TUNISIA ECONOMIC MONITOR

Economic reforms to navigate out of the crisis

Winter 2021

WORLD BANK GROUP
Middle East and North Africa Region

EXECUTIVE SUMMARY

The recovery is slow

After the dramatic drop in 2020 (–9.2 percent), Tunisia's economic recovery has been slow in 2021. The economy is estimated to grow by 3 percent, which is well below the expectations at the beginning of the year. As a result Tunisia's economy has shrunk during the Covid-19 crisis (2019–21) more than comparator countries in the region. The slow recovery has increased further the already high unemployment rate by 3.3 percentage point to 18.4 percent by the 3rd quarter of 2021. The rate is particularly high among youth, women and in the west of the country.

The Economic Monitor examines four possible factors behind Tunisia's slow recovery. First, the drop in mobility related to the pandemic may have been more harmful in Tunisia. However mobility in Tunisia has dropped to a similar extent as other countries and it has now returned to pre-pandemic levels following the acceleration in the vaccination campaign since July. If anything the mobility drop in Tunisia has resulted in a lower reduction in economic activity than in comparator countries as Algeria and Egypt. Second, it could be that the level of public support to the ailing firms and households may have been particularly low. However at 2.3 percent of GDP, the Covid-19 stimulus package in 2020 was in the same ballpark as other comparators in the region.

Third, the structure of the Tunisian economy, particularly its reliance on tourism, may have exposed it to the negative demand shock more than other countries. Indeed hotels, cafe and restaurant and transport are the sectors which have contracted the most since the start of the pandemic. The losses of these sectors explain a significant portion of the negative effects of the crisis in Tunisia, although they do not fully account for such slow recovery.

The steep restrictions on investments and competition appear another important factor behind Tunisia's poor economic performance during the pandemic. These restrictions limit the reallocation of resources across as well as within sectors, which is particularly important during a time when new activities need to replace those negatively affected by the pandemic. The rigidity of the Tunisian economy is a consequence of the over-regulation of markets, both product and factor markets, which is the subject of part B of this Economic Monitor. The financial sector is a case in point of a market where regulations which constrain the reallocation of resources in the economy. Such rigidities include complex restructuring regulations, obsolete bankruptcy regulation, the lack of institutions that facilitate credit risks assessment and of financial products suitable to viable businesses subject to shocks.

This has exacerbated fiscal pressures

The weak recovery has exacerbated the pressure on public finances in spite of the reduced budget deficit (7.6 percent of GDP in 2021 from 9.4 percent in 2020). The increase in tax receipts—driven by VAT—has

outstripped the increase in public expenditures, driven by public salaries, transfers (including growing energy subsidies) and debt service. The budgetary deficits that have accumulated since 2011 have resulted in a sharp increase in public debt from 52 percent of GDP in 2015 to 84 percent of GDP in 2021, most of which external. The rising debt, the lack of reforms and the delay in negotiations with the IMF have effectively cut the Tunisian government off international capital markets with sovereign ratings plummeting in 2021.

As a result the government has resorted in the use of Central Bank financing to cover much of its debt repayment in 2021. This is crowding out the credit to the private sector and has contributed to an acceleration of inflation, which is now at 6.4 percent. On the other hand the pressure on the balance-of-payments decreased in 2021 despite the deepening trade deficit (17 per cent) and the significant decline in services exports.

Pandemic containment and structural reforms are necessary to navigate out of the crisis

According to our forecasts, the recovery will continue to be slow in 2022–23, unless decisive structural reforms addressed the rigidities discussed in this monitor. The gradual decline in the budget deficit is expected to continue over the medium term, reaching 5–7 percent of GDP in 2022–23, given the expected reduction in health-related expenditures and provided that the moderately positive spending and revenue trajectory is maintained.

These forecasts are presented with significant downside risks, as the recovery will depend on several factors, particularly the government's ability to: 1) Contain the evolution of the pandemic through the continuation of vaccination efforts as well as the effectiveness in addressing potential new variants, including Omicron; 2) Manage to fiscal deficits and debt repayment and maintain macroeconomic stability, which requires an economic, political and social climate conducive to resource mobilization and the confidence of investors, ideally through a new IMF program; and 3) address key barriers to the efficient resource allocation.

Part B elaborates on these barriers, which explain why ten years after the revolution, the level of competition between sectors in Tunisia has further decreased, as has the creation of dynamic companies, even compared to the pre-2011 period. These barriers fall into three groups. First, the state distorts markets through command-and-control regulation. Tunisia's regulations restrict competition in both enabling sectors and the real sector, limiting entry of new firms and facilitating collusion among incumbents. Second, the state displaces the private sector through direct ownership of enterprises and preferential treatment of SOEs. The Tunisian government owns or favors public enterprises in a wide range of commercial sectors, including three out of the four sectors covered in the CPSD. Third, despite recent progress, the institutional and regulatory framework for antitrust remains under development and does not protect market participants from anti-competitive business conduct.

Addressing barriers to competition and weak enforcement would be essential to help the Tunisian economy emerge from the crisis, return to a sustainable path and benefit households with higher employment and lower prices. A wholesale rather than a sector-by-sector approach may be needed to remove restrictions to competition as the experience of the 2018 reform of the authorizations regime suggests. Strengthening the Competition Council is also crucial to ensure the enforcement of fair competition practices across sectors.

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