developing the national capacities, its growing involvement in international competition fora, and the its proactive attitude toward participating to voluntary peer review exercises with an open attitude toward increasing the effectiveness of its competition intervention. Nonetheless these steps have not been sufficient to increase the effectiveness of antitrust and competition framework in Tunisia.

Competition policies involve a range of measures aimed at reducing and/or eliminating impediments to well-functioning markets that arise from public policy interventions, such as statutory monopolies and price controls, and restrictive business practices, such as cartel agreements and anticompetitive mergers. Competition policy in domestic markets affects the international competitiveness of national firms-and therefore can be self-immolating. Firms typically acquire many of their production inputs transport, energy, telecommunications, financial services and more in local markets. If these upstream markets lack competition, goods and services needed for production are not priced competitively. As a result, firms may be less competitive than their foreign rivals and domestic GDP growth inevitably suffers.

Currently the domestic market in Tunisia is dominated by small number of players, and entry is both difficult and costly. Moreover, government intervention in economic activity is still significant and prohibitive; some sectors remain closed to any competition at all; and, for many goods and services, prices are still not freely set but, instead, are subject to state control. The reasons for these shortcomings are many. They stem from both the design of legal framework, which remains weak, and the fact that implementation is only partially effective, and not necessarily consistent with international best practices. Good competition frameworks combine various elements:

- i. They apply to all sectors and all economic agents in an economy engaged in the commercial production and supply of goods and services;

⁴² This Policy Note has been developed under the World Bank Programmatic Economic and Sector Work ESW work “Advancing Tunisia’s global integration- Reforms options for deepening integration with the EU” P128506.

- ii. include clear provisions identifying the abuses subject to enforcement and sanctions, specifying as well possible exception granted in a predictable manner on pre-defined cases;
- iii. are enforced by an independent authority whose decisions are based on sound economic and legal analysis and are not subject to the vetting of political intervention;
- iv. specify a clear due process procedure which provides enough transparency to the parties and any third interested parties;
- v. establish an advocacy mechanism wherein the government' policies are analyzed to assess, *ex ante*, their potential impact on market foreclosure;
- vi. include a mechanism screening all state interventions in the economy to better target them to identified market failures.

These elements are only partially present in the Tunisian case. This work goes into detail on each single shortcoming. For a transformational impact, sequencing and prioritization is recommended. Key priority drawbacks to be faced include:

Prices are administrated in key markets of the Tunisia' economy. For example, the government set the price or retail margin of an extensive list of goods such as bread, flour, couscous, vegetable oil, sugar, milk, hot beverages, rice, fruits, eggs, vegetables, salt, coffee, tea, etc.

Further, in Tunisia, SOEs exist in several sectors (such as Office des Céréales, Office National de l'Huile), and hold monopoly positions over marketing of certain food staples (such as cereals) and/or may also intervene in the market through commercial operations with the purpose of maintaining low retail prices for the respective products. On the other hand, food products whose prices or margins are administered are not always affected by the fluctuations of the international food prices to justify persistent subsidies through price administration – for instance, the pass-through effect for wheat (used for bread) in Tunisia is very small compared to developing and developed economies.⁴³

Encouraging more competition in the product markets where prices are currently administered and implementing a sound competition policy against anticompetitive practices, including cartels, would help open the market to new private entrants, including foreign investors. In the medium term, as demand and offer reach equilibrium, this would lead to lower prices for consumer goods markets previously closed to competition consumer savings and lower government spending as the scope and magnitude of subsidies decrease.

Wide spread state interventions in the economy that distort the level playing field. In Tunisia, Government-endowed advantages - preferential public assistance in the form of financial aid and more - are conferred on an arbitrary, selective basis without a state aid legal framework that defines *ex ante* their objectives and modalities for granting – and with there is no monitoring mechanism in place. Further, the Competition Council is not involved in the control of their potential distortive effect in the market. Each ministry can approve, *ad hoc* and without planning, their own state aid (that take various shapes) with possibility of granting them even if they unnecessarily distort trade. Moreover, the principle of competitive neutrality -substantiated in a sufficient disclosure of commercial activities of the SOE; identification of direct costs of any given functions; tax, regulatory, debt neutrality; neutral public procurement rules, between state-owned enterprises (SOEs) and private companies- is not yet embedded in the government actions. As a consequence, the level playing field between public and private business is not maintained. Recent research by Aghion and others (2011) revealed that lower growth is registered in sectors where subsidies and aid are concentrated in a few firms. Thus discriminatory or selective subsidization policies are mostly detrimental to productivity growth, especially in developing countries (Harrison and Rodriguez-Clare 2010).

⁴³ CPI for wheat in Tunisia was 0.6 compared to 6.6 in Algeria, 19 in Argentina, 6 in France and 14 in Belgium. IMF (2012), Albertin G. and Crivelli E., Les subventions aux produits alimentaires and énergétiques en Tunis.

Weak institutional independency of the Competition Council threatens its effectiveness. The institutional setting is weakened in various ways. Foremost the legal framework gives numerous possibilities to the line Minister to intervene on a case-by case. For example the Minister is assigned the possibility of granting exemptions to agreements without a rigorous analysis of their impacts on markets, thus excessive discretion of government intervention in case-by- case decisions. The Minister is also the ultimate decision maker in case of mergers operations. The ties to the Ministry are also reinforced by the bifurcated institutional setting wherein the functions of enforcing competition are split by two institutions in charge of competition: the Competition Council and the Ministry of Commerce. This split is duplicative and results in the inefficient use of public funding. In addition, the decision-making process of the Competition Council is not transparent, and, thus, its impact is reduced. There is no requirement to publish the Council decisions, so there is limited transparency; the annual report is not available online and it is issued only in Arabic, thus limiting the pressure from international peers to review and comment on Council activities; and the Council holds hearing only beyond closed doors.

All these aspects are likely to threaten the effectiveness and credibility of the Competition Council. Cross-country studies reveal that antitrust enforcement has a significant positive effect on productivity growth. This result is robust across developed and developing countries alike. In developing countries de facto independence of the competition authority—as reflected in the autonomy of its decisions—and an emphasis on promoting competition play a crucial part in driving total factor productivity growth. For a developing country, de facto independence of the competition authority will translate into a 17 percentage point reduction in the productivity gap with the United States (Voigt 2009).

Moreover, even if the competition framework does not exempt specific sectors, some sector-specific legislation applies rules that do not reinforce competition in the affected sectors and tend to prevent entry by new players. For example, this is evidenced in the tourism, professional services, and telecommunications sectors. These major deficiencies can be addressed by a clear competition legal framework and its effective implementation to have an impact on the market. The goal is to assist the Tunisian government increase the effectiveness of its antitrust and competition framework; reduce anticompetitive behavior; enact effective and non-intrusive merger control policies, minimize economically perverse state aid; and enact measures to reduce anticompetitive government legislation and behavior.

3.1 Background

In 1995, within the context of the euro-Mediterranean partnership, Tunisia was the first country to sign an Association Agreement with the EU. Among the different chapters, the one on Competition and State Aid constitutes a pillar for a deeper integration between EU members and Tunisia. The Competition Chapter includes rules prohibiting anti-competitive activities (e.g. cartels, mergers, price fixing, market sharing, predatory pricing), and it extends to government transfers to private or public enterprises in whatever form (e.g. subsidies, guarantees, tax breaks) that distort competition.

In December 2011, the European Commission was mandated to prepare negotiations for *Deep and Comprehensive Free Trade Agreements (DCFTAs)* with the four signatories to the Agadir Agreement (2007): Egypt, Tunisia, Morocco and Jordan. The purpose is to deepen liberalization, and speed up market access. The chapters on competition and state aid provisions are at the core of the DCFTA.

While the EU proves that competition rules can play a major role in deeper regional integration and can have spillover effects in the neighboring countries via bilateral treaties, from the prospective of the embracing country the adoption of European rules should be assessed against their specific impact in the country. Generally speaking, the adoption of amendments should be favored if EU rules reflects international best practice; they help to remove significant non-tariff barriers;

they help overcome the resistance of vested interests to domestic reforms, and if their implementation can be undertaken at a reasonable cost.⁴⁴

BOX 3.1 SCOPE OF COMPETITION FRAMEWORKS

According to UNCTAD, competition frameworks and in particular competition laws should be general in nature and application. In other words, competition laws should apply to all sectors and all economic agents in an economy engaged in the commercial production and supply of goods and services. Therefore, both private and public owned and operated enterprises should be subject to the same treatment.

Additionally, the OECD and the World Bank Group have jointly stated that “Competition law is an essential part of the economic constitution of a free market country. It should, as much as possible, apply to all market transactions and to all entities engaged in commercial transactions irrespective of ownership or legal form. All exceptions to the application of the law should be explicitly identified in pertinent legislation.”

Source: UNCTAD Report on the ‘Application of Competition Laws: Exception and Exemptions’, 2002. OECD & World Bank Group publication ‘A Framework for the Design and Implementation of Competition Law and Policy’, 1998.

Within this context, this note analyzes in detail major shortcomings of the current competition framework and its implementation. For each specific shortcoming the rectifying measures will be identified to align the competition practice to international best practice. Furthermore, specific steps needed to fulfill the association agreement with EU and the related action plan will be identified. The objective is to achieve a level playing field for private sector participation and increase economic opportunities for economic growth. At the economy-wide level, the regulatory framework towards competition and antitrust enforcement is reviewed in order to identify potential bottlenecks derived from government policies. Aspects that would be analyzed include: granting of statutory monopolies, controls on prices and other market variables, absence of competitive neutrality and discriminatory rules against new entrants, including scope and effects of potentially distortive state aids, wide exceptions regime from the normal application of the competition law, lack of clarity in the law and institutional weakness. In addition, antitrust rules will be analyzed against international best practices, notably the EU acquis, while taking into account the ongoing efforts of deeper harmonization among neighboring countries within the North Africa region and the specific characteristics of the Tunisia economy.

3.2 Status of the competition in the Tunisia market: an overview

Tunisia is characterized by an economic environment where the State still interferes with market forces and private initiative and market conditions are systematically stifled, while rents and corruption are the norm. Tunisia’s productive capacity is centered mainly on low value added activities, such as assembly of imported intermediate inputs from a few EU countries (mainly France and Italy) for re-export to the same countries. Further, the combination of market distortions introduced through various regulatory instruments (such as the Investment Incentives Code, the Labor Code), and the excessive burden of regulations and red-tape, have skewed investment towards low-value added activities. Unemployment remained persistently high at above 13 percent since the early 2000s, increasingly affecting the youth.⁴⁵ Most of the jobs created by the economy were in low productivity, low-value added activities and mostly in the informal sector, offering low wages and no job security, which did not meet the aspirations of the increasingly large number of university graduates. The Tunisia revolution has

⁴⁴ See, Deeper Integration and Trade in Services in the Euro-Mediterranean Region, 2005, Daniel Müller Jentsch, Jointly financed by the European Commission and the World Bank.

⁴⁵ Unemployment rose to 18.9 percent in 2011 following the revolution and stabilized at 16.7 percent as of end-2012.

highlighted the need to open markets to competition and private sector investment, given the urgency to accelerate job creation and share the benefits of growth.

The economic environment under the ex-President Ben Ali was characterized by lack of transparency, cronyism and anti-competitive practices which discouraged entrepreneurship and private sector investment, particularly in the “onshore” domestic economy. The domestic economy continues to be characterized by regulatory barriers to competition, heavy state intervention and red tape. Moreover, delays and limitations in opening up entire segments of the domestic economy to trade and competition have encouraged inefficiencies and survival of low-wage productive sectors.⁴⁶ On the other hand, the exporting sector (“offshore regime”) has successfully attracted foreign (and domestic) investors and has been a key engine of economic growth, through an advantageous fiscal regime, a simplified regulatory burden, as well as low wages,⁴⁷ but investments have been largely limited to low value added production, mainly taking advantage of the cheap labor for textiles and assembling units for re-export to the EU. Tunisia’s integration in global markets remains highly skewed, with over 50 percent of its trade limited to three EU countries, and largely limited to manufacturing products.

Over time, this has translated into slow productivity and firm growth in most sectors. In particular, there are large gaps in productivity and export performance of firms operating in the onshore and offshore sectors, respectively. Very large firms are scarce, operating mainly in the offshore sector and typically showing superior productivity and export performance. Most firms are small and typically do not grow, hampering job creation. Productivity is especially low in Tunisia’s manufacturing sector, which in 2011 employed 18 percent of Tunisia’s workforce and 11 percent of Tunisian skilled workers. In fact the productivity gap between manufacturing and agriculture is very low at 1.7 in Tunisia. This compares to a similar gap of 2.3 in Africa, 2.8 in Latin America and 3.9 in Asia (Rodrik and McMillan 2011). Today, 77 percent of Tunisian workers are employed in sectors with below average levels of productivity.⁴⁸ In the manufacturing sector (agro-food, chemical products, textiles, footwear, electronics, ceramics), total factor productivity (TFP) and labor productivity⁴⁹ growth have stagnated during 1995-2010, with the highest sectoral TFP growth rate being 1.5 percent for firms in the chemical industry and average annual growth rate of less than 1 percent for most sectors - compared to around 10 percent growth of output per worker hour in manufacturing in the Czech Republic or around 3 percent in France during 2000-2007.⁵⁰

At the same time, investment in physical capital and innovation has been limited. High correlation of TFP and labor productivity growth in the manufacturing sector (calculated based on firm-level data collected for 1997-2007) indicates that firms’ investment in physical capital has been limited. This also mirrors limited investment in innovation – according to ITCEQ, R&D expenditure accounted for around 1.2 percent of GDP in 2009, whereas OECD countries⁵¹ spend on average 2.3 percent of their GDP on R&D.⁵²

⁴⁶ World Bank (forthcoming 2012). Development Policy Review: Creating jobs and accelerating inclusive growth. The World Bank, Washington D.C.

⁴⁷ 10 years tax holiday, duty-free imports, fast trade procedures, free repatriation of profits.

⁴⁸ World Bank (forthcoming), Background Report for the Tunisia Development Policy Review – Tunisia’s structural Transformation. Evolution of Productivity, Employment and Exports.

⁴⁹ Measured as output per worker.

⁵⁰ World Bank (forthcoming), Background Report for the Tunisia Development Policy Review – Private Sector Paralysis: Firms Dynamics in Tunisia.

⁵¹ OECD countries have much higher GDP and therefore such differences are much larger in absolute terms.

⁵² World Bank (forthcoming), Background Report for the Tunisia Development Policy Review – Private Sector Paralysis: Firms Dynamics in Tunisia.

Tunisia’s productivity⁵³ could grow significantly faster if firms were given the right incentives to eliminate inefficiencies in the production process and to invest more in innovation that reduce the costs of production. In fact, it has been empirically shown that the firm rivalry intensity affects firms’ decision to innovate⁵⁴ and therefore boosts productivity growth. Empirical analysis⁵⁵ covering 90 sectors of the Tunisian economy shows that a 5 percentage point decrease in the marks up in a sector is expected to increase labor productivity by 5 percent. Labor productivity growth may accelerate to a much larger extent in individual sectors.⁵⁶ In Tunisia, the effect of very fierce competitive pressures dampening productivity growth (also known as “Schumpeterian effect”) cannot be identified. Less market power seems to always provide firms more incentives to innovate and stimulate productivity growth, with no evidence of a nonlinear relationship between PCM and labor productivity growth. This finding suggests that the initial level of competition in Tunisian markets is so low that any increase in the intensity of competition leads to significant productivity gains.⁵⁷

When excluding those sectors where SOEs are present⁵⁸ and analyzing only the Tunisian manufacturing sectors, the empirical analysis indicates that more intense firm rivalry has a greater impact on labor productivity. In Tunisia, several SOEs apply administered prices or may serve interests other than economic ones. Unlike private enterprises, they may also have special access to government funding. A sector with a state-owned monopoly, for example, lacks competitive pressure, but this will not be necessarily reflected in high PCMs if the prices for the monopoly’s goods or services are regulated or if this SOE is incurring publicly funded losses over several years. An increase in the level of competition intensity that translates into 5 percentage point lower mark-ups in a Tunisian manufacturing sector is expected to increase labor productivity growth by nearly 6 percentage points.

Productivity dividends from an increase in competitive pressures in Tunisia are significant in several sectors. Sectors which have been identified as being affected by less competitive conditions are

⁵³ Productivity may be measured either in terms of total factor productivity (TFP) or labor productivity (output/value added per worker).

⁵⁴ Bassanini and Ernst, 2002, Bloom et al, 2011.

⁵⁵ This analysis follows the empirical framework proposed by Aghion et al. (1997, 2005 and 2008), which showed that the level of competition intensity affects firms’ decision to innovate and therefore boosts labor productivity growth. The power of a firm to charge prices that are above the costs of producing the good (defined as price-cost margins - PCM) can be employed as a proxy for the intensity of product market rivalry in that specific industry. PCMs or markup were computed using annual data from 2000 to 2010 for more than 90 different sectors of the Tunisian economy. All data was obtained directly from the Institut National de la Statistique (INS) in Tunisia. Output, value added figures and data on salaries was requested from the National Accounts department. Strong firm rivalry typically implies that firms set prices near the costs of producing the good in order not to be undercut by a competitor. The intuition behind these results is that higher competition provides firms with a strong incentive to innovate, which boosts industry-wide productivity growth. Stronger incentives to innovate due to high competition levels affect industry-wide growth of productivity. For a detailed analysis, see also World Bank (forthcoming), Background Report for the Tunisia Development Policy Review – Opening Markets to New Investment and Employment Opportunities in Tunisia.

⁵⁶ Based on firm level data, productivity growth, be it measured through total factor productivity (TFP) or labor productivity (output per worker) was found to be slow in Tunisia. World Bank (forthcoming), Background Report for the Tunisia Development Policy Review – Private Sector Paralysis: Firms Dynamics in Tunisia.

⁵⁷ In general, the Schumpeterian effect is further only witnessed in sectors in which at least some firms are very close to the technology frontier (leaders). These results therefore seem to highlight that the distance of firms with respect to the technology frontier is still large in Tunisian markets and that there is ample space to ‘escape’ from competition through innovation.

⁵⁸ The impact of high competitive pressures in markets may be underestimated given the presence of state-owned enterprises (SOEs) in many Tunisian markets. Unlike firms in the private sector, SOEs do not necessarily act according to the profit-maximizing principle, which is one of the assumptions of the empirical model used in this report.

among those for which the empirical analysis suggests significant potential productivity gains from more competition: agriculture, air transport, road transport, and business services. Insufficient competitive pressures (either price or quality of service rivalry), particularly in the service sector, negatively affects other segments of the economy since services are often intensely used as inputs in value chains.

BOX 3.2 PRICE COST MARGINS (PCMs) AS A MEASURE OF COMPETITIVE PRESSURE IN MARKETS

We follow the standard approach of the literature in which the measure of market power, the Lerner Index, is derived from the first order equilibrium condition of a profit-maximizing firm that chooses prices. It follows that

$$L_i = \alpha_i / \varepsilon = \frac{(P-MC)}{P},$$

where L_i is the Lerner index expressed as the equivalence of inverse demand elasticity ε weighted by α_i , the market share of firm i , and the PCM, indicating the difference between price and marginal cost (MC) as proportion of the price. In the case of a monopolist, α is equal to 1 and the Lerner index can be derived from the monopoly equilibrium condition $MR=P(1+1/\varepsilon)=MC$. Note that the Lerner index varies between 0 and 1, where 0 reflects $P=MC$ and hence perfect competition. Thus, the higher the PCM measure the higher is the average market power in the sector.

Using average costs to approximate marginal costs, the extent of pricing power in an industry is calculated as the difference between value added and labor costs as a proportion of output (all measured in current prices), as follows:

$$PCM_{jt} \approx \frac{(\text{value added})_{jt} - (\text{cost of wages and salaries})_{jt}}{\text{output}_{jt}}, \quad (1)$$

where j denotes the sector and t denotes the respective year (varying from 2000 to 2010). Output is defined as the total production of all firms in one specific sector. This includes sales and changes in inventories. Value added is computed as output less intermediate consumption. Due to lack of data, financial costs of capital are not included in the average costs. However, Aghion et al (2005) show that excluding costs of capital from the Lerner measure does not affect the results given that these costs are relatively small and constant over time. Changes in PCM within a sector drive changes in productivity, while the different levels of PCMs across sectors are not indicative of differences in productivity levels. Typically, the capital stock or cost and the capital rent as a fraction of value added does not change dramatically from year to year within one sector.

The PCM measures are used to evaluate the relation between market power and real labor productivity growth. Exceptional growth in labor productivity can occur independently from competition firm's innovation efforts. The analysis therefore accounts for productivity shocks that occur economy-wide at specific points in time and for differences across industries in the growth rates of productivity that are unrelated to competition levels and do not change over time. Higher margins could be the result rather than cause of innovation and changes in productivity growth. When looking at contemporaneous values, the cost-advantage gained by innovation could translate into higher margins. In order to address this problem, the analysis relates PCMs from the preceding year with changes in contemporaneous productivity growth.

The relationship between competition and productivity is not necessarily the same for all levels of competition intensity. Recent studies (Aghion et al 2005, 2008) have shown that when competition is extremely intense (firm's margins on their sales is almost zero), additional competition does not provide incentives for firms with backward technology to innovate more and at times even less. This dampening effect is known as "Schumpeterian effect". By allowing for a non-linear relationship between market power and productivity growth, we assess whether any markets in Tunisia present such absence of market power and whether additional competition could harm productivity growth in such sectors.

Therefore, efforts to create competitive market conditions need to focus on those markets which are significant contributors to growth and provide strong forward and backward linkages with other sectors. Specifically, it is important to enhance market conditions in those sectors that make an important contribution to national income, are providers of inputs and services to other sectors, provide scope for wider gains through innovation, improved distribution and business processes, are significant for investment and increasing productivity levels, and are important for consumers. Tunisia has a relatively competitive manufacturing sector reflecting to a certain extent the dynamics of the textile and mechanical spare part industries. Besides manufacturing, tourism, agriculture, transport and telecommunications services are examples of sectors that are key for economic growth. In some cases, such as agriculture, transport, and telecom, the presence of state-owned enterprises requires special attention given that government interventions in the markets may affect firms' ability of entry and exit, and can stifle market conditions and consumers' ability to shop around. For example, the *tourism sector* is locked in low value mass tourism; the lack of differentiation of hotel offering is an indicator of low quality of service for tourists. In the *agriculture sector*, the government controls over prices and distribution margins for a wide range of agriculture products, combined with various taxes and charges, distort incentives for increased quality of produce, as producers incur higher costs, but commodity prices or margins are capped. In the *transport sector*, the national median trucking price⁵⁹ per ton-km of USD 0.219 (or TND 0.34060) is around the US average of USD 0.26,⁶¹ and higher than other developing countries such as Vietnam (USD 0.14), India (USD 0.06) and average freight prices in Sub-Saharan Africa (USD 0.05 – 0.13).⁶² In the air transport, per kilometer price of a one way ticket (economy class) is USD 0.3 from Tunis to Washington D.C. compared to USD 0.1 from Casablanca to Washington D.C.⁶³ In the *telecom sector*, voice and internet costs are high for consumers and private sector. Cost of a call from Paris to Tunis is 11 times more expensive than a call from Paris to Istanbul. A benchmark on “Skypeout” calls shows that a Skypeout call to Tunisia costs \$0.395 (Morocco is at \$0.25, Algeria, Libya and Egypt are between \$0.15 cents and \$0.20, Turkey is at \$0.036, France is at \$0.023).⁶⁴

Nevertheless, a wide array of regulatory restrictions stifles market conditions across sectors. They impose restrictions on the number of competitors allowed to operate in several sectors (water), provide legal constraints to the sale of the stakes owned by the government in publicly-controlled firms, control market variables (set or recommended minimum prices in the case of architects and legal services, respectively; prohibition of advertising for professional services), provide extensive exclusive rights (architects, lawyers, engineers and accountants) or introduce additional authorizations for certain types of businesses (in the retail sector, the regulatory framework⁶⁵ introduces an additional authorization for the opening of large outlets, while the process of obtaining such an authorization is burdensome).

Furthermore, state involvement in business operations and direct government participation in markets play a dominant role in many important sectors in Tunisia, with the government controlling firms in markets that are typically open to private sector participation, such as manufacturing and services. From a market perspective, governments can sometimes use market mechanisms (“competition for the market”) to deliver their policy objectives and, if well designed, these can increase efficiencies and consumer choice. Market mechanisms are generally less restrictive than

⁵⁹ Due to high variance in price and cost figures, we use sample medians in the ensuing discussion.

⁶⁰ All TND to USD conversions are based on PPP exchange rate USD 1 = TND 0.658 (IMF, 2012).

⁶¹ Pakistan, Brazil, USA, Africa – Teravaninthorn and Raballand (2009); India, Vietnam, Malawi, Tunisia – World Bank trucking surveys in respective countries.

⁶² World Bank (forthcoming), Draft Note on Connectivity in Tunisia.

⁶³ http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/ASJ_vol14%20Sta3%20Eng.pdf

⁶⁴ World Bank (forthcoming), Background Report for the Tunisia Development Policy Review – Opening Markets to New Investment and Employment Opportunities in Tunisia.

⁶⁵ *Loi no. 2009-69*, August 12, 2009.

traditional “command and control” interventions. A well-intended “command and control” intervention could in some circumstances result in goods and services provided at inefficiently high costs or poor quality, given that the Government does not typically have access to prices as signal of consumers’ preferences. Within this framework, similar to other EU countries, SOE presence (a form of traditional “command and control” interventions) is found especially in certain segments of network industries in Tunisia. However the Tunisian government controls at least one firm in 19 sectors (against an OECD average of 12 sectors). SOE presence is relatively large in sectors such as manufacturing, transport, tourism and recreation including hotels and restaurants and other services that are attractive for private sector participation and are key for job creation. For example, there are 3 SOEs providing golf facilities and 12 SOEs in the real estate sector.⁶⁶

The Government also maintains extensive price controls at all levels of production and distribution for a wide range of food and non-food products and services. Specifically, it has been pursuing a price control policy for a series of agriculture products (cereals, milk, bread, etc.), and imposing caps on distribution margins for others (vegetables, rice, poultry, etc.). The downside of such extensive price controls is that the administered prices do not mirror downward trends of commodity prices in international markets, even if they buffer the local economy from upward spikes of international commodity prices. This results in an opposite effect of the intended policy since consumers do not benefit from lower international prices. In addition, they discourage increases in productivity or quality of supplied products.

Openness to FDI appears to be broadly constrained. Statutory or other legal limitations to the number or proportion of shares that can be acquired by foreign investors are frequent. Such restrictions cover almost all the sectors of the economy, including non-strategic areas such as construction, tourism sector, wholesale trade, including motor vehicles, professional services, or motion picture projection and distribution.

Overall, allocation inefficiencies persist in the Tunisian markets, with no significant reallocation of resources towards more productive firms. This highlights that there is scope for significant growth if market distortions that obstruct efficient reallocation of resources can be removed. On the other hand, the persistent lack of firm growth, combined with low exit rates, is not only indicative of restrictive labor regulations that make firing costly and difficult, but also of limited competitive pressures. To accelerate creation of new job opportunities, it is therefore important to remove constraints to growth of incumbent firms and to promote new entry – the success of the offshore regime in creating jobs and attracting foreign direct investment is testimony to the fact that policy reforms that minimize market distortions and release constraints stifling firm growth pay off.⁶⁷

In this respect, Tunisia has implemented a large number of reforms to enhance the investment climate, but further attention should be paid to those policies that enhance efficient allocation of resources and reduce barriers to entry. Following the signature of the Association Agreement with the EU,⁶⁸ a large number of reforms focused on industrial upgrading, trade facilitation programs and facilitation of firm creation. However, an enterprise survey from 2008⁶⁹ highlighted that among import-competing firms there was a widespread perception of a skewed operating environment compared to the offshore sector. In particular, firms that sold into the domestic market complained about anti-competitive practices and the unfair advantages of informal competitors that do not pay tax and social security

⁶⁶ World Bank (forthcoming), Background Report for the Tunisia Development Policy Review – Opening Markets to New Investment and Employment Opportunities in Tunisia.

⁶⁷ Id.

⁶⁸ Entered into force in 1998.

⁶⁹ IEQ, 2008. The survey included 851 Tunisian enterprises in most sectors.

contributions. Close to three quarters of responding firms complained about one form of anti-competitive practices – either through artificially low price setting (60 percent of respondents), abuse of dominant position (15 percent of respondents), explicit or implicit agreements (14 percent of respondents) or all of these, highlighting that market conditions in Tunisia are far from providing a level playing field for businesses.

Competition policies ensure that market conditions facilitate easy allocation of production factors (labor, capital, know-how, technology) and enhance economic welfare. The 2010 World Bank Development Policy Review highlighted that Tunisia need to reduce controls on business in the onshore sector, improve the quality of public services to firms, enhance market competition and improve the functioning of the labor market in order to accelerate the country’s structural change.⁷⁰ In practical terms, competition policy usually involves the promotion of measures to enable firm entry and rivalry, through the elimination of restrictive product market regulation,⁷¹ and the enforcement of antitrust legislation to address any market distortions induced by anticompetitive business conduct and mergers among rival firms.

A comprehensive assessment of competition conditions⁷² recently completed as input to the forthcoming Development Policy Review for Tunisia highlights the potential of reforms of the competition framework to enhance market efficiencies and competitiveness. In particular: (i) the potential for enhancing labor productivity in the economy that would result from better market conditions, with a focus on selected key markets (tourism, agriculture, transport and telecommunications services), which are critical for the Tunisian economy; (ii) the cost of restrictive regulations and government policies that affect product markets through unnecessary barriers; and (iii) the effectiveness of economy-wide enforcement of antitrust rules in removing anticompetitive regulation to promote firm entry and/or expansion and correct market distortions stemming from anticompetitive behavior of firms. The present assessment of the antitrust legal framework will complement the analysis under pillars (i) and (ii). The findings will ultimately inform policy recommendations on how competition policy framework in Tunisia may play a key role in addressing bottlenecks related to market inefficiencies, anticompetitive behavior and regulatory barriers to entry.

3.3 The EU – Tunisia relationship on competition matters

The Euro-Mediterranean Partnership (or Barcelona Process) started in 1995, with the aim of deepening relations between the European Union and its Southern neighbors. In the case of Tunisia, this was put in action through the Association Agreement (AA) of in March 1998. After the EU political geography changes brought by its enlargement of 10 new member states in 2004, the EU decided to strengthen its partnerships with its neighbors through the *European Neighborhood Policy* based on strong commitments to shared values and political, economic and institutional reforms.

From the EU perspective, this is an offer to partners’ countries to access at favorable conditions to the EU Internal Market and of further economic integration. The AA includes rules prohibiting anti-competitive activities (e.g. cartels, mergers, price fixing, market sharing, predatory pricing), and it extends to government transfers to private or public enterprises in whatever form (e.g. subsidies, guarantees, tax breaks)- called state aids- that distort competition. The competition and state aid

⁷⁰ World Bank (2010). Development Policy Review: Towards Innovation Driven Growth. Report No. 50847-TN. The World Bank, Washington D.C.

⁷¹ For more detailed, see International Competition Network (ICN) Report on Assessment of ICN Members’ Requirements and Recommendations on Further ICN Work on Competition Advocacy, 2009.

⁷² World Bank (forthcoming), Background Report for the Tunisia Development Policy Review – Opening Markets to New Investment and Employment Opportunities in Tunisia.

provisions of the AA will only become effective upon the enactment of implementation regulations,⁷³ as specified in the Action Plan. Analogous to EU-internal rules, bilateral competition and state aids provisions with all these countries only apply to cases affecting cross-border trade. On the most recent Action Plan to implement the EU- Tunisia Association agreement, the chapter on competition, specify the priority actions for each chapter (See Box 3.3).

BOX 3.3 COMPETITION POLICY

Short term

(31) Adopt the implementing provisions of Art. 36(3) of the Association Agreement

– Adopt a decision of the Association Council on the implementing provisions of Art. 36(3) of the Association Agreement.

(32) Implement and consolidate undertakings made on competition law (Art. 36 of the Association Agreement) and develop legislation and a control mechanism compatible with those in the EU

– Assess the current Tunisian legislative framework and its implementation, in particular respect for the principles of non-discrimination, transparency and procedural fairness;

– consolidate the status of the Competition Council, in particular by (a) guaranteeing its independence and ensuring adequate staffing levels and budgetary resources;

(b) endowing it with appropriate powers, notably for decision-making, enforcement orders and effective sanctions (e.g. fines); the possibility in the medium term of own-initiative investigations; (c) ensuring appropriate training for competition authority staff;

– ensure the right of appeal to an independent court against decisions on anti-trust;

– ensure specialist training for judges dealing with competition cases.

State monopolies

(33) Implement commitments made under Articles 37 and 38 of the Association Agreement

– Exchange fully information on State monopolies, public enterprises and enterprises with special or exclusive rights.

State aid

(34) Implement commitments on State aid made under Art. 36 of the Association Agreement Medium term

– Establish full transparency as regards State aid, in particular by (a) laying down a uniform definition of State aid (agreed by both parties); (b) drawing up a complete list of bodies granting aid; and (c) creating a national mechanism for centralizing information on State aid granted in Tunisia, with a view to drawing up the report referred to in Art. 36(4)(b) of the Association Agreement.

(35) For Tunisia to participate in a specific sector of the internal market, it must introduce a State aid control regime and legislation compatible with that of the EU:

Medium term

– a legal principle of prohibition of State aids which distort trade between the EU and Tunisia;

– an ex-ante control system involving the competent authorities.

EU-Tunisia Action Plan http://trade.ec.europa.eu/doclib/docs/2006/march/tradoc_127990.pdf

⁷³ These are to be drawn up by the bilateral Association Councils, within five years after the entry into force of the Association Agreement. This deadline, however, only seems to be indicative and has already lapsed in the case of Tunisia.

A new Action Plan was announced on February 2012 in the Joint Declaration EU-Tunisia⁷⁴ where, among other commitments, the resumption of the bilateral negotiations with the goal of the finalization of a “privileged partnership” through a new Action Plan.⁷⁵ The main problem in the Arab Mediterranean Partners (MPs), however, is actual enforcement. Most competition authorities are insufficiently autonomous (e.g. regarding the right to initiate investigation or the ability to enforce decisions) and institutionally weak (few technically qualified staff, insufficient budgets). None of the Arab MPs have effective state aids policies and in many cases, competition rules do not apply to key parts of the economy (e.g. infrastructure sectors, state-owned monopolies). These weaknesses are reflected in the case-load, the economic significance of the cases investigated, as well as the fines levied. As part of their mise-a-niveau process, the MPs will have to determine how fast and how far to move in the area of competition policy. In many of these economies, more blatant impediments to competition still exist (e.g. legal barriers to competition, state-owned monopolies, and unregulated cases of market failure in key services sectors) and should be a priority for reforms. Given weak countries do not yet seem ripe for elaborate competition regimes. Nonetheless, well-designed competition laws and competition authorities can play a useful role. They should initially focus on the main anti-competitive conducts (e.g. cartels, abuse of dominant position) and act as an advocate for the development of a “competition culture” (e.g. advise to governments on competition-related policies or the issuing of public opinions). Their mandate and institutional capacity could then be gradually expanded. The implementation of such regulations could be used as an external anchor for such domestic reforms. As in all other policy areas, however, regulatory harmonization with the EU should not be pursued for its own sake, but only to the extent that it effectively facilitates trade or economic reform in the MPs. Flanking measures would be donor-sponsored capacity building projects, the exchange of best practice through regional networks of competition authorities, or peer reviews. Given the different stages of development across the MPs, a differentiated and gradual approach is called for.”⁷⁶

In May 2011 the EU also pledged to offer Deep and Comprehensive Free Trade Area (DCFTA) to four Mediterranean states in the aftermath of the 2011 “Arab Spring”: Egypt, Jordan, Morocco and Tunisia, that provides for the gradual dismantling of trade barriers and aim for regulatory convergence in various areas, including competition. The goal is to “keep pace with regulatory developments in the EU’s Internal Market. For the most advanced partners, a DCFTA can lead to a progressive economic integration with the EU Internal Market. Through progressive approximation of EU rules and practices, DCFTAs require a high degree of commitment to complex and broad-ranging reforms. This requires strong institutional capacity. The reforms can be politically challenging and require the involvement of the business community as well as other interested parties.”⁷⁷

Tunisia is one of the four signatories of the Agadir free trade agreement (8 May 2001), an important sub-regional initiative for a combined market of more than 120 million consumers with a combined domestic product of nearly €200 billion, with Morocco, Egypt and Jordan, which is open to accession by other countries. These four partners expressed in a Declaration their intention to set up a free-trade area among themselves, assisted by both a financial and technical support of the EU. With the Agadir partners plus Syria, Tunisia has concluded cooperation agreements containing specific obligations of:

⁷⁴ MEMO/12/62 Brussels, 2 February 2012 Relations UE – Tunisia: Joint Declaration "Towards a privileged partnership".

⁷⁵ The Joint Declaration, supra, also mentions a non-paper on the privileged partnership distributed to the Tunisian authority during their official visit to Brussels in February.

⁷⁶ Deeper Integration and Trade in Services in the Euro-Mediterranean Region, 2005, Daniel Müller Jentsch, Jointly financed by the European Commission and the World Bank.

⁷⁷ Joint Communication by the High Representative of The Union For Foreign Affairs And Security Policy and the European Commission, Brussels 25 May 2011 available at http://ec.europa.eu/world/enp/pdf/com_11_303_en.pdf.

- Notification on the law application areas affecting the important interests of the other party.
- Consultation to solve problems of law enforcement.
- Coordination of the work with regard to anti-competitive practices that affect the interests of both parties.
- Providing assistance in research.
- Cooperation and exchange of expertise between the bilateral competition authorities in the field of competition.

For the impact that the potential gains of trade liberalization may be accompanied by adverse effects on natural resources, environmental quality and social development the European Commission commissioned in 2007 a Sustainability Impact Assessment (SIA) Study of the Euro-Mediterranean Free Trade Area (EMFTA) study⁷⁸ identifying the main cause and effect relationships between trade liberalization and potentially adverse impacts on sustainable development. A new SIA has been announced in relation to the new DCFTAs.

The EU’ deeper integration is sponsored through comprehensive regulatory harmonization, in which the accession countries transpose the entire EU *acquis communautaire* (corpus of EU law) into their national legal systems. Some studies have assessed this degree of harmonization as “unrealistic, and in fact undesirable, for the Arab MPs.”⁷⁹ Tunisia has for long express its desire to “bring the national legislation closer to the European legislation and international standards, especially under the comprehensive review of the European competition legislation in 2000”.⁸⁰ Keeping as a point of reference these commitments with the EU, the following sections will analyze in details the legal framework on competition currently in place and the gaps compared to the international best practices.

3.4 Shortcomings of the competition policy framework: the competition law⁸¹

The existence of a well-designed competition law constitutes a necessary, even if not sufficient, part of the competition policy framework. An analysis of the Competition Law reveal major shortcomings: despite many changes since it was adopted in 1991, retains numerous shortcomings that stand in the way of the development of a healthy competitive environment. In fact, the law contains distinct exceptions to its application – variously: an excessive list of goods and services that are not subject to the law because they are under the regime of administered prices and/or because they are provided by legal monopolists, thus excluding some key markets from the application of the law; the line Minister is assigned the possibility of granting exemptions to agreements without a rigorous analysis of their impacts on markets, thus excessive discretion of government intervention in case-by- case decisions.

The ties to the Ministry are also reinforced by the bifurcated institutional setting wherein the functions of enforcing competition are split by two institutions in charge of competition: the Competition Council and the Ministry of Commerce. This split is duplicative and results in the inefficient use of public funding.

⁷⁸ Sustainability Impact Assessment of Euro-Mediterranean Free Trade Area, Final Report of the SIA-EMFTA Project, Revised November 2007 Available at http://trade.ec.europa.eu/doclib/docs/2008/february/tradoc_137777.pdf.

⁷⁹ Deeper Integration and Trade in Services in the Euro-Mediterranean Region, 2005, Daniel Müller Jentsch, Jointly financed by the European Commission and the World Bank.

⁸⁰ The National Report on the Competition Policy and Law in Tunisia, Arab Center for the Development of the Rule of Law and Integrity- ACRLI, hereinafter (‘ACRLI Report’) Beirut, January 2010, p.99.

⁸¹ This document is a synthesis of the “Competition policy and reforms options in the context of Tunisia’ deeper integration with the EU”, Investment Climate Department of The World Bank Group. For detailed analysis and policy options, please refer to the full report.

Moreover, the principle of competitive neutrality — substantiated in a sufficient disclosure of commercial activities of the SOE; identification of direct costs of any given functions; tax, regulatory, debt neutrality; neutral public procurement rules, between state-owned enterprises (SOEs) and private companies- is not yet embedded in the government actions. As a consequence, the level playing field between public and private business is not maintained.

The Competition Council’s advocacy functions are also not fully exploited and therefore the Council’s impact on the market remains limited. The Council would do well to review draft laws in addition to decrees, which might have an impact on competition and conduct market analysis to assess main barriers to free market competition; furthermore, under current law, its opinions are nonbinding. Government-endowed advantages - preferential public assistance in the form of financial aid and more - are conferred on an arbitrary, selective basis without a state aid legal framework that defines ex ante their objectives and modalities for granting – and with there is no monitoring mechanism in place.

In addition, the decision-making process of the Competition Council is not transparent, and, thus, its impact is reduced. There is no requirement to publish the Council decisions, so there is limited transparency; the annual report is not available online and it is issued only in Arabic, thus limiting the pressure from international peers to review and comment on Council activities; and the Council holds hearing only beyond closed doors.

Currently, the system of sanctions does not function as a deterrent and does not constitute a credible threat to business, as the sanctions can reach maximum 5 percent of the turnover and they are rarely applied. There is lack of prioritization in the Council’s intervention in the enforcement of the competition policy due to the failure to carry out market studies to identify the main competition economic constraints. This is reflected on the fact that some of the most serious anticompetitive practices – especially cartels – are not controlled. The Competition Council’s decision-making process tends to be very legalistic and based on the literal application of law: this approach is consequential. First, economic reasoning, very essence of every antitrust decision, is weak and rarely at the core of the Council’s final decision. Second, the procedural approach inevitably triggers the need for clear implementation rules and guidelines specifying provisions and mechanisms already covered by the law that need further details in order to be operationalized. This is the case for practices of abuse of economic dependence; predatory prices; and leniency mechanism. Another consequence of the literal approach is the need to have a reference in the Law of every power or obligation entrusted to the Council, as for example, due process rights and appeal procedures.

The following sections analyze the identified shortcomings and suggest specific policy options to address them.

3.4.1 Competition law contains broad exclusion and exceptions to its application

Key markets are excluded from competition rules. The Competition Law⁸² (CL) foresees in Art. 2 a broad application of its rules to all Tunisian markets. However, a careful look identifies major exceptions to its scope of application which translates into broad exceptions to the free play of competition. In fact, Art. 3 excludes from its application certain products because they either a) are products considered of first necessity; or b) because the sector is monopolized; or c) for long lasting difficulties of supply due to legal/regulatory barriers.⁸³

⁸² Competition Act No. 91/64 of 29 July 1991

⁸³ UNCTAD peer review calculated that in the production sector, the prices of 13 per cent of products are still regulated, as compared with 20 per cent in the distribution sector. Therefore the UNCTAD Peer review concluded that “It therefore seems that a non-negligible part of the Tunisian economy is not open to free competition, and there

Price control is common practice in several markets. The competition framework establishes a list of goods and services that are subject to administrative price control. Decree 91-1996, as modified by decree 95-1142 contains 3 Annexes where goods are listed according the different system applicable to them: goods and services where the homologation applies to both production and distribution stage or to either one.

Rationale for limiting the exclusion: the international experience. Generally price controls over goods and services are introduced by governments to maintain the affordability of staple foods and goods and to prevent price gouging during shortages. International experience shows that similar interventions have failed to achieve their intended goals and on the contrary brought unintended consequences. Recent international benchmarking from OECD Database on product market regulation in 2008, evidence that only 7 countries (China, Russia, Israel, Korea, Iceland, Canada and Greece) out of 32 countries analyzed applied some type of price control on certain staples such as milk and bread.

Tunisia case is drawn from historical heritage. In fact, the option to link the regulation of prices and the competition law is unique within the region as other Middle Eastern countries have adopted a competition law independent form price regulation. This historical inheritance combined with current reasons of avoiding social explosion creates a situation where a large basket of goods are subject to price control. Furthermore, progressing in the policy of price liberalization, especially in some sectors where there is sufficient level of competition such as vegetables and fruits, and coffee shops tariffs “has been already identified by the Government as one of the one of the structural reforms to promote competition in the economy.”⁸⁴

Tunisia price control system does not necessarily affect good and services of first necessity. The selection of Table A-C (annexes of the Decree 91-1996) includes many products that are not necessarily of first necessity and therefore should be excluded from the exception. A comparative overview of the products excluded in other jurisdictions proves that the list of excluded products in Tunisia is very broad. For example, Morocco also has a similar approach in defining the scope of the Competition Act, but the list of excluded products is more limited than the Tunisian list of products, most notably in the case of agricultural products.

- **Policy Options:** abolish the system of fixing the price or margin of goods and services excluded from the competition regime. The system might be replaced by a general subvention system with targeted programs that directly assist the poorer in ensuring them goods and services of first necessity at affordable prices. The general competition law should apply to every good and service and the Competition Council should intervene only when the cartels or other anticompetitive behaviors are present in the market.⁸⁵

Goods and Services where competition is limited due to the existence of monopolies. Monopolies are excluded from the application of competition Law. Art. 3 excludes legal “monopolies” from the application of the competition law, without any further clarification. The Competition Council confirmed that no action is taken in markets that are state monopoly. The Competition Council interprets Art. 3 as applying only monopolies established by law or regulation, although the law is not totally clear in this

are no signs of improvement in this respect. Further liberalization is envisaged once conditions are favorable.” See Voluntary Peer Review: Competition Policy in Tunisia, 2006 available at http://archive.unctad.org/en/docs/ditccplp20062overview_en.pdf.

⁸⁴ ACRLI Report , p. 98

⁸⁵ The price setting culture is very much entrenched in the Tunisian culture. In fact UNCTAD peer review underlies that “The public, for its part, sometimes perceives competition as a greater threat than price regulation, which reassures consumers”.

sense. Moreover, the Law neither contains a definition of state monopoly nor a complete list of them and it seems referring to all kind of monopolies not only the statutory ones, or to sectors not yet liberalized. According to UNCTAD, state enterprises are still of considerable economic importance, with a value added representing about 13 per cent of GDP, and which account for 8 per cent of total employment in the country. Among the sectors are fertilizers, mining, electricity, and construction materials.

Holding a dominant position or a monopoly of a market is not illegal in itself, however certain categories of behavior can, when a business is dominant, be considered abusive and therefore incur legal sanctions. Therefore, even in case of legal monopolies, competition law should still apply. For instance in the EU, when applying competition law, the European Commission always takes account of the special obligations placed on any organization benefitting from 'monopoly rights'. This approach ensures that there is fair competition without handicapping the State-funded provider, which is obliged to provide services in the public interest even where this is not profitable. In fact, firms enjoying a legal monopoly are more likely and prone to exercise market power as they are not facing current competition neither are facing potential competitors in the near future. The result is likely that they discretionally set the price they charge.

Sectors not yet liberalized. Differently from the monopoly regime is the case of liberalization of specific sectors. The economic rationale for regulation of these markets is that economies of scale are so substantial that a single firm can produce total business output at a lower unit cost, and thus more efficiently than two or more firms. In the long-run average costs are falling over such a wide range of production rates (relative to demand) that only one firm can survive in such an industry.

In these situations we are in presence of natural monopolies, which give rise to a potential conflict between cost efficiency and competition, with an increased number of competitors leading to some loss of scale efficiencies. Through liberalization program competition law is extended to previously state monopolized industries. Given that these sectors were considered often natural monopolies, the entry of new provider, in certain sectors requires a great deal of investment and it is not always the efficient solution to introduce competition while maintaining universal and high quality service.

For example, the EU developed the concept of legally separating the provision of the network from the commercial services using the network, in so introducing competition in the sector. Opening up new markets requires additional regulation to ensure that public services continue to be provided and that the consumer is not adversely affected. Therefore, depending on the degree of liberalization, the competition law should apply and only sectors that have not been liberalized are excluded from competition.

- **Policy Options:** It is recommended to 1) amend the law to avoid exception for generically "monopolies" 2) to have a full disclosure on State monopoly, public enterprises and enterprises with special or exclusive rights as specified as well by Action Plan with the EU (par 33); 3) to assess the liberalization stage for the sector not yet to liberalized with the goal of opening them gradually to competition.

Goods or services that might face sourcing difficulties. Traditionally, countries rooted a legal tradition of Islamic law tend to include the regulation of hoarding within the Competition Act. Indeed, based on the Qur'an' prohibition of the Ih'tikar the legislature sometimes has understood that hoarding needs to be specifically addressed in the Competition Act. In this respect, competition acts that regulate restrictive trade agreements and abuses of dominant positions serve for the purpose of guaranteeing that efficient competition takes place in the markets. As such, the prohibition of hoarding practices fall under the prohibition of either a restrictive agreement or an abuse of dominant competition on a case by case basis and therefore do not need to be specifically addressed.

- **Policy Options:** Eliminate the possibility to further exclude certain goods and services that might face sourcing difficulties.

3.4.2 Shortcomings of the institutional set up

Nature of the Competition Council: Current proposal to make the Council a constitutional level authority or a tribunal. Interviews with the Competition Council and the Director General for Competition and Economic Research in the Ministry of Commerce (DGCEE) revealed that among the possible outcomes of the constitutional assembly work is the “constitutionalization” of the role of the Competition Council, that can take two different forms: a) the new Constitution will mention the Competition Council among the independent administrative authorities (such as the Central bank etc.)⁸⁶; or b) the Competition Council will be given a juridical status.

In international best practices, the enforcement of competition legal framework is mostly achieved through independent administrative authorities, with possibility of an appeal before the judiciary (common or specialized judge). To have an implementing competition authority that has a judicial nature will run against the separation of powers and will not ensure that the proper checks and balances exist in Tunisia. For example, if the competition authority is given a judicial nature, then it will not be able to perform advocacy activities, as the judiciary is expected not to directly influence the legislature.

- **Policy Options:** Clarify the administrative nature of the Competition Council to avoid confusions that might lead to see the Competition Council as part of the judiciary.

Delimitation of the Competition Council mandate to avoid duplication of portfolios of different agencies. The Competition Council’s competences are limited by its position as *non unique* body in charge of competition law enforcement. The main constraints result from: (i) the mixed role of the government as operator in the economy and authority in charge of enforce competition framework. (ii) the duplication of functions of the two institutions (Competition Council and DGCEE within the Ministry of Commerce) in their investigation powers, and (iii) the ultimate decision power granted to the Minister of Commerce in key enforcement areas, such as in case of merger approval and negotiation of fines. Decisions of Competition Council are not published which reduces accountability and transparency of decision making process.\

The intertwining of the Government with the independent authority is a situation widespread in the Tunisian economy.⁸⁷ From the competition enforcement viewpoint, both the Department of Competition and Economic Investigations (DGCEE) and the Competition Council have joint responsibilities to implement the Competition policy by monitoring the market, promoting competition and investigating anticompetitive practices. DGCEE could be established as the governmental body responsible for directing competition related policies, whereas the Competition Council and other sector regulators could

⁸⁶ This is the case of the Constitution of Morocco where Art. 166 states that « Le Competition Council est une autorité administrative indépendante chargée, dans le cadre de l’organisation d’une concurrence libre et loyale, d’assurer la transparence et l’équité dans les relations économiques, notamment à travers l’analyse et la régulation de la concurrence sur les marchés, le contrôle des pratiques anticoncurrentielles, des pratiques commerciales déloyales et des opérations de concentration économique et de monopole. »

⁸⁷ For example, in the telecom sector, Tunisie Telecom, the main operator of fix line and operator of mobile line, partially privatized, is under the Secrétariat d’Etat chargé des Technologies de la Communication (SETC) which at the same time appoints the President of the Telecom Regulator (INT) in charge of the regulation of the sector. See Aide Mémoire Mission Aide-mémoire, Secteur des Technologies de l’Information et des Communications (TIC) of August 2011, where among the recommendations it is said that the regulatory framework and the competition need to be reinforced in Tunisia.

be in charge of implementing the competition policies directed by DGCEE. The delimitation of the Competition Council’s mandate will increase legal certainty and transparency for market participants.

Limited independence of the Competition Council. The institutional setting of the Competition Council and the role given to the line Ministry by the Competition Law underlines that the Competition Council’ independence is very limited in Tunisia. Notwithstanding the amendments introduced in 2005, the possibilities for the Ministry to intervene in case by case handling are still present. The inheritance of a political economy where privileges and individual concessions were a shadow possibility gives a sense of uncertainty to investors. Eliminate these possibilities for the Ministry to intervene, particularly in Art. 3, 7, 9, 59, even if less and less used in practice, will send a strong signal to private investors that the rules of the game have changed and Tunisia is now open for business.

Excessive powers granted to the Minister to 1) grant antitrust exceptions; 2) clear mergers; and 3) fining. The law, in Art. 4, 9 and 59 opens the door for interventions of the Ministry to regulate prices even in situations where the increased in price was a result of the seasonality of the product to ultimately decide on a transaction discourages foreign investors from entering the Tunisian markets, and to negotiate the fines decided by the Competition Council and it can intervene until a definitive judgment has taken place. This creates a distortive intervention – that does not need to be motivated-on the technical assessment conducted by the Competition Council. The parties should consider the appeal as recourse against Competition Council decisions.

3.4.3 Enforcement weaknesses

Competition enforcement is weak and not focused on the main competition restrictions present in the markets. In fact, the number of competition cases decided and sanctioned by the Competition Council each year remains very low⁸⁸ compared with other law breaches such as unfair competition or not respect of contract conditions. Also, the type of cases undertaken by the Competition Council seem almost absent in cartel enforcement. In fact “the largest proportion of cases brought before it are related to abuse of a dominant economic position or abuse of a situation of economic dependence. This reflects to some extent the market structure that allows the emergence of these two types of practices”.⁸⁹

BOX 3.4 DEVELOPMENT OF THE COMPETITION COUNCIL ACTIVITY							
	2002	2003	2004	2005	2006	2007	2008
Decisions and Opinions	20	26	27	35	68	74	50

Source: ACRLI Report, p. 69

Lack of Prioritization Policies. The Competition Council seems to lack of a prioritization policy that governs its interventions and enforcement Activities mostly due to the failure to carry out market studies to identify the main competition economic constraints. This is reflected on the fact that some of the most serious anticompetitive practices – especially cartels – are not controlled. About 60 percent of firms operating in the domestic market denounced the existence of anti-competitive practices, such as implicit agreements, discriminatory practices and tied sales,⁹⁰ while 67 percent of firms denounced at least one type of unfair competition in the domestic market. This shows that firms tend to engage in anti-competitive agreements, but the current competition policy framework and its enforcement do not seem to

⁸⁸ ACRLI Report, p. 69. These data might not necessarily reflect the internal Competition Council’a analysis of their own activities as per discussion held during the workshop to present the draft of the this report on June 10, 2014

⁸⁹ ACRLI Report, p. 92

⁹⁰ Institut d’Economie Quantitative (2006). Rapport Annuel sur la Compétitivité 2006, Tunis.

be able to address the most pervasive anti-competitive conduct or to remove regulatory barriers to entry; this assessment is confirmed by the government.

Weak reasoning of the decisions for lack of substantial evidence and weak economic analysis to determine anticompetitive practices. Notwithstanding the procedural approach followed by the Competition Council in enforcing the law, the reasoning and motivation on which the decisions are taken lack of rigorous methodology, especially on the economic assessment. From interviews with the Competition Council⁹¹ appears that the Competition Council' focuses its intervention mainly on price level (high or low, even in the absence of evidence of collusive behaviors or abuse of dominance position). When cases of cartels are tackled, often time the participating firms are not realizing their wrongdoing in so demonstrating the low awareness of the provisions of the law and limited competition culture.⁹² When these clear cut evidence are not available, the underlining reasoning of the Competition Council is weak and not grounded in sound economic analysis of geographic and product market, market share, etc.

- **Policy Options:** Increase economic analysis in the course of the investigations, refine the reasoning of the decisions and publish the outcomes of the investigations both in Arabic and in French.

Exceptions to cartels based on broad and general technical/economic progress defenses. The Competition Law excludes certain products and services and does not apply to every undertaking. Exemptions to cartels- including cartels on prices which have been found to be on average up to 35 percent higher than in competitive markets in developing countries – can be granted based on generic technical or economic progress defense.

Art. 6 establish possible exemptions to anticompetitive behaviors, including cartels, if they can be justified by technical or economic progress defense and fair share to consumers. This article, cleared inspired by Art. 101(3) of the Treaty on the Functioning of the European Union (TFEU), lacks some fundamental and essential conditions of it. In fact, the balancing of anti-competitive and pro-competitive requires 4 cumulative conditions: (i) efficiency gains; (ii) fair share for consumers; (iii) indispensability of the restrictions; (iv) no elimination of competition. As currently drafted, Art. 6 gives the possibility to grant exemptions based on the assessment of the first two conditions and without any sounding rigorous method. Especially in cartels on prices (the so-called hard core cartels), the international best practices allow no exemption as they are the most harmful form of anticompetitive behaviors that cannot be counterbalanced by efficiencies. This provision may encourage the creation of further cartels instead of encouraging its disappearance in so facilitating the foreclosure of markets.

Furthermore, the exemption if granted by the Ministry therefore is inspired by political discretionarily and the technical advice of the Competition Council- that the ministry needs to request before its decision- is not binding on the Ministry.

- **Policy Options:** a) Amend Art. 6 to include focused conditions for its application, notably including the indispensability of the restrictions and the control that no elimination of competition would occur; b) considering the adoption of ex ante block exemption regulations, to align Tunisia

⁹¹ Almost all documents produced by the Council (opinions, decisions, annual reports) are in Arabic only.

⁹² This has been the case in 2004-2005 of a banking services case in which the offending practice involved an agreement between the banks, within the framework of their professional association, to fix cheque commissions. *Source:* UNCTAD.

practice to those of EU and some other regional Arab countries like Egypt and Saudi Arabia.⁹³

Inexistence of a link between dominance to the abuse of economic dependence. Elements. In order for an abuse of economic dependence to be ascertained, European best practices have developed in such way that the following essential requirements must be met: 1) The undertakings involved are placed in vertical relation; 2) The victim of the abusive behavior is dependent on the abusing undertaking due to the absence of equivalent alternatives for either the supply or distribution of its goods and services; 3) The dominant undertaking's conduct is considered to be abusive vis-à-vis the other undertaking. Examples of such conduct comprises of the refusal to deal and the unjustified termination of an existing commercial relationship between the undertakings involved, taking into account, inter alia, their previous commercial relations and commercial usage; and 4) The abusive economic dependence has an impact on the market or the structure of competition.

The Tunisian practice of abuse of economic dependence: Although the jurisprudence of the countries that explicitly inserted this provision may vary, the common elements described above are always present. Despite the fact that the elements mentioned above have been taken into account in the Tunisian case law, in some instances the provision has been used to sanction ordinary breach of contract situations not connected to anticompetitive practices.⁹⁴ In fact in Tunisia, “the inclusion of these practices in the Competition Law allowed to address some situations of arbitrary cut of trade relationships in the context of commercial representation contracts, which are practices observed in the past years flowing the opening of the Tunisian market.”⁹⁵ Statistically this provision has been used in 13 percent of cases by the Competition Council.⁹⁶

Policy Options: It is recommended to issue guidelines specifying the required elements that need to exist in order for the Competition Council to establish that there has been an abuse of economic dependence practice.

Clarification needed in the regulation of abuse of dominant position. Inexistence of a presumption of Dominance. Art. 5 prohibits the abuse of a dominant position without establishing a presumption of dominance based on market shares. The international practice is not homogeneous in this regard. Some jurisdictions have opted to include a market share presumption of dominance in the core of the relevant competition acts; others have developed the presumption through case law and eventually incorporated such presumption in secondary legislation such as guidelines. A review of a number of jurisdictions that incorporate abuse of dominance provisions proves that the majority of countries have opted to establish a market share presumption of dominance either in core or secondary legislation. Average market share presumption is of 40 percent. Against this international benchmark exercise, it is recommended that the Tunisian competition framework adopt at least secondary legislation where an approximate 40 percent market share presumption is established.

The provision on Predatory Pricing is vaguely drafted and lead to its excessive application. Predatory pricing is internationally defined as a deliberate strategy by a dominant firm of setting very low prices to drive its competitors out of the market. Once the predator has successfully excluded existing competitors

⁹³ ACRLI Report, p. 66.

⁹⁴ For instance the Council applied the provision in a contest of public procurement and relative delay in providing the procured goods. See ACRLI Report, p. 46.

⁹⁵ ACRLI Report, p.45.

⁹⁶ ACRLI Report, p. 72.

and deterred entry of new firms, it can raise prices and earn higher profits. Although certain authorities⁹⁷ in specific situations do not require dominance to apply predatory pricing provision, the international jurisprudence refers to situations where a position of dominance is found.⁹⁸

Art. 6, comma 5 of the competition law is vaguely drafted and tends to be overused by the Competition Council. Firstly, it does not contain the precondition of dominance. Then, it lacks the necessary subjective element of intent of predation while replacing it with objective criteria.

The international practice shows that in general predatory pricing are extremely difficult to prove and they do not constitute the main area of intervention of competition authorities; a three prong test has been developed:⁹⁹ 1) prices set by a dominant firm below its average variable costs are presumed abusive, 2) prices above average variable costs but below average total costs are abusive if they are intended to eliminate a competitor, and 3) prices above average total costs are conclusively legal.

- **Policy Options:** A revision of the provision is necessary in order to link predatory pricing to the ex-ante existence of a dominance position. Furthermore, the Competition Council should revisit its frequent use of this provision and establish guidelines for its application.

Lack of clarity in the merger control regulatory framework. Notwithstanding the overall alignment of the Tunisian Merger control regime with international best practices, there are still several shortcomings in place that could decrease its efficiency, increase administrative costs and diminish legal certainty as it is analyzed below.

Notification thresholds need to be adjusted to Tunisia's economic characteristics to increase its efficiency. Art. 7 includes a subjective threshold fixed at 30 percent of the aggregate share of the relevant market.¹⁰⁰ This exercise implies an identification of the relevant market for the product and service that the international best practice avoids inserting as a condition for ex ante notification for being an inefficient and subjective exercise. In fact, in recent years jurisdictions have moved towards the elimination of market share thresholds such as in the case of Turkey, and Brazil. Consequently, it is

⁹⁷ For example the French Competition authority. To be noted that the international best practice goes in the direction of requesting "dominance" before proving predation. For example Australia requires the business first to have a 'substantial share of a market'

⁹⁸ See for example EU Commission "Notice on the application of the competition rules to access agreements in the telecommunications sector" (98/C 265/02), par. 110 where "Predatory pricing occurs, inter alia, where a dominant firm sells a good or service below cost for a sustained period of time, with the intention of deterring entry, or putting a rival out of business, enabling the dominant firm to further increase its market power and later its accumulated profits. Such unfairly low prices are in breach of Art. 86(a). Such a problem could, for example, arise in the context of competition between different telecommunications infrastructure networks, where a dominant operator may tend to charge unfairly low prices for access in order to eliminate competition from other (emerging) infrastructure providers. In general a price is abusive if it is below the dominant company's average variable costs or if it is below average total costs and part of an anti-competitive plan. In network industries a simple application of the above rule would not reflect the economic reality of network industries."

⁹⁹ European Court of Justice (ECJ) in the AKZO judgment (1986) and DG Competition, European Commission Office of the Chief Economist, Discussion Paper "A Three-Step Structured Rule of Reason to Assess Predation under Art. 82, Miguel de la Mano and Benoît Durand, 12 December 2005.

¹⁰⁰ As opposed to subjective criteria, objective thresholds are based on aggregate turnover of the parties to a transaction. The determination of the turnover thresholds should take into consideration the estimated costs and benefits of merger review as well as the characteristics and size of mergers and corporations mergers' and firms' sizes in the Tunisian economy. In Tunisia the objective criteria is fixed by Decree n. 2005-3238 of 12 December 2005, Art. 1 at 20 million Dinars.

recommended that the threshold based on the market share of the parties be eliminated.¹⁰¹

Merger control discriminates foreigners during the review procedure. Art. 9 bis of the Law incorporates, as part of the merger review procedure, the consideration by the Competition Council on whether a notified merger will privilege national corporations. The merger control regime should aim at scrutinizing whether proposed transactions will have an impact on the structure of the markets without taking into consideration political or subjective elements such as the protection of national market players.

The Minister has broad discretionary decisional powers during the merger review procedure. Art. 7bis establishes that the Minister of commerce can take all appropriate measures deemed necessary to ensure or to re-install efficient competition in the markets. Even in the few countries (see South Africa example, box below) where the possibilities to impose remedies that take into consideration economic and social considerations have been incorporated merger control regimes internationally, such remedies are generally not imposed solely by the relevant Minister but by the independent competition authority to avoid political interference and preserve its independence.

The timing for review mergers needs to be shortened to avoid excessive regulatory burdens. Art. 8 establishes that transactions that trigger the notification thresholds have to be notified to the Competition Council within 15 days of the signing of the Memorandum of Understanding, publication of the offer, or exchange of rights and obligations. Internationally, in suspensory regimes the closure of transactions is contingent to the authorization of the competition authorities. Therefore, parties should be free to schedule the timing to submit a transaction since an early or late notification does not impose any constraints on the competition authorities' scrutiny task.

Merger ultimate decision power of the Ministry and not of the Competition Council: As analyzed before¹⁰² Art.7 bis gives the Ministry of commerce full powers to enjoin a merger/concentration that does not conform to international best practices.

- **Policy Options:** It is recommended to eliminate the discretionary power of the Minister during the merger review procedure. It is also suggested that the merger control framework is revisited to adjust the threshold to Tunisia's economic characteristics as well as to align the review timing to international best practices.

Fines imposed by the Competition Council still remain symbolic and do not meet the international average.¹⁰³ The main elements that need further clarification are namely the following: (i) introduction of due process and legal certainty guarantees by adopting guidelines on the method to calculate the fines; (ii) optimizing the amount of the fines for anticompetitive conducts to ensure a deterrence effect (for example Art. 34 establishes a cap limit on the fine amounting to 5 percent of the Tunisian turnover of the infringer during the previous fiscal year) ; and (iii) avoid sanctioning illegal practices already covered by other laws and enforced by other government authorities, to ensure an efficient use of the public resources

¹⁰¹ Admittedly, the Tunisian authorities find as well the identification of the market share in M&A difficult: "While the market share standard is considered the best criterion, the identification of a second standard related to turnover aims at facilitating the process for companies as it is sometimes difficult to determine the market share, in addition to the possibility of disagreement on the exact definition of the market ". ACRLI Report, p. 49.

¹⁰² See Section on "Excessive ultimate decisions power granted to the Ministry", above.

¹⁰³ Voluntary Peer Review of Competition Policy: Tunisia, 2006 (UNCTAD/DITC/CLP/2006/2), p. 31 "However, it appears that fines are not a priority for the Competition Board and that the amount of the fines is still often symbolic. This situation cannot continue, since the lack of penalties risks indirectly encouraging criminal behavior. A change in the policy on fines should also be envisaged."

available to the competition authority (for example Art. 44 of the Competition Act typifies and sanctions an infringement relating to fraudulent pricing practices that are not generally competences of the competition and consumer protection authorities and within the scope of the Tax Authority).

3.4.4 *Due Process and parties' guarantees*

Insufficient standing before the Competition Council. Art. 11 of the Tunisian competition law catalogues an exhaustive list of plaintiffs which does not include individual consumers that might be affected by an anticompetitive practice when there are not affiliated to NGO or consumer associations.¹⁰⁴ Nonetheless, according to conversations held with the Competition Council natural persons have been granted with the possibility to launch a complaint and stand before the Competition Council through the case law.¹⁰⁵ There is no reason in terms of administrative efficiency to exclude individuals from having the right to submit a claim before the Competition Council as later clarified by the jurisprudence.

Duplication of administrative costs. Art. 13bis mandates that a representative of the government will have standing and serve as a party in all procedures before the Competition Council. In this sense, the mandate to have a government representative as a party before the procedures of the competition authority impedes the correct implementation of the Competition Council's tasks and duplicates administrative costs. The Competition Council is expected to be the sole independent administrative responsible for defending the public interest in the framework of anticompetitive cases, as opposed to acting as an arbitrator between the government and the parties.

Insufficient due process guarantees. Art. 20 foresees several instances where the Competition Council may order interim measures such as the closure of establishments or impose certain conditions without recurring to the judge. It is suggested to require the judge's intervention when ordering interim measures to ensure that due process rights have been observed, and that the imposition are not left at the discretionary power of the Competition Council.

Imprecise statute of limitations. Art. 11 establish a three year statute of limitations for anticompetitive practices but fail to determine the exact moment when the statute of limitations starts running. In other words, it remains unclear from the text of Art. 11 whether the three year statute of limitations shall start for example in the case of cartels when such cartel was constituted, when the cartel was broken up, or simply when the harmed consumers learned from the existence of such agreement; therefore it is recommended that the statute of limitations be amended as to specify that it shall start running from the date that the harmed individuals learn from the existence of such practice.

Lack of public hearing proceedings. Art. 15, as modified in 2003, states that the hearings before the Competition Council are not public. In the international experience, public hearings are considered as a key element to ensure that due process rights are respected. For example German Act against Restraints of Competition (Arc)¹⁰⁶ provides that the "cartel authority may hold a public hearing on the application for recognition where everyone shall be free to raise objections against the recognition" (Section 25) and that "the cartel authority may, acting *ex officio* or upon request of a party, hold a public hearing." (Section 56(3)). It is recommended that the an oral hearing procedure is introduced in the Competition Act, at least in leading cases, to ensure due process rights with the sole exception based on public order reasons.

¹⁰⁴ ACRLI Report p.99.

¹⁰⁵ For instance, on a case involving – still open-a de facto monopoly of a tourist agency organizing religious travels, the Council has received a complaint from a natural person.

¹⁰⁶ Available at http://www.bundeskartellamt.de/wEnglisch/download/pdf/GWB/110120_GWB_7_Nouvelle_E.pdf.

Need to codify the right to access files in the context of proceedings. Art. 31 of the Rules of Procedure of the Competition Council¹⁰⁷ establishes the right of interested parties to have access to the files in the course of the proceedings before the Competition Council. In this regard, the initial efforts introduced in the internal procedural laws of the Competition Council are in line with international best practices. Nonetheless, the Rules of Procedure are not public and are not codified in the form of a law or decree and it is suggested that the Competition Council takes a step further and codifies the Rules of Procedure of the Board in a Decree or Law and makes it publish so that interested parties to a procedure before the Competition Council have their due process rights legally guaranteed.

Publication obligations of Annual report and key decisions. It is internationally agreed that competition acts should introduce publication obligations for the competition authorities as a tool to introduce accountability obligations. The practice of the Competition Council has introduced for some cases, and the latest modification of the Competition Law has codified in Art. 20, the publication of the decision in local newspaper and online and their rationale. It is recommended to introduce publication obligations of the annual report in French and online; publish more systematically Competition Council' decisions and their rationale the publication of the decision in local newspaper and online.

Standing of the Competition Council before the Judiciary. According to Art. 13 of the Competition Act the Competition Council has no possibility to stand in the appeals before the judiciary. The lack of possibility to file a complaint before the tribunals is directly linked to the problematic concerning the nature of the Competition Council as perceived of judicial nature. International practice generally grants standing to the competition authorities before the tribunals, as it is understood that in most instances the nature of the competition authorities is administrative as opposed to judicial. More precisely, in civil law systems such as the Italian or the French jurisdictions, the attorney general represents the national competition authorities in the appeals before the relevant tribunals.

Almost all decisions involving the imposition of a financial penalty have been appealed, as the appeal suspend the obligation to pay.¹⁰⁸ The Competition Council should be represented before the administrative tribunal either by the state representative¹⁰⁹ or by Attorney general. In addition, in the long run, it is suggested that special tribunals are created with jurisdiction over competition issues to confined competition related cases to tribunals specialized in economic law matters.

Delimitation of the role of the Competition Council and public procurement. The Tunisian Competition Council is involved in the public procurement via the referral to the Minister of Trade Council in case of abnormally low tenders (Art. 79 of the Decree of Public Markets).¹¹⁰ The role of the Competition Council should be clearly delimited to avoid duplication of tasks in the oversight of public

¹⁰⁷ Rules of Procedure of the Competition Council approved by the General Meeting of the Competition Council on Thursday April 20, 2006.

¹⁰⁸ See Voluntary Peer Review: Competition Policy in Tunisia, 2006 available at http://archive.unctad.org/en/docs/ditccpl20062overview_en.pdf.

¹⁰⁹ Toward this solution is the Acrli report that suggests having the state representative "Providing his observations automatically in the appellate and Supreme Court phases, as he is defending the public economic system in all competition issues, and entitling him to the right of appeal in all these cases", p.100.

¹¹⁰ Décret n° 2002-3158 du 17 décembre 2002, portant réglementation des marchés publics. Art. 79 as modified by Decree n° 2008-2471 du 5 juillet 2008 establishes that « L'acheteur public informe le ministre chargé du commerce des offres financières éliminées en raison des prix excessivement bas entachant la concurrence loyale. Dans ce cas, le ministre chargé du commerce peut saisir le conseil de la concurrence d'une requête à l'encontre des soumissionnaires de ces offres conformément aux dispositions de la loi n° 91-64 du 29 juillet 1991 relative à la concurrence et aux prix. »

procurement principles.¹¹¹ While the first activity has been increased, a big part of the Competition Council activity seems still to check as well that the conditions of “cahiers de charges” are properly followed in the individual “appel d’offres”. The Competition Council for instance verifies that the lowest offer- which is still the main criteria for adjudicating public procurement- is selected. This task goes beyond the role of a competition authority and might create duplication with other authority in charge of public procurement.

Refinement of the role of the Competition Council and public procurement. Internationally, it is recognized that public procurement is a showcase for collusive agreements¹¹² (market division, concerted withdrawal of bids, partition of markets, etc.).¹¹³ Moreover, these practices vary widely by sector (small market, competitive or weakly held), the product or service (product homogeneous, single or without replacement) and contract type (e.g. repetitive offers).

In this regard, the role of the competition agency in public procurement should cover two types of activities, namely: a) the ex ante verification of the design of the procurement process to ensure that they not foreclose the participation in the tender or facilitate the formation of cartel agreements and other forms of anticompetitive behavior; b) ex post verification to check, on an ad hoc basis if any collusion among participating firms has occurred through direct communication or coordination of activities.¹¹⁴ In Tunisia the role of the Competition Council in public procurement seems focused only on violations of the public procurement system with a very low activity on the ex post verification.

Widespread use of invitation to tender tools. In Tunisia mostly all sector of the economy every time a new license or new operator needed to be admitted in the market, a specific invitation to tender is issued. For instance “Although the Telecommunication Code does not limit the number of licenses in the market, it requires a tender every time a new license is granted. This principle, which is justified in the case of allocation of scarce resources, is not appropriate to develop a fully competitive market. All countries of the European Union (late 1990s), the countries of Eastern Europe (in the mid-2000s), and Turkey (2008), have adopted a schedule of “total liberalization”, setting a date after which the government cannot reasonably refuse to issue a license to a telecommunications operator interested and qualified”.¹¹⁵

- **Policy Options:** it is suggested that the Competition Council prioritizes its responsibilities in the oversight of public procurement by focusing on bid rigging activities and avoiding duplication with the High Commission or other administrations.

The advocacy competences of the Competition Council appear weak and rather will need to be reinforced. The Competition Council’s advocacy mandate -although increased in 2005- is limited to consultations on draft regulations that might have an impact on competition, but does not necessarily

¹¹¹ The Competition Council, during consultations held in June 2014, claimed however that duplication does not occur in practice.

¹¹² Simon J. Evenett, “Is there a case for new multilateral rules on transparency in government procurement?” In *The Singapore Issues and the World Trading System: the Road to Cancun and Beyond* (Bern: State Secretariat for Economic Affairs), 2003.

¹¹³ OCDE Guidelines to fight against bid rigging in public bids, report 2009, <http://www.oecd.org/dataoecd/27/20/42340181.pdf>

¹¹⁴ Art. 7 of the Réglementation des Marchés Publics, March 2010, states that « Les exceptions prévues par le présent décret découlant de la nature spécifique de certains marchés n’excluent pas l’observation des règles de concurrence et d’égalité entre les soumissionnaires ».

¹¹⁵ See Aide Mémoire Mission Aide-mémoire, Secteur des Technologies de l’Information et des Communications (TIC) of August 2011, where among the recommendations it is said that the regulatory framework and the competition need to be reinforced in Tunisia.

cover draft laws¹¹⁶. On the latter, the Ministry of Commerce retains the power to decide whether to require the Competition Council's opinion. Moreover, the relations with other government agencies – both regarding advocacy and enforcement – are poorly defined and create overlapping interventions by different institutions, which increase the cost of doing business in key markets such as telecommunications.

Some jurisdictions have emphasized advocacy functions over enforcement. For instance, the Korean Competition Authority, acknowledging that policies once finally formulated are difficult to change, the KFTC inputs competition perspectives into major policy making procedures such as cabinet meetings as a regular member on an ongoing basis. Through the proper promotion of a competitive environment via non-enforcement mechanisms and by increasing public awareness of the benefits of competition, the Competition Council could achieve its institutional goals and make an impact complementary to its enforcement activities. From interviews with the Competition Council it appears that there is no record on this activity and its impact on the market, as there is no track of how many advices have been followed up, the reasons why it was decided not to follow its opinion and the impact of the advices followed up.¹¹⁷

- **Policy Options:** It suggested expanding the field of mandatory counseling of the Competition Council to cover as well draft laws that have an impact on competition.¹¹⁸ Furthermore, additional systematic mechanisms to have the Council inputs into major policy making procedures should be considered.

3.4.5 Lack of competitive neutrality between state-owned enterprises (SOEs) and private companies.

In Tunisia, “despite the abandonment of the state of many competitive activities and the progress of the privatization program, the presence of public sector in economic activity is still important, especially in the field of public services (electricity/water/sanitation/passengers transport) as well as in the import of some basic sensitive products such as cereals, tea, coffee, vegetable oils, iron and medicines.”¹¹⁹

SOEs in Tunisia receive special treatment in various forms. Many SOEs act as monopolist in the production, import and distribution of goods subject to the subsidies system. Their losses, taken in charge directly by the national budget, result in structural losses. According to the IMF, the mechanism is the following: SOEs are often monopolies in the production and assembly, imports, and distribution of the products subject to the subsidy system. Their operation leads to structural losses. The General Compensation Unit (GCB) pays to operators the difference between the production price or the import price and the administrative sale price in order to cover their losses. The GCB receives state transfers as provided for in the national budget.¹²⁰ Moreover, the enforcement of the Competition Law has been, over the years, more lenient toward SOEs.

¹¹⁶ The Decree n° 2006-370 of February 3, 2006, has reinforced the advocacy power of the Competition Council as set up in Art. 9 of the Competition Law. In fact, there is an obligation to consult the Council on draft regulations that a) impose quantitative or qualitative conditions to the entry to the market or to the access to a professional activity, b) grant advantages for to exercise of an activity in a specific region, c) impose uniform negotiation conditions on prices or selling modalities.

¹¹⁷ The Government acknowledges this priority as one of the five main axes of the reform agenda of the Government under the 11th National Development Plan (NDP) was enhancing the role and impact of the competition.

¹¹⁸ See ACRLI Report, p. 99

¹¹⁹ ACRLI Report, p. 18

¹²⁰ IMF (2012), Albertin G. and Criveli E., Les subventions aux produits alimentaires and énergétiques en Tunis. Furthermore, in the energy field, ETAP (oil and natural gas), STIR (oil products) and STEG (electricity) receive direct transfers from the state's budget to cover the losses due to administrative prices.

SOEs should operate under the same competition law framework as private enterprises. Beside the type of state control, the conduct of SOEs may present similar competitive concerns to that of private actors in the market and the potential for anticompetitive effects may be even greater in the case of SOEs due to the various advantages conferred upon them as a result of government control. Competition law alone is not sufficient in ensuring a level playing field for SOEs and private enterprises, which is why policies aimed at achieving competitive neutrality between in markets where public and private enterprises compete.

OECD defines Competitive neutrality as a regulatory framework (i) within which public and private enterprises face the same set of rules and (ii) where no contact with the state brings competitive advantage to any market participant.¹²¹

Especially for the sectors recently liberalized it is particularly important that competitive neutrality policies are in place, to ensure the leveling playing field between former state monopoly incumbents and private entrants. The lack of competition neutrality might translate into state aid and subsidies such as capital injections and guarantees for SOEs in financial difficulty, which is granted through an ad-hoc process instead of clearly defined criteria and often offers recurrent bailing out to loss-making SOEs, putting pressure on the state budget. A mechanism to effectively monitoring and enforcement these policies are equally important.

- **Policy Options:** Introduce competitive neutrality principles in the legal framework. Competition Council shall list all SOEs and their granted advantages, including non pecuniary. This list might inform the list on possible state aids granted by the government (see below).

3.4.6 Lack of State Aid framework.

In Tunisia, the scrutiny of state aid, grants and subsidies are not grouped under a specific law or authority. There is currently no uniform state aid surveillance or control regime comparable with that of the EU. Each ministry can approve, ad hoc and without planning, their own state aid (that may be granted through various instruments or objectives). The Ministry of Finance participates in each sectoral commission where state aids are decided.¹²²

In Tunisia, state aids can be found in various forms such as (i) fiscal advantages, (ii) capital transfers, and (iii) guarantees for SOEs in financial difficulties. Fiscal advantages take the form of direct tax exemptions and indirect imports with reduced VAT and tariffs/customs duties. Capital transfers can take the form of injections dependent on strategic outlook and sectoral focus granted by the Comité Général du Budget. At the same time, government-controlled firms may receive financing (e.g. loans guaranteed by the state, preferential loans from state-controlled banks or the state itself, etc.) which is not available to private companies. Finally, Directorate General debt grants guarantees for SOEs in financial distress as permitted under the Association Agreement with the EU of 1998.

Rationale for implementing a state aid framework. In the European Union (EU), State Aid control is an essential component of competition policy and it is framed to encourage Member States to strengthen the competitiveness of their economy while increasing social and regional cohesion while mitigating wasteful use of public resources by requiring stakeholders to verify whether State Aid is an appropriate policy instrument to achieve objectives of common interest.

¹²¹ Id.

¹²² The website of the Ministry of Finance lists all the legal/regulatory instruments that grant a fiscal or financial advantage. See http://www.portail.finances.gov.tn/accueil_fr.php.

Benefits from implementing a State Aid Regime. In the case of Tunisia, the introduction of a comprehensive State Aid legal framework could ensure a level playing field for companies and avoid using public funds to support distortive State Aid schemes that will discourage expansion and entry of new investors. In the long run, it is expected that implementing this framework would reduce the amount of State Aid and target it towards more “horizontal” objectives instead of firm-specific aid. For instance, EU State aid reform aims to redirect aid to Lisbon-related objectives, such as R&D and innovation, risk capital measures, training, renewable energy/climate change and other measures for protection of the environment.

Exceptions to State Aids granted by Tunisia. Tunisia is bound by Art. 36 of the Association Agreement with the EU of 1998, confirmed by the Action Plan of 2012, whereby “the Parties recognize that during the first five years after the entry into force of this Agreement, any State aid granted by Tunisia shall be assessed taking into account the fact that Tunisia shall be regarded as an area identical to those areas of the Community described in Art. 92(3)(a) of the Treaty establishing the European Community. During the same period of time, Tunisia may exceptionally, as regards ECSC steel products, grant State aid for restructuring purposes provided that (i) it leads to the viability of the recipient firms under normal market conditions at the end of the restructuring period, (ii) the amount and intensity of such aid are strictly limited to what is absolutely necessary in order to restore such viability and are progressively reduced, and (iii) the restructuring program is linked to a comprehensive plan for rationalizing capacity in Tunisia. The Association Council shall, taking into account the economic situation of Tunisia, decide whether the period should be extended every five years.”

Transparency in the grant of state aids. In the Association Agreement, there is an obligation to ensure transparency in the area of official aid, inter alia by reporting annually to the other Party on the total amount and the distribution of the aid given and by providing, upon request, information on aid schemes. In this respect, the website of the minister of finance publishes a list of laws and decrees by which subsidies and grants are granted.¹²³ Nonetheless, the inclusion of a list of laws and regulations that permits the provision of aids seems insufficient to comply with the requirement of transparency.

Maintaining an Inventory of State Aids. In the long run, it is suggested that Tunisia adopts a state aid framework in line with the EU framework. However, in the short run, it is recommended that Tunisia compiles the different aids granted so far in a single inventory to be able to keep track of the aids provided by the Tunisian Government. It would be desirable as well to carry out an analysis that evaluates the impact that the aids granted thus far have had on the Tunisian markets and to estimate the size of such aid given its impact on budgetary expenditure.

- **Policy Options:** it is suggested to create an Inventory of all granted state aids, not only what can in theory be granted by the laws but what actually each single ministries has granted in practice, the beneficiary, the reason, the amount and the length. The Competition Council should assess the impact of granted aids on the Tunisian markets. In the long term, the government should implement of a state aid legal framework that includes an authority to scrutinize granted aids and specific objective to be achieved via the state aid policy.

3.5 A Roadmap for reforms options in the context of deeper integration with the EU

This chapter has identified a number of reform options specifically to the Tunisian situation that the Tunisian government should take if it intends to create a level playing field within the Tunisian

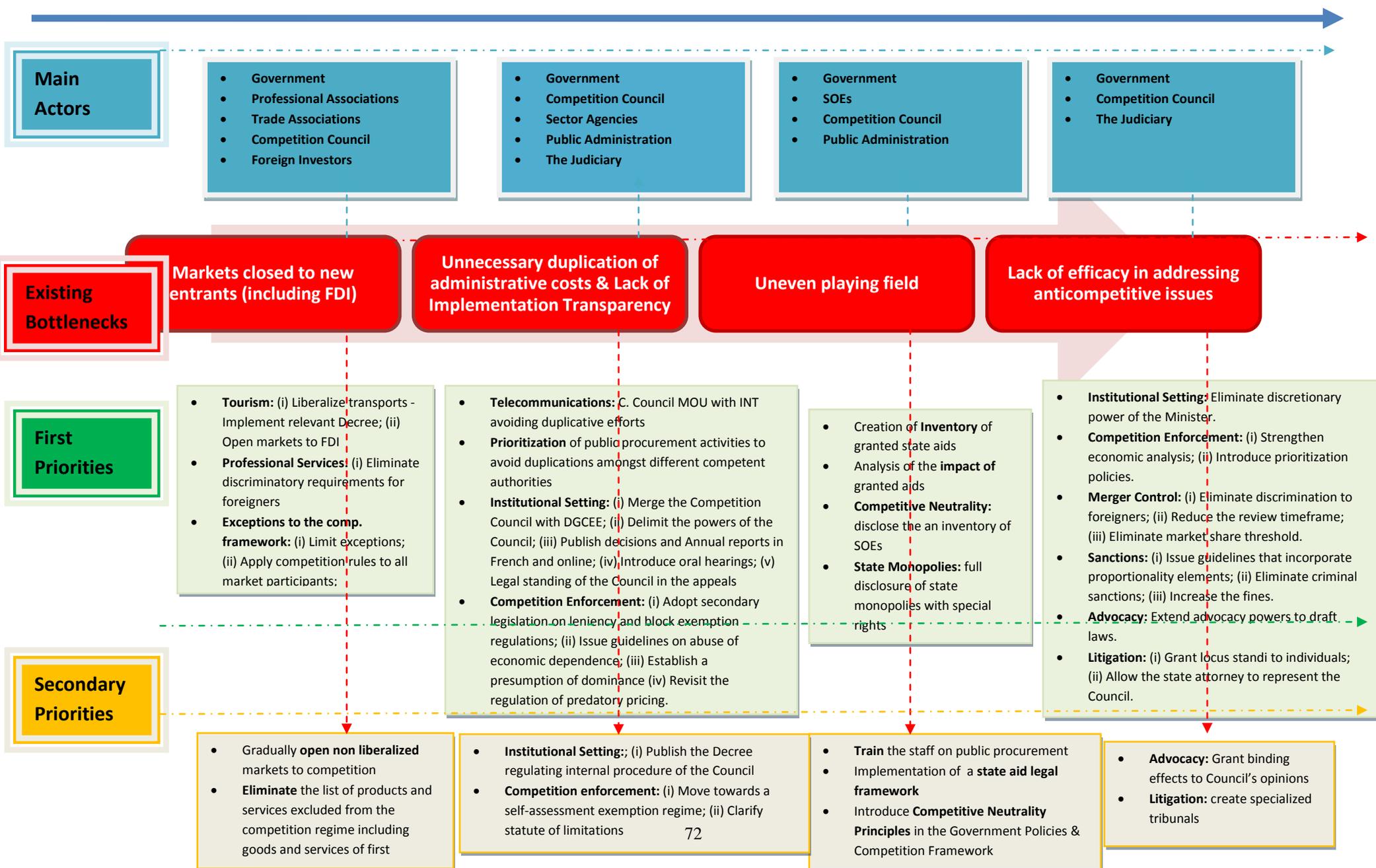
¹²³ See http://www.portail.finances.gov.tn/accueil_fr.php.

economy and offer reform options that will broaden the nation's engagement with the global economy. The recommendations are summarized in a table (see below) and itemized by priority and feasibility. The economy-wide interventions, mainly improving the current legal framework through amendments to existing law and issuing secondary legislation, are complemented by sector-specific competition policy reforms aimed at creating a competitive playing field and increasing the effectiveness of antitrust policies. These measures are part of the priority measures under the Development Policy Loan completed in November 2012.

Introducing these amendments, targeted legal reforms, will enhance the transparency of Competition Council's actions and its accountability vis-à-vis national and international market participants, while limiting the room for Government' discretion. Limiting the room for discretion will also facilitate the implementation of the legal framework. These reforms: (1) will equal market conditions for all businesses; (2) promote private savings by reducing business costs while increasing transparency in law enforcement, and reducing costs for consumers due to lower prices due to increased competition on the market. At the same time, they will allow entry of private firms in sectors that are currently dominated by public monopolies established by law, while helping to improve private sector productivity and the growth, plus the welfare of consumers. They will also guarantee access to vertically integrated markets and deter abuse of dominant positions and/or other anti-competitive practices. In addition, an ex ante scrutiny of draft laws under competition lenses produce better rules, adapted to the operation of competitive markets, that minimize the risk of causing distortions in the free play of competition.

The decision of Tunisia to enter in the DCFTAs with the EU requires a high degree of commitment to complex, deep and broad-ranging, inclusive reforms. The proposed recommendations are intended to be a step in that direction.

Sequencing & Main Actors Involved Towards Effective Competitive Markets



4. The legal framework for opening Tunisia Public procurement to international markets in the context of regional trade agreements.

Public procurement plays an increasingly important role in the global economy. Each year, it can be estimated that approximately US\$4,000 billion is devoted to purchases through public procurement, including 2,288 billion Euros in 2009 for the countries of the European Union and US\$535 billion in 2010 for the U.S Federal Government. The stakes are thus quite sizeable, as on average public procurement represents 15 percent of the GDP in these countries. The figures are even higher in developing countries where public investment remains the key driver of national growth. Public procurement bears economic leverage through targeted social and economic actions, offers market prospects to the private sector, can help to generate budget savings through adequate reforms, and has a key role in development and in the fight against corruption. For these reasons public procurement has been given increasing international attention during the recent years, and several countries have launched national reform programs.

For Tunisia, the negotiations for access to its public procurement and of its own companies' access to public procurement in other countries clearly show these stakes. The preliminary discussions with the European Union and the United States have shown the same to be true for its partners. Therefore the topic requires all the more attention, especially as the assessment of Tunisia's public procurement system that launched in 2011, after regulations of public procurement had been revised to boost public investment, is currently at the recommendation phase for comprehensive reforms in national procedures, while the introduction of e-signature procedures for procurements are also being planned. At this stage, it is important to include an international component into the public procurement reform in Tunisia.

This chapter will focus on (1) presenting the challenges related to the international framework on public procurement, and analyzing (2) the current Tunisian policy related to the participation of foreign companies, (3) the current international agreements effective in Tunisia that focus on public procurements, and (4) the public procurement policies contained in the agreements by the European Union (chapter IV) and by the United States (chapter V) with other countries.

4.1 International Framework on Access to Public Procurement

Although the issue of public procurement has for long been confined to the national scope under the guise of state sovereignty, it emerged into the international scene in the 1990s, with a notable recent surge. Among the international agreements that have recently been adopted, one must particularly mention the United Nations Convention against Corruption from 2005, an agreement detailing the 9 key rules to put in place in order to fight against corruption on the public procurement scene, as well as the revision of the General Agreement on Government Procurement (GPA) in 2011.

The GPA was originally signed in Marrakech in 1994 as a plurilateral agreement, included in annex 3 of the establishment of the WTO Agreement. It now consists of 42 countries after the recent addition of Armenia, including the European Union's 27 countries. Several countries, including some from the Middle East and North Africa, are in the process of joining (Oman and Jordan) or obtaining observer status (Saudi Arabia and Bahrain). *The candidate countries must guarantee non-discriminatory and fair conditions beyond certain financial thresholds for the companies of fellow member countries.* The annexes that accompany the principal Agreement text define, by country, the buying entities that are subject to these obligations, as well as the ones covered by them. Certain exceptions exist for national security reasons (defense procurement) or for safeguarding public order and wellbeing, human health, animal and environmental safety, and the protection of intellectual property. Specific exceptions have been requested by member countries, allowing for the eventual modulation of the bilateral framework for negotiations between member countries and the GPA. Finally, the treaty requires that the member countries put in place effective procedures for foreign companies that breach the obligations. After

several years of negotiations, the measure was finally implemented in December of 2011. In addition to integrating new public purchasing techniques, the newest version of the GPA contains clear provisions for the gradual opening of markets in order to increase participation of developing countries. Also, it has to be noted that the GPA has today impact beyond its member countries: it is becoming the reference model for bilateral free trade agreements, notably at the behest of the United States and the European Union.

Recently there has been a proliferation of free trade agreements, currently negotiated or already ratified, that contain public procurement provisions. As such, there exist currently two generations of free trade agreements, with the most recent ones systematically dealing with the question of access to public procurements, while the older generation has ignored the issue. To date, it can be estimated that of such provisions 87 bilateral or regional treaties out of 390 existing ones are already in effect, and the number is constantly on the rise. On the basis of reciprocity, these trade agreements aim to expand terms of access to public purchasing by ensuring a wider breadth of competition through the removal of non-tariff barriers for public contracts, at the very least for companies originating from participating countries. Among the treaties that address this issue, three types of provisions can be found: (i) although increasingly rare, those that purely exclude public procurement in international trade; (ii) those that advocate a future opening of public procurement but without a concrete roadmap; and finally (iii) those that precisely list the conditions of access to procurements of member countries in detailed publications. The objectives of these trade agreements are thus different from those of the investment treaties, which look to protect the freedom of establishment and guarantee the rights of the investor. When applied to the field of public procurement, the investment treaties aim to protect the rights of the contracting authorities. It is therefore more advantageous to intervene during the execution of the contract by instilling stipulations to promote the stabilization of the legal environment against government intervention in order to ensure the security of investments. In this regard, a larger number of investment treaties have caught the eye of Tunisia in the landscape of international issues affecting public procurement.

Regional partnerships, notably Free Trade Zones, Common Markets and Customs Unions constitute another area of potential expansion for the rules governing public procurement procedures. Several are already in effect; the FTA's (NAFTA, CAFTA, SICA, TPP) and regional unions which regulate (UEMOA, COMESA, CARICOM, SACU, SICA) or wish to regulate (GCC, MERCOSUR) public procurement access of their respective members. These groupings are often one of the domains where intervention and exemplary work of the member states in encouraging regional and national development can be seen. When participating in these regional partnerships, Tunisia will have to be alert in terms of obligations of public procurement transparency placed on a few particular potential partners that are members of COMESA as well (Djibouti, Egypt, Libya, and Saudi Arabia which has a special status).

In terms of non-binding documents, the adoption in 2011, after more than 6 years of revisions, of the new Model Law on public procurements prepared by the United Nations Commission on International Trade Law (UNCITRAL) should be noted. The Model Law proposes, to countries that wish it, a model to help them redesign their entire national public procurement system, utilizing recourse mechanism procedures offered to companies that are against the contractor-choice. Its previous 1994 version was adopted in approximately thirty countries where it laid the foundations for a coherent national system. This second version allows for the integration of new techniques, notably framework agreements or electronic reverse auctions (ERA's) and a sophisticated pre-contractual review system. It will be accompanied by an implementation guide, which is still under discussion, but should focus on the institutional capacity and support necessary for the proper functioning of a national system for public procurements.

Although a number of differences exist on technical key points, the instruments adopted into the United Nations' framework share similar principles. Advocating the freest possible competition, they particularly strive to limit or prohibit discrimination based on the nationality of the company applying for a contract. For their part, the common provisions of multilateral banks

(expressed in the Master Bidding Documents) accept preference margins of up to 15 percent to bids submitted by domestic construction companies or on offers comprised of national products for supply contracts. But these preference margins are undifferentiated; in other words they play a role no matter the nationality of the candidate foreign company.

In contrast, under a bilateral or regional trade, the opening of national public procurement contracts can be selective and therefore remain confined to companies who are affiliated to countries belonging to these free trade Agreements. It is the logic of the principle of reciprocity that is now put forward to negotiate target openings granted on the basis of a general principle of closure. These negotiated schemes may, however, water down free trade openings by allowing certain countries to continue to benefit from these protective measures. The new version of the GPA accepts some of these non-tariff protectionist measures for all acceding developing countries (with a distinction between the least developed countries and other developing countries), but under certain conditions and only for a limited period of time.

Even the European Union, in its Public Procurement Directives, to this day has not specified if it only provides benefits to member countries, now focusing on access to public procurement (which represents 19.4 percent of the European GDP) based on the principle of reciprocity. In the EU, it is also under discussion to promote giving regional preference for European companies when an EU member state calls for tenders. Realistically, this framework could evolve in the near future with the proposed revisions of the current EU Directives on public procurement, as presented by the European Commission in December of 2011. Today, these directives impose standardized procedures for all member countries for contracts above a certain financial thresholds, which are aligned with those of the GPA . However, the effect of harmonizing the directives is felt across all allocation procedures, including the vast majority of markets that find themselves under the thresholds. As we already know that the impact of rules imposed by the EU directives greatly exceeds the 27 member countries and also concerns the 8 candidate countries, the 4 EFTA countries , and the 16 European Neighbourhood Policy countries, it is very likely that their next modifications will also affect 54 countries, including Tunisia.

The Implications for Tunisia:

- Having acceded to the 2005 United Nations Convention against Corruption, Tunisia needs to comply with all its obligations, in particular to its Article 9 which deals with the fight against corruption in public procurement.
- In the short term, Tunisia is not directly concerned with the GPA, but that is subject to change if Tunisia asks to be granted an observer status, and if it wants to join. However, there already exists a polarization of public procurement policies in the free trade agreements entered into by the United States and the European Union surrounding the GPA model (this will be detailed later on).
- Tunisia must ensure consistency of access conditions to its public procurement. Tunisia should therefore avoid the conflict between specific rules that may be unique to specific Agreements.
- Common provisions of multilateral banks are necessary for projects that they have recently financed: that they do not call into question the entire Tunisian regulations but create exception rules that, at times, complicate the tasks of officers charged in identifying the applicable procedures. This complexity is amplified by the various rules that may be specific to certain bilateral or multilateral ones. Even if the international community has committed itself to focusing on the application of national law, and whether progress may be occurring, there is still progress that is necessary in order to achieve harmonization in this area.
- If the EU's Directive draft revisions are released by the European authorities, Tunisia will need to monitor them closely since the revisions, on the basis of reciprocity, are based predominantly on the idea of limiting access to European markets. The actual conditions of access to European markets might therefore have to be greatly modified and the negotiations of an agreement on public procurement would be even more necessary.

- In its regional partnerships, Tunisia will need to be very attentive to its obligations on opening up awarding public contracts to its potential partners who are also members of other regional agreements (such as COMESA).

4.2 Tunisian Policy for Providing Foreign Companies Access to Tunisian Procurements

Local laws governing access to public procurement vary fundamentally from country to country, from liberalization movements from prohibitive access to all foreign companies to a complete openness with no restrictions. Between these two extremes, national rights promote gradual access in order to balance competition (in the sense of international competition discussed here) and local economic development.

The principle of opening or closing Tunisia’s public procurement to international competition is not, legally, established in a satisfactory manner in the current legislation: we can note redundancies and incoherencies in what is currently in place. Indeed, it can be derived from the article 20 of the 2002 Decree (which was amended) that only certain bids are effectively open to the international scene: bids dubbed ‘international’ but without further details. In fact, one must turn to the Government Bulletin to find a provision that specifically states that research contracts (and only them?) are not open to foreign companies, unless the companies were to ally themselves with a local company. Legally inferior to the decree, the Bulletin of 1987 should not impose such a principle of prohibition. As it stands, the ban on foreign company participation put in place by the Bulletin is illegal, but all the local public authority parties, starting with service buyers, are convinced that this principle has legal merit. At the very least, a clarification in a future decree or law is essential. This issue has been raised in the self-assessment of the Tunisian procurement system conducted in May of 2012.

Moreover, it should also be noted that this policy framework is based on the historical distinction between international bidding and national bidding, with only the former requiring a specific type of advertising on the international level. And for this regard, the participation of foreign companies would only be considered for the so-called international bids. Yet this vision now seems challenged by the advancement of technology. During the internet era, limiting the spread of bids for local companies seems obsolete as even the most geographically distant companies will have access to this information. This historic separation between bids based on national and international access to information is fading; nothing longer impedes a foreign company to be as well informed on local matters. So what should therefore be the meaning of the distinction between international and national competitive bidding? Should we go as far as to specifically prohibit the inclusion of foreign companies on national bids? What will be the scope of negotiated exceptions in the context of free trade agreements with other countries? Access to international Tunisian bids only or access to national bids also? Whatever the outcome may be, the Tunisian policy documents governing public procurement must be clear and the exceptions based on international agreements negotiated on the basis of reciprocity with other countries precisely identified.

Finally, the laws governing Tunisian public procurements do not identify what is specifically meant by “foreign companies”. This is contrary to the Tunisian Investment Code which appears to distinguish between companies established in Tunisia but owned by foreign entities, and those that are not located on Tunisian soil.

Even in this context that is marked in principle by a lack of prohibition to access public contracts, Tunisia has, however, a very wide range of measures to protect local companies from foreign competition during competitive bidding, by adding direct and indirect barriers to their participation. In this regard, one could go as far as to say that Tunisia, with its numerous (7 items in

the sole 2002 modified decree) and diverse tools, is an international case study¹²⁴. We must also add the provisions from the May 25th, 2011 Decree that favored Small and Medium Enterprises: 20 percent of the SMEs' (defined by the number of workforce and turnover rate) contracts must be reserved (article 7) and are exempt from the interim bail (article 6). But yet again, the decree does not specify whether these more favorable provisions only apply to Tunisian SMEs or whether they could be claimed by a foreign SME. To these provisions, which create just as many direct barriers to the participation of non-Tunisian companies, indirect barriers should also be added, such as standards of reference for the definition of the technical specifications that must normally be national and only in rare instances be international (Article 18).

In addition, the new Decree No. 2014-1039 of 13 March 2014 introduced a preferential treatment for Tunisian companies. First of all, Art. 26 provides that Offers submitted by Tunisian companies for works and the products of Tunisian origin in all contracts for the supply of goods are, if of the same quality, preferred to Offers of foreign companies and to the products of any other origin, even if the financial offers of Tunisian companies appear to be less competitive (maximum 10%) than the offers of foreign companies. In addition, the requirement of reference to similar projects cannot work against Tunisian companies (Art. 25). The Decree also requires (Art. 23) that the specifications must encourage foreign consulting firms to associate to one or more Tunisian consultants or experts and the contract must clearly show the tasks entrusted to Tunisian firms/experts and the relevant amounts.

This is in sharp contrast to the principle that is proclaimed by the international agreements in the field (e.g. by the GPA), since upholding local technical standards over the international ones would undoubtedly benefit local businesses. A similar approach should accompany the introduction of computerized procedures for certain steps of public procurement in Tunisia in order to maintain the widest possible access to public contracts. In this respect, the introduction of these new techniques will also have to keep track of developments in Europe, as the interoperability of these systems will be a major challenge of these changes. There is a specific program, dubbed PEPPOL (Pan-Europe Public Procurement Online), which aims to establish common standards to connect the national systems within Europe.

Beyond the formulation of legal provisions¹²⁵, the question of the current system's effectiveness is important. If the opening of Tunisian public procurement is successful (which remains to be seen), the detailed, and even confusing, nature of the Tunisian policy framework might complicate the task of preparing bids for Tunisian contracts, when candidate companies try to determine whether they have a chance of being allowed to participate. The framework might discourage a number of companies from bidding, thus reducing competition. But more importantly, it is also a source of potential disputes. In the light of the current pre-contractual review system's weakness the issue has not emerged yet, but can become relevant if the system will be improved as recommended by the results of the national public procurement system's self-assessment exercise conducted in May of 2012. This distinction is not relevant anymore after the enactment of Decree 2014-1039 of 13 March 2014.

¹²⁴ To date, the mentioned 7 items are:

- o Article 19a on the contracts reserved for SMEs (with new thresholds per sector, defined in 2011)
- o Article 20 for regulations on subcontracting for Tunisian companies
- o Article 21 on the 10 percent preference margin for Tunisian products
- o Article 23 on alternatives reserved for Tunisian companies
- o Article 24 on the mandatory association with a local consultancy
- o Article 25 on the mandatory association with local IT companies
- o Article 26 on the principles of non-discrimination in favor of local companies, particularly with the attenuation to demand similar references

¹²⁵ For instance, the April 1st, 2008 Law on the Concessions Regime: Only few provisions of the law on concessions deal with the participation of foreign companies, and the participation is not prohibited or restricted by principle. Article 5 discusses the participation of foreign capital in companies pursuing concessions in the context of regulations on imports and foreign investment law. But in this case, the company created for executing the contract must be incorporated under Tunisian Law. In addition, one should also verify whether the decree on concessions contains provisions on the participation of foreign companies .

Consequences for Tunisia:

- Current regulations applicable to public procurement in Tunisia thread between openness and protectionism. It is also important to resolve the uncertainties and clearly express the conditions of access for foreign companies;
- The negotiation of international agreements that affect access to public procurement should be undertaken in this context; the national legislation must then organize the implementation of said agreements.
- It will be also necessary to ensure the accuracy of information from government officials, for example, through a Government Bulletin on the participation of foreign companies and through explanations in the regulations manual

4.3 Importance of Access to Procurement in the Agreements Signed by Tunisia

Tunisian agreements with its regional partners usually do not cover public procurement, with only one exception (Table 4.1). This contrasts with the agreements concluded with the European Union and Turkey.

Procurement Issues: Missing in Tunisia's Agreements within the close neighbors

There is no mention of procurement the Arab Maghreb Union Treaty, signed in 1989 by Algeria, Mauritania, and Tunisia, nor in the 1998 GAFTA (Greater Arab Free Trade Area) agreement, which later became the Pan Arab Free Trade Area (PAFTA), focusing on the elimination of tariffs on goods. Nothing is said on the subject of public procurement in the 1998 agreement with Jordan. In contrast, the Agadir Agreement on customs tariffs signed on February 25th, 2004 (which started to be enforced in 2007) between Tunisia, Egypt, Jordan, and Morocco (and Palestine since September 2011) explicitly applies to public procurement, but is subject to preferential treatment from the member country.

However, since the Agadir Agreement only concerns tariffs, it does not address the issue of access to national public procurement in terms of freedom of trade. Article 11 mentions:

“The provisions of this Agreement shall be adhered to as regards customs duties and taxes actually imposed in the comparison of offers related to international tenders for the supply of goods in each Member Country, in accordance with the provisions of this Agreement and in a manner not conflicting with the operative laws and procedures as regards preferential treatment in each Member Country.”

Procurement Issues: Present in Tunisia's Agreements with European Countries:

Only the agreements reached between Tunisia and the European Union, the EFTA and Turkey include articles on public procurements. And yet, it is most often these articles that cause most worry regarding future liberalization of trade in this domain.

The Euro-Mediterranean Tunisia Association Agreement of 1995, entered into force in 1998, had proclaimed a goal of liberalization in Article 41:

“1. The parties shall set as their objective a reciprocal and gradual liberalization of public procurement. 2. The Association Council shall take the necessary measures for the implementation of paragraph 1”.

However, in the EU-Tunisia Action Plan of 2004 for a period of 5 years under the neighborhood policy framework, this device has been clarified and has been agreed on for the purposes of public procurement, as following:

“(37) Facilitate the full implementation and effective use of Article 41 of the association Agreement, which provides for a reciprocal and gradual opening of public procurement.

- Improve the functioning of the current system through increased transparency, better information, more extensive training, and appropriate legislative amendments;*
- Align with the fundamental principles that govern public procurement across all levels (transparency, competition, and access to legal aid);*
- Establish a system of appeals against decisions taken by committees acting for public procurement;*
- Exchange of experiences and expertise on the possibility of an independent / judicial review in case of disputes;*
- Facilitate reciprocal access to public procurement markets, including examining ways to eliminate national preference stipulations;*
- Strengthen the structures and institutions in charge of public procurement, notably in the education / information sector, and the exchange of experience / expertise.”*

For its part, the EFTA, from the model of the European Union agreements, has concluded a bilateral free trade agreement with Tunisia in 2004 which was subsequently ratified in 2005 (along with Morocco in 1999, Jordan in 2002, Egypt and Lebanon in 2007). Chapter VII of this association agreement focuses on public procurement, with one single article (article 30), proclaiming the goal of progressive and reciprocal opening of markets and the obligation to initiate negotiations between the parties if access to public procurement was awarded to a third country.

Finally, in the free trade agreement framework signed with Turkey in 2004 and entered into force in July 2005, the article 29 proclaims the commitment of the parties to the goal of opening procurement markets on the basis of non-discrimination, transparency, and reciprocity. The article equally refers to the principle of Most Favored Nation (MFN): each party must commit to provide to candidate companies from the other party a treatment that is as favorable as the ones accorded to companies from other countries.

TABLE 4.1 PUBLIC PROCUREMENTS PROVISIONS IN TUNISIA TRADE AGREEMENTS

Tunisian Trade Agreements (by chronological order)	Provisions on public procurement	Nature of the provisions
Treaty on the Arab Maghreb Union, with Algeria, Mauritania, and Tunisia (1989)	No	
Euro-Mediterranean Tunisia Association Agreement (1995)	Yes	Article 41 proclaims the goal of future liberalization « <i>reciprocal and gradual</i> »
GAFTA –PAFTA (1998)	No	
Jordan Agreement (1998)	No	
Turkey Agreement (2004)	Yes	A single article proclaims the goal of the future of liberalization + the Most Favored Nation clause
EFTA Agreement (2004)	Yes	A single article 30 proclaims the goal of <i>progressive and reciprocal</i> openings
EU Tunisia action plan for 5 years – implementation of the Association Agreement (2004)	Yes	Detailed plan for the implementation of the principles of: “ <i>transparency, non-discrimination, competition and access to legal aid</i> ”, as well as <i>institutional reform, expertise, and training</i> . + “ <i>facilitate reciprocal access to public procurement markets, including consideration of how to eliminate favoritism of nationals’ clauses</i> ”
Agadir Agreement on Customs Tariffs between Tunisia, Egypt, Jordan, and Morocco (and Palestine since 2011) (2004)	Yes	Single article This Agreement specifically applies to public procurement but is subject to compliance national preferences

Consequences for Tunisia

- The introduction of a regional dimension to the issue of public procurement should advance in the medium term: to the extent where certain countries from the MENA region are also in a phase of bilateral negotiations with the European Union and with the United States; this regional dimension will inevitably emerge.
- It is necessary to examine whether the investment treaties answer the question of their application to public contracts – PPP-markets – especially in the area of public works projects.

4.4 Procurement Provisions in the Agreements Signed by the EU

Background on European Policy

The EU pursues an active policy of bilateral negotiations. Several bilateral agreements on trade services have been signed with countries from the MENA region: with Morocco in 2000, Jordan in 2002, Lebanon in 2003, Egypt in 2004, and Algeria in 2005 – virtually all countries from the region except Syria . In 2006-2007, the bilateral Euromed negotiations on the liberalization of services and on the freedom of establishments started with Egypt, Morocco, and Tunisia. But it was not until 2008 that these bilateral negotiations achieved the dismantling of tariffs on industrial products . In December 2009, the signing of a bilateral protocol established a system of dispute settlement; with Lebanon and Morocco in 2010, and Jordan in 2011. This step has allowed for the opening of a path towards DCFTA (Deep and Comprehensive Free Trade Areas) with Egypt, Jordan, Morocco, and Tunisia. For this reason, a “scoping exercise” was launched in the beginning of March 2012 to assess the situation in these countries.

Unlike a traditional Association Agreement, the DCFTA covers all domains related to trade, such as services, intellectual property rights, customs tariffs, energy, competition, and even public procurement, and it goes as far as setting up sectoral, political, and social cooperation. In the area of public procurement, improving the transparency of procedures is an aim for the “alignment of standards in regulation”. Already progressing, the negotiations with the Ukraine reveal that the Ukrainian laws and standards will need to become “compatible” with those of the European Union. Specifically, for public procurement, the stated objective is to get in Ukraine “the laws, standards, and also, eventually, the public procurement practices, and competition be sufficiently similar to that of the European Union”. Thus, this enlargement and deepening of the scope of the DCFTA will further strengthen the harmonizing effect on the institutional fabric and the national regulatory framework in the field of public procurement.

In terms of trade policy, the EU wants to develop its bilateral Agreements progressively with every country from the south of the Mediterranean, in particular the ACAA agreements (Agreements on Conformity Assessment and Acceptance of Industrial Products) which could have an impact on public procurement of goods.

However, it should be noted that a change in the EU trade policy on the participation of non-local companies in the public procurement of European countries has occurred. It is no longer a question to liberalize European procurement without consideration. The defensive measures against trade distortions such as subsidies and dumping are actively opposed by a Commission framework dubbed “European Trade Defense” (TDI), which focuses on specific regulations that do not necessarily target public procurement but can have an effect on it.

European policy on public procurement

After many years of political openness and freedom of access to European procurement without exception, the Brussels authorities, under pressure from member state governments that have been suffering the effects of the economic crisis, have recently proposed to tighten the conditions for access by requiring reciprocity. This has particularly been reflected in a proposal for European regulation filed in March 2012, which provides more favorable conditions of access to the least developed countries.

Under this proposed regulation, a dual mechanism would be put in place. On one hand, the buying authorities could exclude the offers from which more than 50 percent of the value comes from products or services from countries that are not committed to opening their procurement markets internationally. On the other hand, the Commission could itself decide to temporarily limit access to European procurement markets to countries that undeniably exclude or discriminate against European companies in their national practices and who refuse to grant more favorable conditions during international negotiations.

European FTAs in the area of public procurement:

European FTAs in the MENA region

Already relatively old in comparison to recent developments on public procurement, none of the European agreements cited for the MENA region (Algeria, Morocco, Jordan, Lebanon, and Egypt) are based on the GPA provisions. At most, they state a future goal of liberalization of access to public procurement (see table below). The agreements with Morocco and Egypt (2003) only contain one article which proclaims the objective of future liberalization of access to public procurement without specific provisions. For its part, EFTA has adopted the same approach in its agreement with Morocco.

TABLE 4.2 FTA CONCLUDED BY THE EUROPEAN UNION IN THE MENA REGION¹²⁶

EU Agreements (by chronological order)	Provisions on public procurement	Nature of provisions
EU-Syria Cooperation Agreement 1/07/1977	No	
EU-Palestinian Authority Association Agreement 1/03/1997	No	
EU-Tunisia Association Agreement 1/03/1998	Yes	Article 41 <i>1. The Parties shall set as their objective a reciprocal and gradual liberalization of public procurement contracts. 2. The Association Council shall take the steps necessary to implement paragraph 1.</i>
EU-Morocco Association Agreement 1/03/2000	Yes	Article 41 <i>1. The Parties shall set as their objective a reciprocal and gradual liberalization of public procurement contracts. 2. The Association Council shall take the steps necessary to implement paragraph 1.</i>
EU-Jordan Association Agreement 1/05/2002	Yes	Article 58 Methods and modalities <i>The Parties agree on the objective of a gradual liberalization of public procurement. The Association Council will hold consultations on the implementation of this objective”.</i>
EU-Lebanon Association Agreement 1 st /03/2003	No	
EU-Egypt Association Agreement 1/06/2004	Yes	Article 38 <i>The Parties agree on the objective of a progressive liberalization of public procurement. The Association Council will hold consultations on the implementation of this objective.</i>
EU – Morocco Action Plan 2004	Yes	<i>(37) Develop conditions for an open and competitive award system of public procurement contracts, in accordance with Article 41 of the AA. – Consolidate (including through appropriate legislative or regulatory adjustments) the reform process to ensure openness, transparency, the informing of stakeholders, and competition.</i>

¹²⁶Source : EU Trade http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/agreements/#_mediterranean

– Complete the system of judicial settlement by adding a component of peaceful settlement for disputes relating to contract performance.

– Take into account, to the furthest extent possible, the principle of non-discrimination in the context of a reciprocal and gradual liberalization that is in accordance with article 41 of the Association Agreement.

– An exchange of experience and expertise, particularly in terms of:

– Establishing procedure for the settlement of disputes;

– The modernization of administrative procedures and management (including certification bodies, development of new technologies, and new forms of procurements.

EU –Algeria Association Agreement
1^{er}/09/2005

Yes

Article 46

1. The Parties shall set as their objective a reciprocal and gradual liberalization of public procurement contracts.

EU- Morocco

The negotiations between the EU and Morocco have helped to overcome several steps in strengthening the ties of trade and the adoption of the action plan in 2004 has opened the way to a deepening of openness and reforms in the field of public procurement. Although close to the provisions of the action plan adopted in the same year with Tunisia, these objectives are adapted to the specificities of the Moroccan public procurement system. The prospect of a DCFTA should further accentuate the impact on the Moroccan national system of public procurement.

European FTAs with other countries

Outside the MENA region, the European Union has concluded multiple Agreements with countries of Eastern Europe. Some of the agreements do not include provisions on public procurement or programmatic-only provisions, while others, for candidate countries for accession into the European Union, are built on the principle of alignment and compatibility of the national system with the requirements of the European Directives. In Latin America, The EU has concluded several agreements, including an agreement with Chile in 2003 (the same year as the FTA negotiated by the United States). The agreement is supported, in a detailed manner, by a set of rules from the GPA with a roughly similar coverage of entities, except for the class III entities (public companies and networks). Thus, the European Union had accepted, at that time, an asymmetrical coverage of entities required to open their public procurement markets, if compared to the agreement entered into by the United States (see below). It may be noted that these EU agreements equally apply to work concessions. Since the GPA has also evolved in its own right, the most recent agreements negotiated by the EU (Association Agreement with Central America and with Columbia and Peru of 2011) reflect the newest version of the GPA (at least one that was negotiated in 2006) by including the BOT contracts and Public Private Partnerships (PPP).

Unsurprisingly, the FTA negotiations with a country which is also a member of the GPA make reference to the document, with some more favorable amendments (agreement with Korea in 2011).

Key Points on the European Agreements:

- The European Union is now seeking to systematically include procedures on public procurement in its bilateral Agreements;

- The most recently negotiated free trade agreements with non-GPA member countries attest to the willingness of the European Union to now align itself with the provisions of the GPA;
- On the more specific plan of access to European public procurement, the new Directives' of 2011 that were developed by the Commission are based on the principle of reciprocity and should lead the Commission to be more selective in its negotiations of international openness.
- The agreements concluded by the EFTA are very similar to those concluded by the European Union.
- In the framework of a DCFTA, the field of public procurement and competition must trend towards alignment of national rules and practices on the European Union model (see the Ukrainian example). The DCFTA will amplify the institutional and regulatory impact of the GPA: the Tunisian reform of public procurement will have to take into account these new requirements.

4.5 Procurement Policies in the Agreements Signed by the United States

Trade policy of the United States in the MENA region is based on several bilateral trade Agreements (with Jordan, Morocco, Bahrain, and Oman), as well as investment agreements and trade and investment framework Agreements (Trade and Investment Framework Agreements – TIFAs).

More recently, the “Partnership with transitioning Arab countries”, negotiated between the United States and Egypt, Jordan, Morocco, and Tunisia on April 12th, 2012, led to the principle of creating a new partnership in trade and investment matters , with emphasis placed on certain areas ((1) investment, (2) trade facilitation, (3) support for SME’s, and (4) good regulatory practices and transparency). In terms of future areas to explore, one will notably find public procurement, services, standards, innovation, intellectual property, labor law, and welfare.

In general, the field of public procurement is systematically incorporated in U.S free trade agreements on the basis of exemptions authorized by the president of the United States under the application of the Trade Agreement Act of 1979. To allow foreign access to U.S public procurement markets, one must in effect expressly derogate the U.S federal law that puts into place discriminatory measures which aim to preference U.S companies and U.S products, such as the Buy American Act. Once the trade representative negotiates the treaties on behalf of the President, on the basis of Executive Order 12260, he must then make sure that opportunities are offered to U.S companies and U.S products on the basis of reciprocity.

The United States has already adopted 19 FTAs that cover public contracts , with a few FTA’s done with countries that are part of the GPA (Canada, Israel, and Singapore), or has regional Agreements such as NAFTA (Canada and Mexico), or CAFTA (Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua). The United States equally has 9 bilateral Agreements with Australia (2005), Bahrain (2006), Chile (2004), Morocco (2006), Oman (2009), Peru (2009), Columbia, Korea, and Panama (2011). Others are currently under negotiation. All these agreements are based on the GPA model (2006 version) with a few adjustments a times, such as extended coverage to BOT type contracts and concessions (U.S-CAFTA, Australia, Bahrain, Chile, Singapore, and Peru) or the addition of clear definitions of corruption and fraudulent practices (U.S Australia and Chile). The application thresholds of procurement procedures can vary greatly, but the non-federal entities (states and municipalities) are, in theory, not subject to any agreement, except in the treaty conducted with Canada.

The United States – Chile Agreement of 2003 is frequently presented as a model for U.S agreements on public procurement. This agreement incorporates the rules of the GPA, but the list of U.S entities required to open their public procurement is, however, more limited than those attached to the GPA by the U.S Federal Government (respectively, only 7 federal entities [called class I] versus 78 in the GPA, 9 sub-federal [class II] versus 37 in the GPA, and also exclusions for class III, public companies, and networks). We find a similar approach in the Agreement with

Morocco in 2006 with some variations: it contains the same coverage for category I as is present in the GPA, 23 entities are covered in category II instead of the 37 in the GPA, and the exclusion of purchases from U.S ports for class III. In the two agreements negotiated in 2006 with Bahrain and Oman, no class III entities are included.

It is clear that the United States intends to draw heavily from the GPA in the most recent FTAs. Although the list of covered entities or of concerning products and services can vary in the bilateral agreements in relation to elements contained in the GPA, it is however certain that the United States refers to this model during its trade negotiations on access to public procurement. But the GPA, which serves as a model to the United States in the negotiations of its bilateral agreements, requires a certain number of elements that do not exist in the current law of public procurement in Tunisia . And especially as we have seen above, the Tunisian law contains numerous restrictions to the entry of foreign companies, while the GPA is specifically designed to eliminate such discrimination. It should be noted that these factors were taken into account during the self-assessment of the national public procurement system conducted in May of 2012, and were presented as recommendations.

In particular, the United States-Morocco FTA (2006) includes a chapter (9) devoted exclusively to public procurement and is based on the 2006 version of the GPA model . With its annexes, which list the public buying entities subject to the Agreement and eventually its excluded markets, and sets the thresholds beyond what the provisions of the Agreement applies to, there are more than 30 pages which detail the rules to follow, notably the allocation procedures and the deadlines to be followed for the preparation of bids or the review of pre-contractual procedures. Notably, this chapter contains the elements of the above mentioned GPA that concern the difference with Tunisian law. As often happens with American documents, the Agreement contains the definition of certain terms and adds to the GPA list, Contracts Exploitation-Transfer (usually referred to as BOT in English) and the public works concessions that also are themselves subject to the FTAs. Finally, the appendices merit attention, in particular annex 9F which allows the United States to protect the preferences and the markets reserved for American SMEs held by minority representatives. However, unlike the new provisions proposed by the new version of the GPA, Morocco has not benefited from the re-development of its obligations (for example, the maintenance of preference margins, higher thresholds, or the deferred coverage of some buyers or sectors). While the GPA provides a maximum transitory period of 3 years (extendable) for a developing country, Morocco has again not benefited from such a deferment, except for a one year delay to establish administrative authorities in charge of managing the review procedures.

It can be noted that Canada draws from the United States' example in the Agreements reached with CA4 (El Salvador, Guatemala, Honduras, and Nicaragua), CARICOM, Columbia, Dominican Republic, Singapore, and Korea.

Highlights of the Agreements Negotiated by the United States:

- The United States systematically negotiates a chapter on the rules related to public procurement matters and proposes to clearly follow the GPA model (in a number of provisions that differ from actual Tunisian law).
- By contrast, the American bilateral Agreements are more restrictive than the ones of the GPA in regards to the application scope of their commitments: their Agreements do not generally include the sub-federal level (state and local communities, i.e. "class II" entities in the GPA), even though the amount of public procurement of these entities is more important than the federal level one, which is 60 percent constituted of Department of Defense purchases. But in the FTA with Morocco, a list of some of the local American entities subject to the Agreement was included.
- It is crucial for the United States to include in their Agreements provisions on anti-corruption, anti-fraud, and against the deviation from the practice of transparency in public procurement, as is required by the U.S law on FCPA . Reports published on official American websites outline the provisions in Tunisian law that already comply with these obligations.

4.6 The simultaneous Negotiations between the European Union and the United States May Drive the Adoption of Dissimilar Policies

- Regarding the difference of origin rules, in order to favor the emergence of regional procurement, the European Union promotes the cumulating of origins or the value-added system, which allows a country to export products of which certain components had been imported, without losing the benefits of preferential access to European public procurement. In its part, the United States, except in special cases, applies the opposite principle and demands that the products exclusively originate from the countries that claim preferential access. This contradiction between the two approaches was particularly apparent after the Agadir Agreement went into effect: the latter found itself at odds with the United States-Morocco Free Trade Agreement on tariffs for agricultural products.
- The list of covered entities may differ significantly between the concluded Agreements; the European Union has a tendency to include sub-state local levels while the United States is more committed on including federal government ones.
- The United States and Europe focus on different principles: for the United States, a principle of closure to public procurement access, in contrast, a principle of openness of public procurement access for the European countries. However, the European position could quickly adopt a position closer to the American one.
- In the formulation of provisions for FTAs covering public procurement, the United States generally offer a list in the annex (a list called “positive”) of entities covered by an exception to the closure principle, while an annex called “negative” list those of markets that are not open to foreign competition. The length of these lists will be a major issue in negotiations.
- The American Agreements still provide a number of market exclusions in order to preserve certain social policies (reserved markets for American SMEs geographical zones that are disadvantaged, American companies held by minorities (such as veterans, women, or members of certain ethnic groups), prisons or American non-profit institutions).

4.7 Conclusions

Recommendations for the international negotiations

- **Consistency:**
 - ✓ Tunisia must ensure the consistency of the conditions for access to its public procurement to avoid the stacking of special rules that would be specific to specific agreements.
 - ✓ The reference to the GPA may serve as a model even if in the immediate future. Tunisia is not directly concerned by the GPA, as the country is neither observer nor candidate for accession. However there is already a polarization of the MP around the GPA model provisions in agreements of free trade concluded by the United States and the European Union.
- **Reciprocity:**
 - ✓ Tunisia should follow closely any project of revision of the European Directives on public procurement because, if accepted by the European authorities, they are based largely on the idea of an express limitation of access to the European markets on the basis of reciprocity. Current conditions for access to European markets would be greatly modified and the negotiation of an agreement on public procurement would be even more necessary.
- **Regionalization:**
 - ✓ The absence of regional dimension for the matter of access to public procurement should evolve in the medium term: to the extent that some countries in the region are

also in a phase of bilateral negotiations with the European Union and the United States, this regional dimension will inevitably emerge.

- ✓ In these regional partnerships, Tunisia will have to be attentive to the requirements for opening public procurement imposed on some of its potential partners who are also members of these agreements.
- ✓ The creation of regional markets of public procurement, thanks to rules of common transparency, allow the quick draw of profits from having better competition. It is also possible to provide regional preference rules to promote the industry development of member countries (WAEMU Directives, EU-CARIFORUM Agreement, and Global Europe Strategy 2006).

Recommendations for the domestic legal framework

➤ Reforms:

- ✓ **The international dimension of the market access must be undeniably reflected in the ongoing reform of the national public procurement system.** The United States, like the European Union, now rely on the GPA model to negotiate on public procurement. This approach also has advantages from the point of view of the other party. For example, to reduce the problems of divergence and costs associated with the implementation of different models, Mexico has stalled its different bilateral Agreements containing a chapter on public procurement (with Europe, the United States, and Japan) on the GPA model. For a country like Tunisia, the recent GPA revision proposed to add additional provisions that would allow the management of preference rules for a few years: they could inspire future bilateral negotiations.
- ✓ **To ensure reforms are effective, It is important to go beyond the simple revisions of the texts**• To complete the implementation of the international obligations of Tunisia in the field of public procurement, it will be important not to limit reforms to the revisions of the text but also to ensure that all agents involved are properly informed, for example through a circular explaining the participation of foreign companies and a manual for the application and implementation of the rules.

➤ Clarity:

- ✓ **Reduce any risk of misinterpretation due the lack of clarity in the legal texts and regulatory framework.** The current regulatory framework hesitates between openness and protectionism. It is important to reduce any uncertainty and spell out the conditions for access of foreign companies
- ✓ **Bring out the component of anti-corruption in public procurement under trade agreements.** Given the dimension of governance and anti-corruption that has now been added to the trade dimension, future agreements will have to include strong commitments to technical assistance, training, and development of local statistics. Having acceded to the UN Convention against Corruption by 2005, the Tunisia must comply with all of its obligations and in particular to article 9, which deals with the fight against corruption in public procurement.

5. Conclusions

The political and economic events since January 2011 have contributed to change the context in which Tunisia is shaping its own global integration agenda. This changing landscape presents new challenges but also opportunities to advance integration in a rapidly globalizing world trade environment. On one side, Tunisia has a great deal to gain from deepening trade and economic integration with its regional and global partners: trade and investment are in fact a key engine of sustainable growth and employment creation. On the other side, Tunisia won't be in the position to fully gain from deeper integration if trade and investment restrictions, a legacy from the old economic and political model, persist and continue to prevent a more efficient allocation of resources. Firms and economic agents, and by extensions Tunisians households, cannot benefit from increased market opening if competition remains stifled and market opportunities limited by an uneven domestic regulatory environment.

6.1 Main Messages

The cost of non-reform is very high and Tunisia might find itself losing more and more ground with respect to its competitors. Progress in domestic reforms and especially in domestic regulatory reforms is well-recognized as the key factor in improving Tunisia's trade and competitiveness. Thus any measure introduced now, even incrementally, in the context of greater international integration will provide a vital signal on the future direction of Tunisia's policy. It will provide critical information to citizens on how the move toward greater trade integration and will be used to improve the local business climate and increase Tunisian competitiveness and economic growth. A previous WB study (Tunisia Global Integration Study 2009) showed how Tunisia could gain considerably from further liberalizing key services sectors. The background papers presented for this report assess the main regulatory and institutional bottlenecks that still prevent the country from reaping the benefits from greater and deeper integrations with regional partners, primarily the EU. In the case of services, both horizontal and sectoral policies are identified to move towards a more competitive environment. In the case of the competition policy, a number of reform options have been identified that could broaden the country's engagement with the global economy. Most of the reforms to remove these bottlenecks are domestic ones and key reforms could be undertaken from a unilateral basis. However, international and regional trade integration could support this process by helping to build consensus and locking in reforms that are necessary. Tunisia could also benefit from support for the implementation of the reforms.

The sequencing of the reform is very important: trade liberalization should be preceded by reforms of the business environment and competition at large. Opening a services sector to domestic (e.g. privatization or suppression of a public monopoly) and/or foreign competition without paying attention to the domestic regulatory and competition environment could have negative effects, allowing for example anti-competitive behaviors and price increases. Transitioning from a rent system, the government needs to ensure that regulatory reforms are effective to guarantee greater competition and remedy market failures.

Alignment to external rules and practices under regional trade agreements should happen only if there is a political will that can ensure long term sustainability of the newly introduced international best practice, if accompanied by capacity building of the enforcing institutions and if it goes in support of the removal of non-trade barriers. In the context of competition policy, for instance, while the EU proves that competition rules can play a major role in deeper regional integration and can have spillover effects in the neighboring countries via bilateral treaties, from the prospective of the embracing country the adoption of European rules should be assessed against their specific possible impact in the country and against a real political commitment. The adoption of amendments should be favored if they help removing significant non-tariff barriers; they help overcoming the resistance of vested interests to domestic reforms, if their implementation can be undertaken at a reasonable cost, and if there is the willingness to make them sustainable in the long run.

It is essential to coordinate reforms under multiple ongoing agreements and negotiations. Multilateral concessions are seen as a first best, topped up by some “open regionalism” .Tunisia is under pressure to make reforms in multiple instances: domestic reform agenda, bilateral or regional trade negotiations, WTO negotiations, etc. Sometime, the concessions asked from individual countries could be conflicting – for instance if market access is granted on a preferential basis. There is a risk that the multiplication of PTAs generates conflicting rules or adds to the complexity of trade (e.g. administrative burden attached to the rules of origin). The same risk prevails when commitments made in bilateral investment treaties (BITs) overlap with mode 3 commitments under the GATS. Greater transparency and information sharing should help the prevention of such conflicts. It is however recommended to favor multilateral concessions (i.e. in the GATS) that could be topped-up by some “open regionalism” and avoid discrimination.

The international dimension of market access must be reflected also in the ongoing reform of the national public procurement system. At the moment there is no international or regional dimension in terms of access to public procurement. The US and EU currently rely on an international model (the UN General Agreement on Public Procurement, or GPA) which could also inspire future bilateral negotiations. To the extent some countries in the region are also in bilateral negotiations with the EU or the US, the regional dimension will inevitably emerge. Tunisia might ensure the consistency of the conditions to access its public procurement system to avoid the stacking of different rules that would be specific to specific agreements. It is also recommended to reduce any risk of misinterpretation due to lack of clarity in the legal texts and regulations of the country in this field. The current regulatory framework does in fact hesitate between openness and protectionism. It is important to reduce any uncertainty and spell out the conditions for access of foreign companies.

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