

# »» Tunisia – the rise of the knowledge economy

No. 24, 31 January 2020

Author: Dr Tim Heinemann, phone +49 69 7431-4784, tim.heinemann@kfw.de

## Economic situation

-  Real growth
-  Private consumption (y-o-y)
-  Inflation rate

## Economic activity is rebounding but from a low level

The economy is recovering slowly but growth remains sluggish, backed by the improved development of agriculture and the services sector, particularly tourism. Phosphate production, which is important to the country, is contributing little to the rebound because of weak global demand. Still, there is a good chance that the recovery will continue in 2020.

## Growth financing

-  Budget balance / GDP
-  Current account balance / GDP
-  External debt / GDP

## The twin deficit remains

Growing tourism revenue cannot fully offset the decline in phosphate exports nor the increasing energy imports. The current account deficit has therefore dropped only minimally. In order to maintain social peace, the government is consolidating the national budget in small steps only. National debt therefore remains on a high level, although it has recently decreased slightly.

## Growth resources

-  Investment ratio
-  Share of manufacturing
-  Labour market participation

## Youth unemployment continues to be the greatest problem

Graduates make up a higher share of the working-age population than anywhere else in North Africa and they are Tunisia's greatest source of growth. Until now, however, the country's economic structures have not been able to harness this potential. Thus, unemployment among young and highly skilled workers is particularly high. This fuels dissatisfaction and leads to a brain drain, reducing the growth potential of Tunisia's economy.

## Economic relations with Germany

-  Germany's share of exports
-  Germany's share of imports
-  FDI inflows from Germany

## Germany is an important trading partner but not yet an investor

Germany is the third most important European trading partner after France and Italy. During the period of political instability (2011–2018) and as a result of the terrorist attacks, German investment activity almost came to a standstill. German businesses are currently investing again, notably in renewable energy, tourism and manufacturing.

The current value is among the ...



## Investment climate – assessment by our local experts

Tunisia's economic and political development can now be classified as stable. The social situation certainly remains tense, leading to occasional protests, but the democratic system is no longer being questioned. The economy has also found its feet again in the course of the political stabilisation. But the 5% growth rates achieved in the past still remain out of reach. To return to those rates, the government would need to adopt far-reaching reforms. Despite these weaknesses, the country is again attractive for investors. It has a well-educated population and an efficient infrastructure. The bureaucracy is also working well and professionally. The new investment act has made it easier for businesses to settle in Tunisia.

Continued on p. 2

## Focal theme: The rise of the knowledge economy

The radical changes that have emerged from the political upheavals in the year 2011 are not limited to society and politics but have also spilled into the private sector. The government passed the Start-up Act in December 2019 with the aim of giving the young and highly trained population new perspectives while strengthening the country's innovative capacity. Manufacturing, particularly the aeronautical industry, has also been contributing to the emergence of the local knowledge economy for some time. In the services sector, private healthcare providers and health tourism are bolstering this development. But the demand for jobs remains high.

Continued on p. 2

**Investment climate – assessment by our local experts**

**The democratic development in the country can be regarded as robust.** The security situation in the country has generally stabilised on a good level. This supports the recovery of the tourism sector and makes the country attractive again for foreign investors. The population now firmly respects the constitution and the institutions are generally operating well. This is becoming particularly clear in the current political situation. The general elections last year failed to deliver a clear majority for a quick formation of government. The old government remains in office on a caretaker basis and is working well with the administration.

**The economy is growing – but not yet at a rate that is fast enough to solve the country’s problems.** The social situation, especially the high youth unemployment rate and inflation, continues to fuel dissatisfaction, which regularly sparks protests. But these are more comparable to those in France. These protests no longer have a large impact on economic life. Last year, there were strikes in schools and the transport sector, while the private sector was less affected. However, school strikes and inflation are problems that affect lives and undermine trust in government institutions. The country’s high debt leads to a classic crowding out of private investment.

**Compared with other North African countries, Tunisia beckons with a well-educated middle class.** This is particularly the case compared with Morocco. Tunisia’s infrastructure – both its road network and telecommunications – is well developed. Bureaucratic hurdles remain despite the new investment act and have an impact on both citizens and businesses. But these affect local business

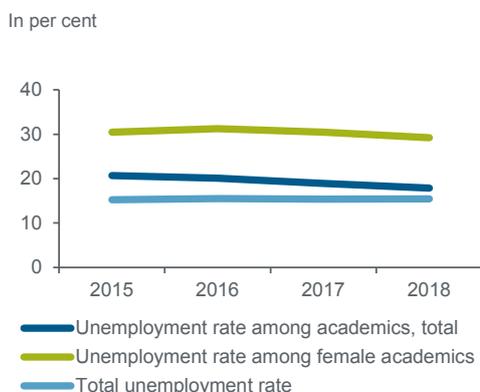
expansion more than newly settled businesses. Compared with Egypt and Morocco, Tunisia is a liberal society and has a good cultural scene in coastal regions.. That makes life very attractive for expatriates and their families.

**Tunisia is and remains a good location for manufacturing.** In particular automotive suppliers and textile manufacturers, as well as pharmaceutical and food producers, can benefit from the good local conditions. Reliable and fast Internet is an important basis for the emerging start-up scene and the digitalisation of production that is currently underway. In the context of Tunisia’s geographic proximity to Europe, the good digital infrastructure is a major locational advantage for the production of fast fashion items and IT services, such as call centres. Europe remains the most important export market for Tunisian products and services; however trade with Sub-Saharan Africa is growing very fast. The country has potential to act as a gateway between Europe and Africa.

**The country has the potential for continued positive development.** But a return to the past growth rates of 5% are unrealistic. Major policy initiatives that would be necessary for macro-economic stability in particular are missing because of the fear of social protests. The administration is well aware that the reforms demanded by the IMF (e.g. consolidating the budget, improving financing conditions for businesses and privatisations) have to be implemented. The only question is who will implement them. Economic policy did not play a role in the past election campaign. That makes it difficult to make a prediction about the future architecture of economic policy.

Based on an interview conducted with Sven Neusinger (KfW Tunis Office Director) on 22 January 2020.

**Figure 1: Unemployment in Tunisia**



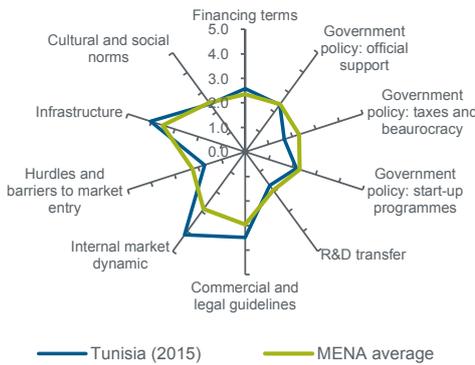
Source: Statistiques Tunisie, own rendition

**Focal theme: The rise of the knowledge economy**

**Unemployment:** Youth unemployment in Tunisia continues to be a problem. What is surprising that it affects young graduates in particular (Figure 1). This is due to the economic structures. Over a long period of time, private sector development was confined to a very narrowly defined area: exports and tourism. The move into the knowledge economy, that is, the production of higher-value goods and innovative services that would also have led to demand for qualified workers, was delayed. The political upheavals following 2011 also gave private enterprise broader space in which to unfold. The freedoms that were gained constitute an important basis for taking the path into the knowledge economy, for which three sectors are illustrative examples. These include the emerging start-up scene, segments of the manufacturing sector and the private health sector.

**Strengthening the start-up scene:** The Start-up Act that was passed in December 2019 was developed in a joint effort with entrepreneurs, trade unions, business associations and authorities – a novelty that highlights the political transformation taking place in the country. It stands for the deliberate strengthening of the private sector, while signalling a new willingness for dialogue between the state and entrepreneurs. Its purpose

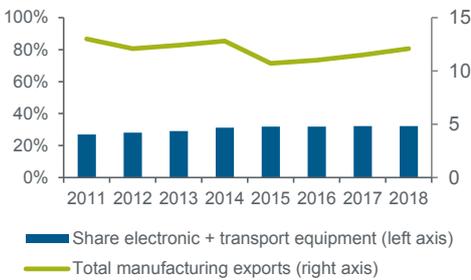
**Figure 2: Tunisia's entrepreneurial environment in a regional comparison**



Source: Global Entrepreneurship Monitor, 2019

**Figure 3: Electronics and transport sector exports are increasing**

Per cent (left axis), in USD billions (right axis)



Source: UNCTAD, own rendition

**Figure 4: Private health sector is growing**

Absolute figures (facilities)



Source: Ministère de la Santé, Statistiques Tunisie, own rendition

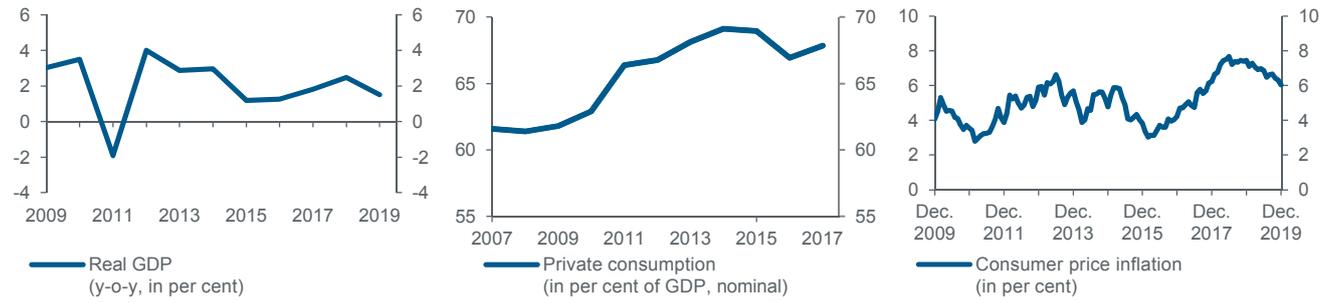
is to increase the number of start-ups in the country and, in this way, to revitalise the entrepreneurial landscape. The new act created the legal basis for the activities of start-ups, which in turn is necessary for granting official support or applying for loans. Entrepreneurs receive further support under the law in the form of a simplified registration process and the provision of support measures such as foreign currency accounts. Newly founded firms enjoy tax exemption for up to 8 years. In addition, the new act entitles all employees to take leave for up to two years to start a business. During this time, a salary can be obtained from the state for up to three years. The new act has the potential to improve the regulatory environment for start-up businesses. Compared with the regional average, the country has some catching up to do with respect to overcoming market access barriers, taxation and bureaucracy (Figure 2).

**Aeronautical industry:** Textiles, the automotive industry and, since recently, the electronics and transport sector are the most important manufacturing industries. Tunisia benefits from its proximity to Europe, as do other countries on the southern Mediterranean coast. Around two thirds of all exports go to the European Union. The aeronautical industry is evolving into a new growth engine of the manufacturing sector. The growth of this subsector is based on rising direct investment from Europe (e.g. by Airbus) and by the growing innovative capacity of local businesses. The approx. 70 firms in this subsector can draw on a vast talent pool in the Tunis area which is being bolstered by institutions such as the Tunis Polytechnic School and the Higher School of Aeronautics. Electronics and transport sector exports, which also include the aeronautical industry, are growing faster than total exports (Figure 3). The past years have also seen new relations forged between the local textile industry and suppliers. The supply of special textiles has provided this sector with new growth opportunities. This subsector could be an important anchor for the development of the local start-up scene as it might create export opportunities.

**Health sector:** Tunisia spends around 7% of GDP on healthcare (as at 2017). That is more than the regional average of around 6.4%. Private healthcare expenditure makes up around 38% of total health expenditure. There are multiple reasons for the development of the private health sector. One is the increasingly demanding middle class which is no longer satisfied with public sector healthcare services. Another reason is that Tunisia has evolved into a **destination for regional health tourism**. More and more health tourists are coming to Tunisia for treatment, particularly from neighbouring countries. The Tunisian health system enjoys a good reputation overall in the region. Foreign investors have also discovered the health sector as an opportunity. For example, an investor from the United Arab Emirates has taken over three private hospitals. Investment is also occurring along the upstream value chain. French and Italian pharmaceutical and medical technology groups are creating production facilities that supply the local and regional market.

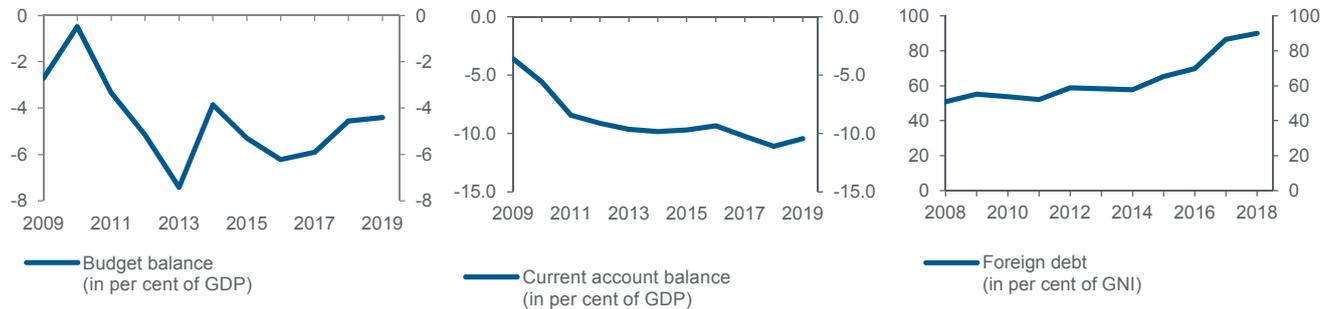
Charts

Economic situation



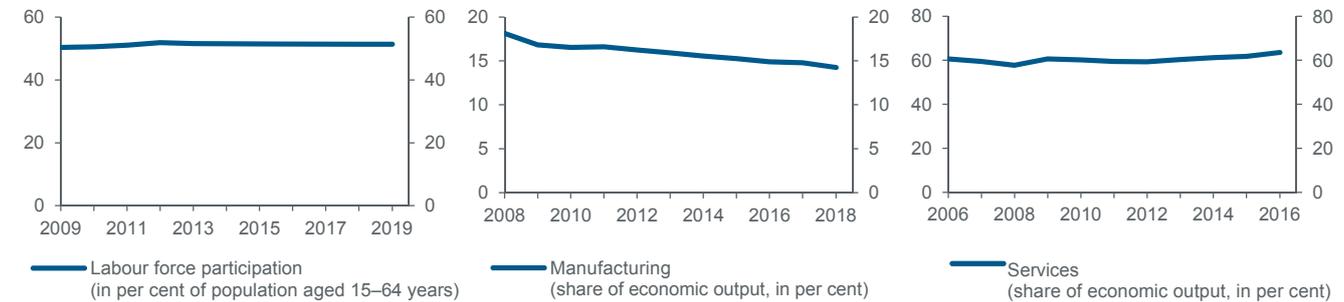
Source: Refinitiv Datastream; IMF, World Bank; National Statistics Institute, own calculations

Growth financing



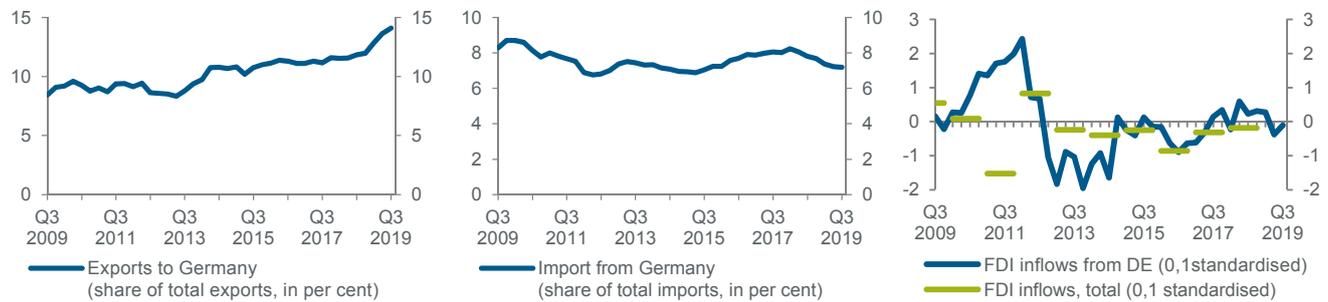
Source: Refinitiv Datastream; IMF, World Bank; own calculations

Growth resources



Source: Refinitiv Datastream; World Bank; own calculations

Economic relations with Germany



Source: Deutsche Bundesbank; Refinitiv Datastream; IMF; UNCTAD; own calculations

Disclaimer

This paper contains the opinion of the authors and does not necessarily represent the position of KfW. All data and information provided by KfW in this publication have been collated by KfW to the best of its knowledge and in good faith. KfW does not provide any assurance that the content is correct, complete or up-to-date. The data and information made available are not intended as individual advice for an investment decision nor as any other form of legal or tax advice and cannot substitute such advice.