ISLAM & LIBERTY NETWORK

TUNISIA ECONOMIC NETWORK

Authors: Dr. Aymen Boughanmi and Dr. Mohamed Nouri
English Translation from Arabic: Tasnim Idriss, Islam & Liberty Network Associate Director and Dr. Aymen Boughanmi

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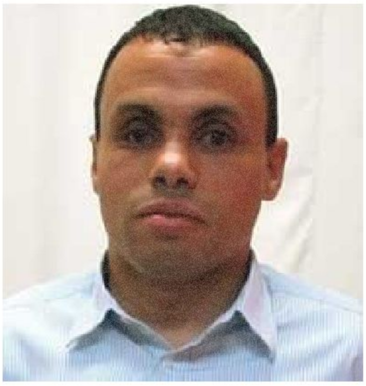
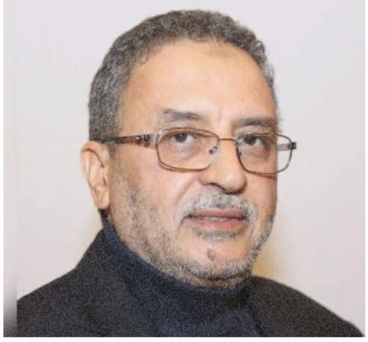
DR. AYMEN BOUGHANMI



Researcher and professor at the Tunisian University. He wrote many books and published several research, studies, and articles specialized in politics and economic geography in Tunisian, Arab, and foreign newspapers and websites in Arabic, French, and English. He holds a PhD in British and American civilization from the Sorbonne University in Paris. He is also a well-known radio political analyst in Tunisia.

DR. MOHAMED NOURI



An economist, expert and trainer in Islamic finance. He has a PhD in Islamic Economics and combines experiences in both professional and civil society life, in addition to research and teaching. He is an advisor to many Islamic investment funds and a member of the 'Islamic Finance Economy Paris Europlus'.

THE TUNISIAN CRISIS: CONTEXTS AND TREATMENTS

Introduction

It is indisputable today that Tunisia is going through a suffocating economic and financial crisis, in addition to an acute political crisis that represents a significant stumbling block in the path of democratic transition. Its signs are clear. They include the worsening budget deficit (8.5% of GDP), the dangerous rise in the level of public debt (85%), an unprecedented rise, the decline in the investment rate, and the decline in donor confidence in the Tunisian state's ability to pay. As a consequence, Moody's has reduced for the tenth time in a row, the sovereign rating of the country to the degree of "SA 2", with high risks and negative prospects. The ability of the economy to reform is questioned given the stagnant growth (1.6% for the current year, according to International Monetary Fund estimates), the high inflation (10%), and the decline in purchasing power and unemployment (15.8%).
Tackling these problems will determine the future of the country. Today, however, the evolution of the economic situation gives priority to the issue of public finances. All indicators confirm that Tunisia is entering a stage of high risk in terms of its ability to mobilize the necessary resources to finance the state budget, especially its ability to repay its external debts. This is causing growing pressure on the financial market at home and on the country's hard currency reserves.
Tunisia has not yet succeeded in reaching an agreement—the urgency of which no one doubts—with the IMF. This represents an obstacle to foreign borrowing in all its forms, including bilateral borrowing and borrowing from the international financial market. Some go as far as to consider that Tunisia is facing the gloomy risk of bankruptcy. The current state of public finances implies three scenarios with different aftermaths, affecting the nature of economic reforms imposed on Tunisia.

These scenarios can be summarized as follows:

1) Tunisia's success in concluding an agreement with the IMF with the availability of external borrowing sources that meet the required needs.

2) The necessity of rescheduling the external debts under the tutelage of the Paris Club, with the necessary agreement of the IMF. This scenario can only be fruitful if the country can secure new sources of funds.

3) Tunisia's failure to agree with the IMF and thus the absence of the possibility of obtaining funds from the international financial market.

These three scenarios would lead to different results. The first scenario would protect the country from the risk of bankruptcy in the foreseeable future. Though the challenge would be costly, this scenario provides reasonable conditions to get out of the impasse and introduce the necessary reforms. As for the second scenario, it may delay the bankruptcy without eliminating its pressure. This means less room for reform with greater pain. As for the third scenario, it means bankruptcy. This bankruptcy may be officially declared if Tunisia fails to pay its external debt, partially or entirely. The bankruptcy may also be less official if the current state of uncertainty and the increasing pressure on the internal financial market will continue. This pressure would further exacerbate the scarcity of liquidity and therefore hinder investments and increase the dependency on occasional financial doses from donor institutions. In this case, reform will be extremely difficult, to an extent that would jeopardize the very stability of the state.

The priority now is to mobilize all efforts to avoid the worst-case scenario. This means reaching an agreement with the IMF as soon as possible while working to purify the political and social climates and to provide guarantees for the implementation of the appropriate reforms. Although the agreement with the IMF does not represent an end in itself, its importance in defining the conditions for reforming the Tunisian economy elevates it to an intermediate end. It seems advisable that Tunisia should initiate some structural reforms even before reaching an agreement with the IMF since the country needs a new political and social contract. Therefore, before suggesting possible solutions for the current situation, this paper presents a set of problems that must be solved.

Structural Dilemmas

Since independence, the Tunisian social contract has been based on an economy in which the state played a pivotal role through its oversight of a public sector that lost its efficiency. Trade unionism played also a decisive role in determining the nature of the social outlook. The history of the Tunisian political economy also reveals a remarkable fluctuation in economic trends and development options between giving priority to the public sector in managing the economy and giving leadership to the private sector. The result was a hybrid system that combined both a liberal market-driven system and a dirigiste state-centered system. It failed to guarantee growth in the long run, and progressively implied a costly social system.

The mainstream economic culture rejects the market economy almost instinctively and therefore refuses liberal solutions that do not give priority to the social dimension. This is manifested through a public discourse that, while acknowledging the need to change the country's development model, does not disclose the content of this change, except to further emphasize the need to protect social benefits and to maintain the role of the state in the economy. This has put Tunisia in a contradiction that harmed its democratic transition since 2011. Its political liberalism was not paralleled with an economic openness or even a discourse calling for market-driven solutions.

Since 2011, the primary role of the state has become the purchase of social peace through two main dimensions. The first, negative in nature, consists of the acceptance of various forms of protests, even when they include law-breaking. The second, positive in nature, consists of an excessive submission to social demands to a level that exacerbated public spending and contributed to the weakening of productivity and the rise of inflation. the second is positive, and it emerged through excessive submission to demand, which exacerbated the level of public spending and contributed to the weakening of productivity and the rise in inflation.

In this context, the state has turned into the most prominent employer, which explains the dramatic rise in the cost of the civil service (Ministry of Finance, Tunisia Government Budget 2023). As for the public sector, it witnessed a decrease in production and a collapse in productivity, which forced the state to subsidize its companies. Despite the worsening budget deficit, the state was unable to reduce social subsidies. The slogan of the necessity to channel resources to the needy people remained a dead letter. Terrorism caused a significant rise in military and security expenditure, which came at the detriment of basic services such as health, education, public transportation, and infrastructure.

Tunisia had to borrow excessively, especially from different foreign sources. The external debt has reached a very high level (35 billion dollars in 2022, almost equating to the annual GDP). Its democratic reputation represented a favorable factor that was lost subsequently after the events of July 25th, 2021. As a consequence, the country is almost cut off from its main external sources of funding. Its public debt rating does not allow it to borrow on the financial market, and its diplomacy has not succeeded in mobilizing enough bilateral loans. As for the international financial institutions, especially the IMF, they have shown reluctance to help Tunisia, except for the limited doses from the World Bank and other institutions within specific programs and targeted projects.

Meanwhile, the real economy continues to stagnate. The growth rate remains very low, especially after the significant contraction that Tunisia incurred (8% in 2021) due to the Covid-19 crisis.
Investments, exports, and consumption remain quite low. As for unemployment, it continues to rise. In addition, the country has become an expeller of competencies, as shown by the acceleration of the emigration of engineers, doctors, and other qualified people. This means a further decline in the scale of economic values.

Today, the Tunisian industrial fabric is facing the risk of collapse, as indicated by bankruptcy numbers and the risk of bankruptcy among small and medium-sized companies (143,000 were forced to close and about 500,000 others are on the verge of bankruptcy). These institutions represent the lifeblood of the Tunisian economy. And yet, they have been the main victims of the public finance crisis. The state did not only provide inadequate support to these institutions during the Covid 19 crisis, but the difficulties of public finances have also turned the state into Danaid's Barrel (a meaningless job that has no end). As a result, wealth-producing enterprises have been deprived of funding, both directly and indirectly. Indeed, banks give priority to the state at the expense of small and medium enterprises. Moreover, the rise of inflation forced the Central Bank to raise the interest rate three times in the past year without significant effect, which automatically raised the debt service and the cost of financing, hindered investment, and fueled the high prices. This cautious monetary policy also contributed to the reduction of the saving levels that hit a historical low of 4% and the reluctance of capital to invest and their emigration towards alternative, more profitable, and safer havens such as Morrocco and other competitors of Tunisia. This situation has also exacerbated corruption which has become an endemic phenomenon in the Tunisian economy.

Reform Perspectives

It is clear from the foregoing that the causes of the Tunisian economic crisis are deep, permeating the country's economic and social structures. This means that overcoming the current public finance crisis will not be sufficient to bring the Tunisian economy into a dynamic of recovery. That is, the solution to the public finance crisis will not be sustainable unless it comes in the context of a profound change in the mode of development that redefines the relationship between the various economic actors, mainly the state and the social partners. To avoid the trap of overgeneralization, we suggest the following points as a general direction for reform:

1) The state must first announce the end of the old developmental model that has exhausted its purposes and is no longer suitable for achieving the country's economic and social goals. It should be replaced with a new consensual model inspired by the social market economy approach that harmonizes the three main sectors: the private sector (the market forces), the public sector (the role of the state), and social solidarity (the society).

2) The state must also announce the end of the prevailing social contract that has reached its limit. Its continuation is exhausting the state institutions without guaranteeing the continued efficiency of the economy and the advancement of society. Tunisia needs, therefore, to define new foundations for its new social contract, in which the state affirms its roles and responsibilities.

3) These roles should be limited to regulation through realistic framework, distribution through a fair tax policy, and the determination of the strategic role of public policies in terms of goals and means. The state should also withdraw from economic activities except for the securing of basic goods and services that the private sector tends to ignore. The state can also assume a super visionary role in strategic sectors. Therefore, the private and social sectors might play their roles in revitalizing the economy and building wealth.

4) The social responsibilities of the state should be limited to the protection of the poor and vulnerable. They also include developing services such as education, health, transportation, and infrastructure. This could be done in partnership with the private and solidarity sectors. The state should also declare the standards it will have to respect about these areas, as well as the means provided for carrying out these responsibilities and achieving these standards. However, the state must admit that can no longer bear the other responsibilities.

5) The state should announce the new principles on which public policies are based in the areas it intends to abandon. This is done either by leaving it to the laws of supply and demand or by opening competition within a legally regulated framework.

6) The state should abandon the demand-driven policies it adopted for decades and adopt a supply- oriented policy, in which public policies are directed to support production, not consumption. These public policies should also be adapted to the needs of each sector. This does not imply the absence of general policies to guide public actions. It rather means responding to the needs of each sector, hence promoting production and productivity and ensuring competitiveness in the international market.

7) More attention should be paid to the export sector, as a major generator of growth. In the same vein, protectionist policies in the name of import substitution should be gradually abandoned.

Indeed, the exposure of the Tunisian economy to the pressure of international competition is not only a guarantee of improving its profitability and raising its added value, but is also the most effective way to break the various forms of monopoly that the Tunisian economy suffers from.
Orienting the economy towards exports will open new horizons for Tunisian producers. It will push large capitals towards more specialization to spread effectively in multiple markets. Therefore, Tunisian capitals would go beyond the Tunisian market and stop diversifying their activities without any search for excellence. Encouraging the export of goods and services will contribute to creating a new generation of Tunisian producers, especially at the level of small and medium enterprises.

8) The currency control laws should be reformed according to a rational policy that protects the national currency but also ensures the fluidity of transactions with the outside world. This is a prerequisite for attracting foreign investors. But it is also a condition to encourage small and medium-sized companies to direct their activities to foreign markets. It is also a condition for preserving startups in Tunisia, as their economic activities require smooth financial dealings with foreign markets.

9) The state should ensure the smooth passage of goods through crossing points, especially harbors. This requires easing procedures, ensuring transparency of customs transactions, and combating bureaucratic restrictions and the corruption they generate.

10) The state should enforce the rule of law and protect production sites and distribution routes, especially in the sectors of mining and various extractive activities. This presupposes ending the culture of dealing with these activities as cash cows with the explicit end of social-peace-buying policies through rent distribution. On the other hand, the state should invest generously in the services that it renders according to the new social contract, in a way that guarantees public interest and social peace.

11) The tax system should be reformed to expand the tax base, integrate the parallel sector reduce tax rates, and simplify fiscal procedures. To succeed, these reforms also need to raise awareness about the importance of paying taxes and increasing the efficiency of administrative control.

12) The state should reform the social system to guarantee its long-term sustainability through adequate measures ensuring the financial balance of the various social funds.

13) The culture of success should be promoted. There is a necessity to put an end to a wide spread tendency to use anti-corruption rhetoric to spread suspicion and to threaten social trust. Therefore, a national reconciliation is most urgent to save the country from the vicious circle in which it has been since 2011 when its past

became the enemy of its future. As for the fight against corruption, it begins with purifying the legal framework from any corruption-generating procedures. Corrupt people should of course be held accountable, but this should be done based on individual liabilities and not based on collective punishment.

14) Trade unionism should evolve to protect the right to protest without degenerating into irresponsibility. Trade unions should assume more social responsibilities to promote their social contribution for the benefit of their members, aligned with the economic principles of solidarity.

15) Efforts should be made to solve real estate problems in Tunisia. For example, a large substantial part of real estate remains without proper legal registration, which hinders their economic worth. Another example would be the real estate-related legal and administrative complications facing the execution of big projects. It is also necessary to find new grounds to benefit from state-owned lands to reach a more efficient way of generating wealth.

Urgent action

The state's adoption of these long-term reforms and the beginning of their widespread promotion as a national project would undoubtedly facilitate Tunisia's access to mobilize the necessary financial resources in the short and medium terms. Indeed, international partners and donors would see a clear will for reform and a real awareness of the seriousness of the current crisis, which has reached unprecedented levels. Over the last years, Tunisia has lost much of its credibility vis a vis the international financial institutions. This loss of credibility can be explained by the donors' conviction that the Tunisian elite are not fully aware of the seriousness of the Tunisian economic crisis and their lack of determination to implement the necessary reforms. Indeed, this elite does not give the impression of any real capacity to convince the Tunisian public of the necessity of these reforms and how important they are for the general interest.

Various international economic reports have been warning against the risks of instability facing Tunisia based on economic and financial indicators, namely the worsening public finance deficit, the trade balance deficit, and the decline in investment levels. On the other hand, the Tunisian decision- makers constantly reiterate the need for reform without taking the necessary measures to implement it. This gives the impression of a continuous waste of reform opportunities due to the exacerbation of political conflicts and the failure to establish stable institutions that combine representation and efficiency.

Of course, the mere declaration of the general direction of reform will not be sufficient to restore the confidence of partners and international financial institutions. Unfortunately, Tunisia's reputation has suffered from the duality of declaring intentions and refraining from taking action.

Therefore, clear decisions must be taken to confirm this direction on the one hand and help alleviate the current circumstantial pressures on the other. Given the difficult circumstances and the apparent weakness of the donors' enthusiasm for providing direct financial support to the Tunisian state budget, these measures must be strong and consistent with the aforementioned general direction. Among the most important possible actions we can state:

1) Amend the state budget as soon as possible to rationalize the expenditure and reduce the deficit. This would of course necessitate taking into account the available resources and revising the unrealistic assumptions that the current budget includes.

2) Initiate the reform of the subsidy system to reduce state expenditures, especially on fuel. The Finance Law of 2023 already includes several measures in this direction, namely the gradual increase in fuel prices. It is noteworthy that this procedure has not yet been acted upon. This further accentuates the international donors' doubts about Tunisia's seriousness in taking measures to control state expenditures.

3) Introdoce some financial support in favor of the vulnerable people who would be mostly affected by the lifting of subsidies, especially with the unavoidable rise in inflation in the short term. This assistance can be ensured through either cash transfers or indirect support via the possible institutionalization of the Zakat Fund and the state's supervision of its resources to direct them to the poor and needy.

4) Protect the Tunisian economic fabric from possible disintegration because of the high risks faced by small and medium-sized companies. The problem here is that the scarcity of resources makes it difficult for the state to provide direct support to these institutions of vital value to the economy.
However, it should be noted that there is room for some flexibility about this type of expenditure which does not contradict the expectations of international donors, who insist upon the necessity to preserve wealth-creating enterprises. This means that there are real possibilities to find external resources to support these productive institutions.

5) Reduce the pressure exerted by the state on financial liquidity because of excessive domestic borrowing. This excess harms companies as it reduces their financing opportunities. Furthermore, the monetary policy causes a continuous increase in the interest rate to resist inflation without real success. This has contributed to the decline in investment due to the high cost of financing. It has also increased the difficulties of small and medium-sized companies and pushed many of them to go bankrupt.

6) Work with various sectors to find some inexpensive solutions that would allow these companies to go through this difficult period by facilitating administrative and customs procedures and overcoming various obstacles that prevent these companies from focusing on production.

7) Change the governance of state-owned companies that should operate by the standards of the private sector.

8) Sell some of the state's shares in non-strategic companies to provide the necessary financial resources. This decision needs acceptance from the general public, which in turn necessitates raising awareness about the benefits of privatization and the cost of some public companies for the taxpayer. Selection should be based on clear criteria, especially the financial situation of the companies and the ability to find adequate bids, but also on the requirements of the new social contract. This contract should also define the extent of concessions to the private sector. However, the pace of these operations should also be linked to the state's ability to secure other resources.

9) Integrate Tunisia into the Open Skies system as soon as possible to boost the tourism sector. This sector should be developed to increase its added value. However, this is a long-term goal that cannot have an immediate impact on increasing public revenues in the short and medium terms. Thus, the short-term solution can only be limited to the enhancement of competitiveness through the price factor.

10) Propose a national initial public offering (IPO) in hard currency in favor of the Tunisian diaspora. Given Tunisia's current financial need, the scope of this solution might be limited, but all possibilities should be explored under the current circumstances.

11) Work on integrating the amounts of hard currency that are known to be circulating in the black market. To achieve this goal, the state should announce an amnesty for a defined period. This mechanism remains the most efficient way in this situation.

12) Integrate some of the parallel sector activities in the formal sector. Many initiatives can help. For example, we suggest a five-year temporary fiscal status according to the principle of lump-sum payment. This sum should be relatively high, which would encourage some traders to consider joining the official sector. This five-year period should also permit to rise in the administration's capacity to collect taxes and control economic activities. Fiscal laws should be simplified to allow more citizens to contribute. Social groups that benefit from the lump-sum payment procedures should be trained as a necessary step to put an end to these particular systems.

13) Try to reduce Tunisia's dependency on hard currency. This may be achieved through the conclusion of a bilateral trade agreement, for example through the Bilateral Swap Agreement (BSA). Efforts should be made in this direction with neighboring countries and raising powers (Algeria, Libya, Türkiye, Malaysia, Indonesia, China, India, South Africa, etc.

14) Learn from the successful experiences of Sukuk issuing. In this regard, the law of 2013 concerning Sukuk should be applied to secure alternative resources for big projects instead of debts.

Summary

The public financial crisis in Tunisia has reached levels that threaten the long-term stability of the state and society. It will not be possible to overcome it except with huge and inevitable sacrifices to avoid the worst scenario mentioned in the introduction to this paper - bankruptcy. Hope remains since bankruptcy can indeed be avoided and the least-worse scenario can be aimed for. This only necessitates an immediate agreement with the IMF for four years. Reforms would ensure that Tunisia would not need to resort to such emergency solutions again.

To this end, an official diagnosis of the economic situation should be made (see the first part of this paper), followed by an official declaration of the direction of reforms in the short and long terms (see the second part of the paper). Then, urgent measures should be implemented as soon as possible (see the third part of this paper). Since no one contests the depth of the Tunisian economic and financial crises, the state of diagnosis seems relatively easy. It is the adoption of the new direction of reforms and the implementation of urgent measures that require strong political will and much pragmatic courage.

Tunisia cannot escape the necessity of reforms. Though these reforms are not necessarily totally in line with the IMF recipe, their quick implementation can only help pave the way to sign the agreement with the IMF and therefore keep the situation within the possibilities of the first scenario (see introduction). This is exactly what this paper calls for.

Unfortunately, reaching an agreement with the IMF has acquired great importance, becoming an intermediary end as aforementioned. Though the roadmap seems relatively clear, success presupposes some conditions that could be summed up as follows:

1) A high level of pragmatism, political courage, and force of persuasion. The scale of the reforms will fundamentally change the structure of the Tunisian economy and redistribute roles among the various actors. Such a shift requires tremendous pedagogical efforts.

2) The necessity of seeking to transform the reform effort into a national project that enjoys some consensus. This presupposes avoiding an equally important effort to include the largest possible number of political, economic, and social actors. The burden should be shared between the political power as well as the various national stakeholders according to their weight and responsibilities.

3) A serious engagement for reform to avoid repeating the mistakes of the past when Tunisia was unable to obtain the various installments of previous IMF loans**.**

4) Showing Tunisia's determination to fulfill its obligations. Since its reputation is already tarnished among many donors, diplomatic efforts should constantly value the already introduced reforms.

5) The need to avoid the trap of turning the IMF agreement into an end in itself. It is an intermediate goal, the ultimate goal being the recovery of the Tunisian economy and the rapid transition towards prosperity and well-being. This means that the signing of the agreement cannot be considered a success in itself, and the political authority should not promote it as such.

Signing an agreement with the IMF is only the first step on a long road, which also includes strategic dimensions, most notably:

1) Developing a plan to end dependence on the IMF within the four-year horizon of the agreement, through building self-reliance while benefiting from successful international experiences. Work on this plan begins as soon as the agreement is reached. Many international experts can contribute, including the IMF itself, which also provides such technical support.

2) Diversifying the Tunisian economic partners. While the world is witnessing increasing risks today due to profound geopolitical changes that intensify international conflicts, some opportunities may mitigate these risks and even allow the country to benefit from the competition between the various international powers. This will not be easy. It requires a deep understanding of the reality of the international situation.

3) Engaging with African partners to benefit from the unexploited economic opportunities in Africa.

4) Placing the economy at the heart of Tunisian diplomatic actions. This requires a lot of effort, especially in training diplomats. These efforts do not concern economic opportunities and partnerships only, they should imply a wider vision to use the economy as a tool to deepen Tunisian diplomatic relations to overcome the stagnation of previously promised projects such as the Maghreb Union.

5) The need to advance reforms at all levels, including reforming education and rebuilding various social structures. Although many of these reforms do not directly relate to the economy, they should include several economic dimensions that would help secure a better future. For example, more focus should be put on work ethics, adaptability to the evolution of the labor market including technological changes, entrepreneurship, transparency, loyal competition, trust, and merit.