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All in the Family: State Capture in Tunisia

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Introduction and summary: Understanding state-business relationships and how they have shaped the institutional architecture of countries in the Middle East and Northern Africa is crucial for the identification of systemic vulnerabilities and reform priorities. In a new paper “All in the Family: State Capture in Tunisia”, we examine the relationship between regulation and the business interests of President Ben Ali and his family, using unique firm-level data from Tunisia for 1994–2010, and document how Tunisia’s investment policy was abused to serve the president’s family’s private interests. Since the regulatory infrastructure instituted under Ben Ali has remained largely intact, our results underscore the urgent need for reforms equalizing opportunities for all.

In spite of widespread recognition of its importance, empirical evidence on state capture has been limited by a lack of data. To redress this lacuna, we merge data on investment regulations with balance sheet and firm-level census data in which 220 firms owned by the Ben Ali family are identified.

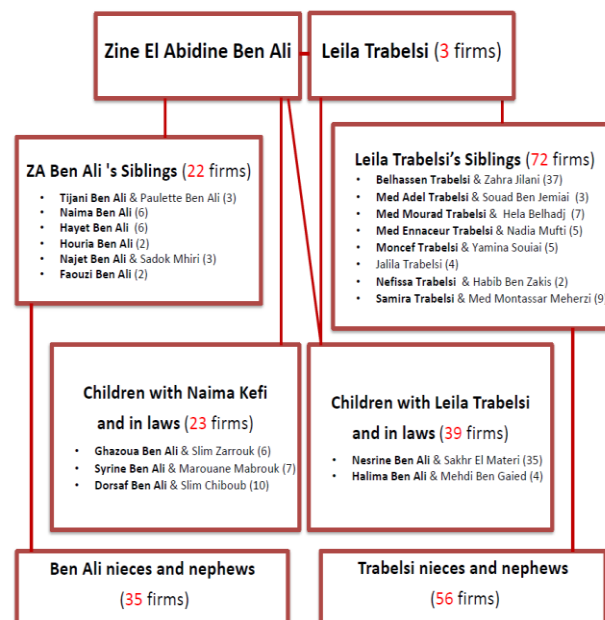
These connected firms outperform their competitors in terms of employment, output, market share, profits, and growth and sectors in which they are active are disproportionately subject to

authorization requirements and restrictions on foreign direct investment.

Figure 1: Business Interests of the Ben Ali Family²



Figure 1: The Business Interest of the Ben Ali Family (# of firms in parentheses)



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² The diagram from PRWP #6810 indicates the Ben Ali clan’s alleged ownership of confiscated firms using information on the website of the Ministry of Finance. The diagram is confined to firms for whom we obtained information from the Tunisian authorities and is not exhaustive. The diagram merely indicates alleged ownership relations without implying improper conduct on the part of the listed individuals. Note that some of the listed individuals are currently contesting the confiscation of their assets.

Sources: http://www.finances.gov.tn/index.php?option=com_content&view=article&id=201:gestion-des-biens-confisques&catid=28&Itemid=577&lang, *Journal Officiel de la République Tunisienne*, 18 mars 2011, No 18, 337-342.

Consistent with theories of capture, performance differences between connected firms and their peers are significantly larger in highly regulated sectors. In addition, the introduction of new foreign direct investment restrictions and authorization requirements in narrowly defined five-digit sectors is correlated with the presence of connected firms and with their startup, suggesting that regulation is endogenous to state capture. The evidence thus implies that Tunisia's industrial policy was used as a vehicle for rent creation for the president and his family.

After the revolution, the same rules that benefitted the family have remained, as Tunisian investment laws have not changed substantially. As a result, rent seeking at the expense of the public and repression of economic freedoms remain a reality. Reforms that open up opportunities for Tunisian entrepreneurs to grow their businesses and create jobs are essential to ensure that the revolution results in shared prosperity for all, instead of an elite few.

This Quick Note summarizes the findings of the longer paper with the same title (details in footnote 1).

The Risk of Regulatory Abuse: The potential for regulatory abuse is well known. Countries with more elaborate business regulations have higher levels of corruption and lower levels of development, yet do not have better public goods (Djankov et al., 2001, Aedes and di Tella, 2007). While these patterns may in part be explained by limited administrative capacity in developing countries (Harrison and Rodriguez-Clare, 2010), they might also be the product of political processes susceptible to capture by special interests. Consistent with this conjecture, political connections account for significant market value in traded firms (Fisman, 2001) and are especially prevalent in countries with weak rule of law (Faccio et al., 2006). Nonetheless, direct empirical testing of the hypothesis that capture and manipulation of investment laws is a mechanism for rent creation remains elusive in spite of in-depth theoretical analysis of the nexus between corruption, rents, and regulation (see e.g. Stigler 1971, Shleifer and Vishny, 1993, 1994, Bliss and Di Tella, 1997, Ades and Di Tella, 1999, Acemoglu and Verdier, 2000).

Methodology: To characterize the Ben Ali family's business interests and their relation to regulation, we identify in the Tunisian firm census 220 firms owned by the Ben Ali family that were confiscated in the aftermath of the Jasmin revolution. We merge these data with administrative data from the tax authorities, containing balance sheet information, and create a database of the evolution of the Tunisian investment law from 1993 until 2010, the last full year of Ben Ali's tenure.

The data set we assembled³ allows us to identify the relationship between investment policies and the business interests of Tunisia's politicians. First, we pinpoint the sectors in which Ben Ali firms were active. Second, the data allow us to document performance differentials between firms owned by the Ben Ali family and their competitors, and to examine to what extent these are explained by regulatory restrictions limiting entry. Finally, the data set allows us to examine whether sectors in which Ben Ali firms were active were significantly more likely to be subjected to new restrictions, effectively testing the endogeneity of regulations, i.e. state capture. Decision-making authority over investment laws can be confidently attributed to Ben Ali since changes to the Investment Code were made by decrees signed by the President himself. Thus, we not only examine whether excessive regulations invite rent seeking, but also whether rent seeking is associated with the proliferation of regulation.

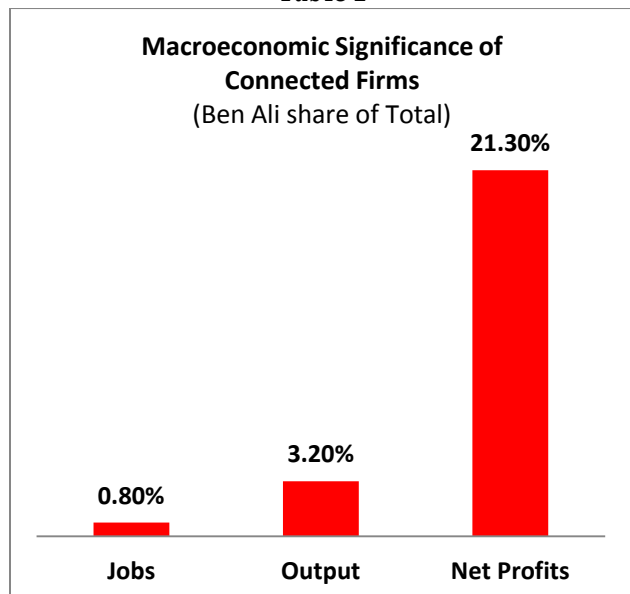
The Tunisian Context: Tunisia provides a relevant context to examine who reaps the rents from regulation. It resembles many other developing countries in having a development model based on rather extensive state intervention. The Ben Ali family's involvement in the economy was by no means secret, and Tunisia's investment promotion agency advertised his close interactions with the business community as enhancing public welfare. In part because Tunisia registered stable positive growth rates hovering around 4-5% per annum, Ben Ali also had a fairly favorable external image. The World Economic Forum repeatedly ranked Tunisia as the most competitive economy in Africa and the IMF as well as the World Bank heralded Tunisia as a role model for other developing countries. Yet, the Tunisian model had serious flaws; unemployment

³ The dataset is accessible at the Tunisian Institut National de la Statistique.

and corruption were high over the period studied, and contributed to Ben Ali's downfall. Last but not least, Tunisia has a high-quality firm census, and authorities willing to grant access to data on both firm performance and political connections.

Exorbitant Profits: We find evidence that entry regulation was captured and to some extent dictated by the Ben Ali clan's private business interests. To start with, Ben Ali family's entrepreneurship was both extremely lucrative and significant from a macro-economic perspective. The ensemble of 220 confiscated Ben Ali firms appropriated 21% of all net private sector profits even though they accounted for only approximately 3% of private sector output and less than 1% of employment⁴. Since we identify only firms with direct links to the Ben Ali family, as opposed to all firms with cultivated connections, this number is probably best interpreted as a lower bound on the importance of political connections.

Table 1



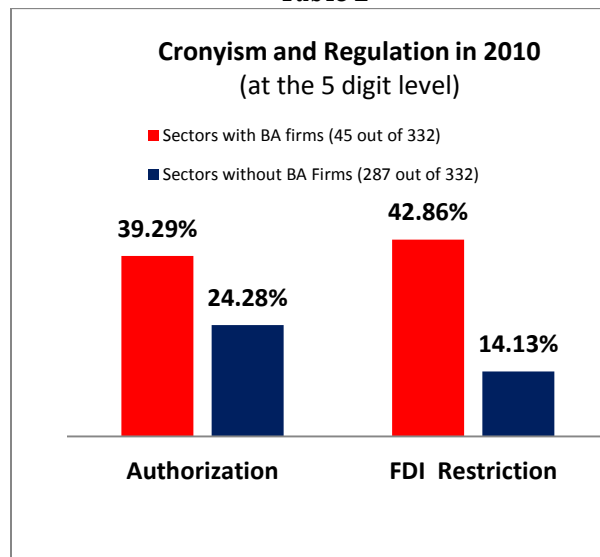
Source: PRWP #6810 (See footnote 1)

⁴ These estimates are in line with previous studies of the economic significance of connected firms. For example, in his study of firms with connections to the Suharto regime, Fisman (2001) observes that the 25 business groups he identifies account for approximately a third of Indonesian GDP. Similarly, Ferguson and Voth (2008) argue that firms with ties to the Nazi regime accounted for three quarters of stock market capitalization in Nazi Germany. A key difference with these studies, which have focused on publicly listed firms, is that we focus on the universe of firms and exclusively on firms with family ties to the Ben Ali regime.

Entry Regulation and Connections: Second, sectors in which Ben Ali firms are active are significantly more likely to be subject to prior authorization by the government and to FDI restrictions. Ben Ali firms dominate the telecommunications and air transport sectors and were also important players in other transport sectors, and real estate, all sectors in which entry is highly regulated.

Entry Regulation and Performance Differences: Third and related, Ben Ali firms outperform their competitors in terms of employment, output, market share, and profits, as well as growth in these variables and do so especially in sectors that are regulated. Performance differentials between connected firms and their competitors are significantly larger in sectors subject to authorization requirements and FDI restrictions. The effects are economically meaningful. Even after controlling for its superior size, the market share of a typical Ben Ali firm is 6.3 percentage points higher than the average firm, and this conditional differential is entirely due to Ben Ali firms sorting into the regulated sectors. Consistent with theories of capture (Stigler, 1971), the superior performance of connected firms is thus to a large extent explained by entry regulation, which is perhaps our most important finding.

Table 2



Source: PRWP #6810 (See footnote 1)

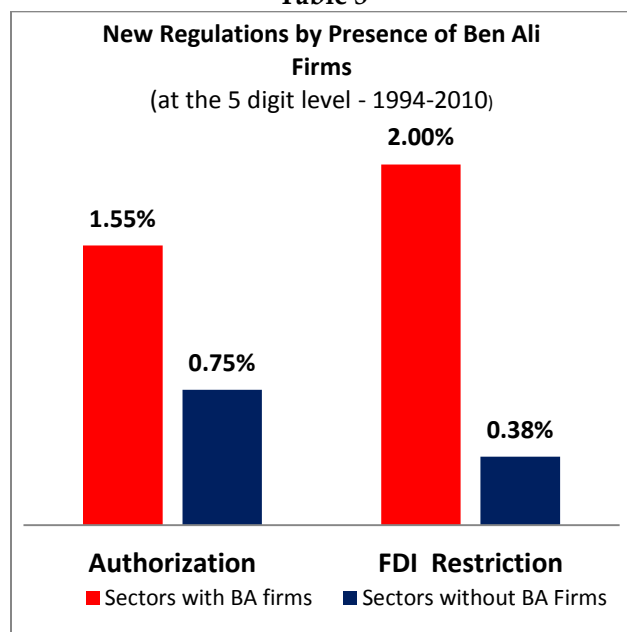
Manipulating Investment Laws: Finally, we present evidence that the Ben Ali clan manipulated investment laws to further its own business

interests. Although the number of observations is limited, the correlation between the presence of connected firms, entry restrictions and protectionism was present in the original Investment Incentives Code enacted in December 1993. In addition, the probability of reforms to investment laws promulgating in additional regulations is significantly higher when Ben Ali firms are present and the null hypothesis of no correlation between Ben Ali presence and the introduction of authorization requirements and FDI restrictions is strongly rejected. Moreover, the start-up of new Ben Ali firms is significantly correlated with the imposition of new authorization requirements and FDI restrictions.

our understanding of the emergence and persistence of suboptimal policies (see the discussion in Rodrik, 1996), and suggest these may be endogenous to cronyism.

What has happened since the Revolution? While Ben Ali and most of his entourage have been ousted, the institutional infrastructure that was put in place under his reign remains. Tunisians today literally continue to pay the price of privileges extended to an elite group of entrepreneurs. Reform efforts have not yet resulted in an opening up of economic opportunities for all, which is unfortunate since this was one of the central demands of those who took the streets a little over three years ago.

Table 3



Source: PRWP #6810 (See footnote 1)

Political Connections and Industrial Policy: These findings illustrate how industrial policies can be abused as a vehicle for state capture (Schleifer and Vishny 1993, 1998, Helmann et al., 2000). By demonstrating how regulatory abuse can culminate in excessive market power benefitting an elite few, they help explain why political connections have been so highly valued (see e.g. Fisman, 2001, Ferguson et al, 2008).⁵ These findings also further

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⁵ Connected firms have been demonstrated to benefit from privileged access to finance (Claesens et al., 2008) including bailouts (Faccio et al, 2006), as well as capital controls (Johnson and Mitton, 2001) and licensing arrangements (Mobarraq and Pursubasi, 2006) limiting competition.