University of St.Gallen

Practical Project in

Development Cooperation

Job Creation in Tunisia

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Abstract

The purpose of this paper is to identify a mix of industrial policies which leads to massive job creation. The Competitive Industries and Innovation Program (CIIP) was the starting point from which the elaboration of a further reaching and more comprehensive industrial policy measure mix was developed. In order to recommend specific measures we chose the case country Tunisia. An extensive literature research about industrial policies in general and about Tunisia was conducted. Concluding, we recommend firstly overall measures of reducing the costs of formalizing business, of privatize domestic and foreign investments and to reform the business tax system. Further, we recommend specific industrial policies measures in order to create low skilled employment. Therefore, we chose the textile industry and the recommendation include building industrial cluster, introducing a Special Economic Zone and the promotion of small and medium sized enterprises. The third mix of industrial policies aims at creating high quality employment on a massive scale. Here, recommended measures to achieve the goal are: the integration of the education system into an industrial cluster and a labour market regulation reform. According to our research, all policy mixes should be implemented in order to reach a sustainable employment environment in the long run. Nevertheless, the actual political instability, widespread corruption and nepotism are a constraint to industrial policy efforts and need to be taken into account in the implementation process.

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List of Abbreviations

AFDB	African Development Bank
BPO	Business Process Outsourcing
CIIP	Competitive Industries and Innovation Program
DCED	Donor Committee for Enterprise Development
EC	Commission of the European Communities
EPZ	Export Processing Zones
ERSAP	Economic Recovery and Structural Adjustment Program
EU	European Union
FDI	Foreign Direct Investments
FIPB	Foreign Investment Promotion Board
FTZ	Free Trade Zone
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GVC	Global Value Chain
ICT	Information and Communication Technologies
ILO	International Labour Organization
IP	Industrial Policy
IMF	International Monetary Fund
IPA	Investment Promotion Agency
MENA	Middle East and North Africa
MSE	Micro and Small Enterprises
OECD	Organization for Economic Co-operation and Development
PPD	Public Private Dialogue
R&D	Research and Development
SEZ	Special Economic Zones
SME	Small and Medium Enterprises
UNIDO	United Nations Industrial Development Organization
WB	World Bank
WBG	World Bank Group
WTO	World Trade Organization

1 Introduction

For the last few years, the Tunisian population has found itself in a situation of upheaval. Political reforms should now pave the way for the improvement of the economy and make everyone better off than under the authoritarian regime of Ben Ali. But unemployment in Tunisia is still a major concern and the economy needs be strengthened in order to be competitive in the global market and attract investments. This is where the Competitive Industries and Innovation Program starts from (CIIP).

While taking the CIIP as a starting point, this paper analyzes which mix of industrial policies might be best suited to increase Tunisia's economic growth and therefore boost employment on a massive scale. Firstly, the methodology and the CIIP will be presented, followed by a chapter discussing different industry policies. In chapter four, the case country Tunisia is presented including its historical and economic background and its currently implemented industrial policies. The focus lies mainly on the economic performance of Tunisia in the past few years and the impact of the already implemented industrial policy reforms. In the last part of this chapter, industrial policies recommendations are given in order to create massive employment based on the literature review presented in the preceding chapters. The first recommended industrial policy measures tackle the overall economy, since without these general reforms positive changes in specific industries are unlikely to succeed in the opinion of the authors. Further, two different policy mixes are suggested in order to promote low skilled and high skilled jobs on a massive scale. In the concluding chapter, the recommendations formulated by the authors are critically evaluated.

2 Methodology and Definitions

2.1 Methodology

This paper takes Tunisia as a case study and recommends different mixes of industrial policies that could be implemented in order to create massive employment, both for low skilled workers and high skilled workers. The recommendations are based on a literature review of the historic, political and economic situation and current industrial policies of Tunisia. The policies analyzed are chosen accordingly to the CIIP. Further, they are expanded and tailored specifically to fit Tunisia's characteristics and taking into account the global economic situation and demand.

The recommended industrial policies are split in three different types. First, overall measures are presented in order to provide a labour encouraging environment. Second, an industrial policy mix to create low quality job is presented, followed by a chapter with recommendations for industrial policies, which aim at encouraging high quality jobs.

2.2 CIIP

According to the first annual report of 2013 – 2014 "the CIIP partnership was created to enhance country growth and employment prospects by supporting public policies and investments that promote competitiveness and innovation within and across industries. The partnership's resources are focused on supporting governments' efforts to develop transformational economic development projects and to aggregate cutting-edge knowledge that can be implemented as part of targeted pro-growth initiatives." (World Bank Group, 2014, p. 2). The CIIP seeks to overcome both market and governance failures of the respective government, which disables companies to compete on a global level (CIIP, 2015). The program is a multi-donor partnership among the World Bank Group, the European Union (EU), the African, Caribbean and Pacific Group of States Secretariat and of Austria, Switzerland (World Bank Group, 2014, p. 7) and since December 2014 also Norway (CIIP, 2015). The program is still young, it started in 2012 with 12 different country operations. Its ambition is to create a medium-term to long-term effect on the economy of the targeted country (World Bank Group, 2014, p. 7).

The CIIP operates mainly in the agricultural sector and its industrial policies heavily rely on the value chain approach, building clusters, economic zones and growth poles and corridors as shown in the table below. (World Bank Group, 2014, p. 9)

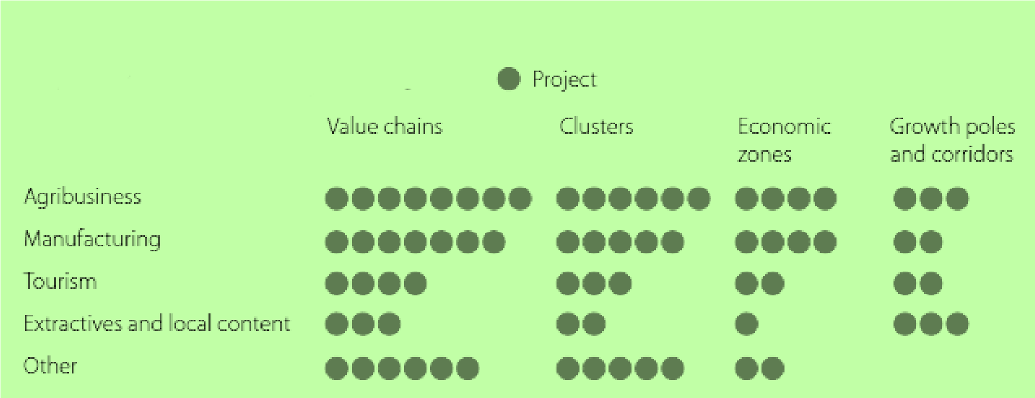

Illustration 1: CIIP project solution by sector (World Bank Group, 2014, p. 9)

The competitive industry approach used by the CIIP tries to increase companies' productivity and therefore attract new investments and increase their market share. The focus is on the support for basic needs of the private sector within an industry, which should increase growth, leverage financial input, increase institutional know-how and promote a growth friendly knowledge environment in order to strengthen the industry. The goal is to make industries more innovative and competitive, which leads to increasing private investment, generating jobs and creating spillover effects that foster the overall economic growth of a country. (CIIPb, 2015)

3 Industrial policies and job creation

3.1 Industrial policy – an overview

3.1.1 Definition of industrial policy and its relevance for economic development

As with a lot of expressions, there is no clear-cut definition for industrial policy in the academic literature. As Warwick points out in his 2013 publication "Beyond Industrial Policy: Emerging Issues and New Trends", one way of understanding industrial policy is to use it synonymously to industrialization policy. Others described it as manufacturing policy, while for others, it specifically means targeted sectorial policies (Warwick, 2013, p. 14). According to the European Commission, industrial policy does not only aim at sectorial interventions, but should also be horizontal in nature, meaning that the government should also provide favourable framework conditions for businesses to improve their competitiveness and productivity (Commission of the European Communities [EC], 2002, p. 3).

A commonly and widely used definition of industrial policy is the one provided by Pack and Saggi, defining it as "any type of selective intervention or government policy that attempts to alter the structure of production towards sectors that are expected to offer better prospects for economic growth than would occur in the absence of such intervention" (Pack and Saggi, 2006, p. 2). To make the definition more inclusive, Warwick modified it to "Industrial policy is any type of government intervention or government policy that attempts to improve the business environment or to alter the structure of economic activity towards sectors, technologies or tasks that are expected to offer better prospects for economic growth or societal welfare than would occur in the absence of such intervention" (Warwick, 2013, p. 16). As the CIIP program is both including horizontal as well as more targeted sectorial interventions, Warwick's definition seems to be a reasonable basis for the purpose of this paper.

Industrial policy is back in fashion as various examples from both developing and developed countries confirm. Besides the emerging nations like Brazil, China or India, where state-led development has been already taken place for decades, industrialised countries like the UK, France, the United States, Japan or the European Union at large are more and more using industrial policies since the late 2000's to increase their economic growth. Reasons for this are manifold: The economic crisis in 2008 and the economic downturn in the following years led to increased pressure on governments to reduce unemployment and to stimulate growth. Some economies also realized that their economies are imbalanced and want to diversify it through promoting certain key sectors (The Economist, 2010,). Another reason is that bail-outs of certain sectors during the financial crisis (e.g. banking, real estate) triggered requests and expectations for state support from other sectors of the economy as well, in combination with an increased doubt that the market mechanisms are able to channel investments into the "right" sectors of the economy (Warwick, 2013, p. 10).

In the case of developing countries (which are especially relevant for this paper) a reason for the revival of industrial policies around the globe is the insight gained in the recent past by the development sector that strategic industrial policy and Business Environment Reform can after all be compatible with each other, despite the common belief so far that one has to either choose one or the other to be successful. As a lot of donor countries have focused on market-based approaches to development with the objective of removing obstacles to doing business, industrial policies have been left out by most of them. The Donor Committee for Enterprise Development (DCED) however came to the conclusion that even vertical (e.g. sector/industry/firm-specific interventions) can successfully be combined with business environment reform when carried out correctly, making the approach more attractive to donor countries (DCED, 2013, p. 20). In addition to this, Rick Rowden claims that the mere reduction of poverty does not have to lead to sustainable economic development. When donor countries do not support profound structural changes within the economy of a developing country during their development support, this country will forever rely on foreign aid, which cannot be considered as successful development (The Guardian, 2011).

3.1.2 Evolution of different rationales for industrial policy

Before going into more detail into the different types of industrial policies and the various measures they can contain, the different rationales under which industrial policies have been carried out in the past will quickly be presented. This demonstrates that industrial policy is very often strongly influenced by the political and economic circumstances of a certain time as well as the ideology that has dominated the thinking of people in the political as well as the business world.

Laissez-faire approach: This view reflects the liberal thinking that there is no need for an active industrial policy, especially not a vertical/targeted one. According to this theory, the state should only focus on providing the framework conditions (Warwick, 2013, p. 19). Not interfering into the economy at all can therefore be considered an industrial policy as well. The United States can serve as an example for such an approach throughout most of the 20th century, especially in the 1980's and 1990's under the Washington Consensus. It is important to mention that even states following such a laissez-faire industrial policy are never doing it in its purest form, also the U.S. government has intervened quite heavily into multiple sectors, for example agriculture.

Traditional approach: Traditional approaches of industrial policy are the most direct way of state intervention into the national economy through production subsidies or other forms of state aid to stimulate certain sectors of the economy. Those approaches have often focused on the manufacturing industry because of its linkages with other industries, knowledge spill overs due to large research and development (R&D) investments and dynamic economies of scale. Those direct interventions became more and more unpopular as it often lead to rent-seeking behaviour of certain economic actors and to an inefficient allocation of public resources (Warwick, 2013, pp. 19-20). Baldwin and Robert-Nicoud also claim that governments very often support ailing industries as those companies have most to lose and therefore lobby the hardest, which again leads to an inefficient allocation of public resources (Baldwin and Robert-Nicoud, 2007, pp. 1088-1089).

Neoclassical/market failure approach: This approach is the recognition that public action is needed to correct market failures (e.g. externalities, market power or capital market failures) and that certain public goods have to be provided by the government (Warwick, 2013, p. 20). While the market failure approach has helped to target policy on certain critical weaknesses in developing countries (e.g. provision of education, infrastructure or risk capital), it also restricts the policy discussion to a narrow range of situations and government's role in industrial promotion is cast more or less as a residual activity (United Nations Conference on Trade and Development, 2007, p. 3).

Endogenous/New Growth theory: This approach is considered a dynamic extension of the neoclassical approach. It emphasizes the positive externalities of associated with R&D and that growth is emerging from technological advances. The New Growth theories have often been used to justify interventions to encourage investment, especially in R&D and education/training (Sharp, 2001, p. 2). The theory of productive capabilities (e.g. personal and collective skills, productive knowledge, etc.) can also be seen as closely related to new growth theories, as proposed among others by Andreoni (Andreoni, 2012, pp. 1 f.).

Systems-based approach: This approach is based on elements of Schumpeterian, evolutionist and institutionalist thinking. The industrial policy of the government, according to this theory, should be to overcome coordination problems between different actors within the economy of a country. Examples for this are that the lack of coordination might hinder the industrial development of countries as coordination between different actors is necessary for large-scale investments with high initial fixed or sunk costs (Warwick, 2013, p. 22). Another example would be a case where economic actors get locked-in to an old standard when it would be in their joint best interests to switch to a new and better standard. Switching to such a new standard also requires a high degree of coordination, which is beyond the powers of companies (Swann, 2010, p. 12). In both examples, an appropriate industrial policy by the state could facilitate this coordination effort.

3.1.3 Overview of different types of industrial policies

In this sub-chapter, the different elements that an industrial policy can contain are very briefly presented in form of a table (presented in the next page) due to the limited scope of this paper. In chapter 4.2, some of these measures will be discussed in more detail as they are especially suitable for large-scale job creation and are therefore already used within the CIIP program or would be recommendable to use in the program.

Domain	Horizontal policies	Selective (vertical) policies
Product Markets	· Competition and anti-trust · Indirect tax · Product market regulation · Exchange rate policy	· National Champions · Nationalisation/privatisation · Output subsidies/state aids · Export promotion · Price regulation · Public procurement · Trade policy · Car scrappage
Labour and skills	· Skills and education policies · Training subsidies · Wage subsidies · Income and employment tax · Management advisory services · Labour market regulations	· Targeted skills policy · Apprenticeship policies · Sector-specific advisory services
Capital markets	· Loan guarantees · Corporate tax/capital allowances · Macro/financial stability · Financial market regulation · Promoting Foreign Direct Investments (FDIs)	· Strategic investment fund · Emergency loans · State investment bank · Inward investment promotion
Land	· Planning regulation · Land use planning	· Enterprise zones · Special Economic zones (SEZ) · Place-based clusters policy · Infrastructure
Technology	· R&D tax credit · Science budget · IPR Regime	· Green technology · Lead markets · Public procurement for innovation · Patent box · Selective technology funding · Centres of expertise
Systems/ institutions	· Entrepreneurship policies · Scenario planning · Distribution of information · Overall competitiveness strategy · SME (Small and Medium Enterprises) promotion · Inclusion of informal sector	· Indicative planning · Foresight initiatives · Identifying strategic sectors · Sectoral competitiveness strategy · Clusters policy · Value chain approach

Illustration 2: Overview over different measures in horizontal and vertical industrial policies (source: Warwick, 2013, p. 27, with own additions).

3.2 Measures leading to job creation within the industrial policies framework

In this chapter, some of the measures mentioned in the last sub-chapter will be discussed in more detail. In the opinion of the authors those measures are especially suitable to create jobs on a large scale in developing countries and have already been implemented in the industrial policies of many countries, both developing as well as developed ones. On top of that, a lot of the measures for large-scale job creation presented here have already been implemented or at least discussed within the framework of the CIIP project.

3.2.1 New legislation and regulatory reform to promote competitiveness

Establishing effective economic frames is a vital condition for market development and growth. In this context regulatory reforms are directed towards enhancing efficiency of a market, providing and supporting a favourable investment environment, fostering development of private sector and enabling economic growth (Kirkpatrick, 2014, p. 162). The economic growth in turn leads to creation of new jobs.

The term regulatory reform itself refers to a complex of measures directed towards improvement of the economic regulatory environment, which implies regulation policy, institutions and processes. Good economic regulation results in development of private sector and a market-lead growth (Kirkpatrick, 2014, p. 163).

As legislative and economic frameworks differ between countries, each reform is tailored in order to take into account the local conditions. Nevertheless, major tendencies of regulatory reforms worldwide could be identified. They include: downsizing the state by means of releasing certain economic functions from the direct management of the government, improvement of corporate governance of state enterprises and of the economic bureaucracy, and assigning to regulators a role of "market referees" (Pearson, 2007, p.718).

According to the DCED intervention in certain areas of state regulation can support the creation of a business environment that enables development of the private sector (Kirkpatrick, 2014, pp. 163-165). These areas are:

- The revision of policies and legislation, e.g. simplification of business regulation, promotion of competition and strengthening control over anti-competitive behaviour.
- The reduction of administrative and regulatory barriers for business, e.g. reform of enterprise registration and licensing.
- Enhancing capacities of relevant ministries, e.g. training of the personnel.
- The Review of tax collection and spending
- Improvement of public financial management and legal framework.

In order to identify the area in which regulatory reform could become a powerful instrument for stimulating the economic development, it is necessary to identify the country-specific economic bottle-necks, i.e. regulatory constraints, on the one hand and market failures, which arise of inappropriate regulations, on the other hand. There are numerous examples of regulatory reforms around the world, which aimed to reduce costs for business and enhance investment climate. But in case of developing countries the implementation of such reforms always met significant pitfalls due to resistance of local bureaucratic system. Hence, although regulatory reforms eased the burdens on businesses, their effect in developing countries was limited (WBG, 2011, pp.9-12). Nevertheless, there are successful examples of introduction of regulatory reforms in developed countries, like for example in British Columbia, a Canadian province: the sub-national tax and regulatory reform starting in 2001 reduced administrative burdens on business, achieved business growth and creation of new jobs (WBG, 2011, p.55-65).

There is empirical evidence of a correlation between the quality of regulation and economic performance. The policy needs to be applied carefully, as there are significant differences within economic and institutional settings between countries, such as national law, order, corruption, regulatory capture, etc. (Kirkpatrick, 2014, pp. 162-163). In this sense it is not possible to identify universal best practices, from which general policy recommendations can be derived.

3.2.2 Labour market institutions and policies

One area of regulation directly connected with job creation is the regulation of the labour market. There is strong empirical evidence for a correlation between labour market regulations and the rate of employment. In general, countries with more rigid labour market regulations experience higher unemployment rates, often especially among the youth (Djankov & Ramalho, 2009, pp. 10 f.; Feldmann, 2009, p.84). More flexible labour market regulations lead to higher aggregate employment (Kaplan, 2009, p. 91) and especially smaller firms benefit (Kaplan, 2009, p. 96).

Apart from the regulation of individual employment contracts the strength of trade unions (defined as proportion of workers organized in unions) has its impact on employment rates. Strong unions often go hand in hand with higher unemployment, except for cases when firms and unions bargain co-ordinately (Garibaldi & Mauro, 2000). According to Feldmann (2009, p. 82) more decentralized collective bargaining appears to have a favourable effect on the female unemployment rate.

Possible labour market related instruments range from the regulation of employment law (individual employment contract) to that of collective relations law (collective agreements, trade unions etc.) and social security law (Djankov & Ramalho, 2009, p. 4). In this context, Boeri, Helppie & Macis (2008) distinguish four major kinds of interventions into the labour market:

- introduction of minimum wages
- mandates benefits
- reduction of dismissal costs
- unemployment insurance

If labour market policies are to be applied in developing countries, special attention must be paid to the fact that the context, in which these policies take place, is quite different from that of developed countries: Often, developing countries are plagued with weak law enforcement, a large informal sector, underdeveloped capital markets and informal credit and insurance networks (Boeri et al., 2008, p. 3). All these circumstances might undermine the effectiveness of interventions into the labour market.

Many European countries recently embarked on labour market reforms. One successful example is Spain whose Government in 1997 enacted new legislation aiming at reducing temporary employment rates by reducing payroll taxes and dismissal costs for permanent contracts. In their study, Djankov and Ramalho (2009, pp. 3 f.) find that the reform increased the rate of young and older men employed on the basis of permanent contracts, and that it had positive effects on the transitions from unemployment and temporary employment into permanent employment.

3.2.3 Formalizing the informal sector

The term informal sector encompasses all economic activities, which generate part of GDP (Gross Domestic Product), but do not have an official registration (Fallah, 2014, p. 1), meaning that they are operating outside the existing system of state regulations (Nelson & Bruijn, 2005, p. 591).

In developing countries the informal sector is of great importance and in many cases the majority of jobs are informal (Fallah, 2014, p. 1). The main reason for this development is that acting in the formal sector, first of all, incurs costs, be it for the registration of a firm and taxes or costs arising out of social protection regulations, which are applied in the formal economy. Hence, acting in the informal sector allows businesses to evade these cost. For many of the poor in developing countries, the informal sector is therefore the only employment opportunity. Often they work in small-size or family businesses with low productivity, often connected with the violation of social protection and labour regulations (Fallah, 2014, pp. 1 f.).

Being stuck to the informal sector often hinders the growth of businesses. Transition from the informal into the formal economy offers firms the opportunity to grow, to increase their production, operations and thereby to create new jobs (Khamis, 2014, p. 1). Therefore, helping businesses to take the step into the formal sector can be an effective tool for the creation of employment in developing countries. In order to do so, it is necessary to change the cost-benefit balance (Khamis, 2014, p. 1) with a set of instruments that are directed towards the reduction of the costs of formalisation and increase the returns to formality (Fallah, 2014, p. 27).

There are a number of instruments that trigger the transition into the formal economy:

- Reforming the registration procedure for firms: reducing costs of registration, simplification of the procedure, access to the information, etc. (Khamis, 2014, p. 1).
- Providing firms with information on the benefits of registration (Khamis, 2014, p. 7).
- Adjustment of the taxation regime for SME’s (Fallah, 2014, pp. 27-30).
- Increasing the tax morale: anti-corruption measures and increasing the quality of public and civil services (increasing the share of public spending) (Fallah, 2014, pp. 27 ff.).
- Strengthening of law enforcement: through inspections of businesses (Khamis, 2014, p. 7).

One successful example of a policy targeted to the transition into the formal sector comes from the city of Brasilia which launched its "Integrated System for the Payment of Taxes and Social Security Contributions of Micro and Small Enterprises" (SIMPLES) in 1996. The scheme consisted of several elements such as reducing taxes and simplifying the tax system for micro and small enterprises. Empirical evidence suggests that the program had a significant effect on the formalization, on the economic performance of firms and on increasing the number of employment (Khamis, 2014, pp. 4f.).

3.2.4 Promotion/strengthening of small and medium enterprises

Small and medium enterprises (SME’s) account for over 60 % of GDP and over 70 % of total employment in low-income countries, while they contribute over 95 % of total employment and about 70 % of GDP in middle-income countries (OECD, 2004, p. 11). It is therefore quite obvious that supporting SMEs in those countries will most likely have a considerable effect on the economic development of a country as well as on the reduction of poverty.

In a first step, SME development programs have to be integrated into the overall national development strategy of a country to make sure that it is considered as relevant enough in the development process. Before more specific measures can be taken into consideration, it is important to first develop the regulatory and infrastructural framework conditions for SMEs.

Very often, the growth potential of SMEs is limited through complicated bureaucratic procedures and the lack of infrastructure to effectively access national and international markets (OECD, 2004, p. 14-18).

Once those basic requirements are given, governments and donor countries should tackle the challenge of the lack of access to finance that many SMEs face in a lot of developing countries because they are considered by creditors and investors as high risk borrowers due to insufficient assets and low capitalization, vulnerability to market fluctuations and high mortality rates. Investing small amounts into SMEs is also very often considered to be not profitable enough (OECD, 2004, p. 23). Taking the example of Columbia, 68 % of SMEs in the country indicated that the lack of access to capital is their primary problem in becoming more successful (Rondinelli and Kasarda, 1991, p. 261). This lack of access to finance can be fought by providing subsidized loans and grants to all types of SMEs, providing loan and exchange guarantees for exporting SMEs, providing grants for quality improvement or by introducing specialised banks for SMEs. Linking up SMEs with venture capital investors is a viable alternative to financing through loans, as investors are often directly involved in the management of the company to assure its success. In developing countries, microfinance schemes are also an important source of financing for SMEs.

Another way of developing SMEs are the creation of Business Development Services specifically tailored for SMEs. Those services include training, consultancy and advisory services, marketing assistance, information, technology development and transfers, and business link promotion (OECD, 2004, p. 31). Experience showed that this should best be provided using a market mechanism with private providers involved, while having the public sector and donor countries only involved by financing such programs.
It is also important to recognise the importance of women entrepreneurship in developing countries, as they contribute significantly to income generation and poverty reduction in the given society. For this, the legal, regulatory and administrative frameworks, which are largely gender-biased in a lot of countries, have to be reviewed to make women's participation in the economy easier (OECD, 2004, p. 6).

Successful examples from developing countries in the area of financing SMEs are the investment of the Venture Capital Funds in Africa Precisioair in Tanzania, which contributed largely to Tanzania's tourism boom, or *KUPEDES*, Indonesia's Model Small Credit Program, which helps village banks to transform into self-sustaining full-service financial units to make them able to provide credit to small borrowers (OECD, 2004, p. 24). A good example for the importance of Business Development Services can be found in Swisscontact's evaluation to micro and small enterprises (MSEs) in Tanzania (Swisscontact, 2001, pp. 47 ff.).

3.2.5 Value chain development approach

Value chain development aims at creating a positive or desirable change in a value chain to extend or improve productive operations and generate social benefits. Results of such efforts could be poverty reduction, income and employment generation, economic growth, environmental performance, gender equity and other development goals (United Nations Industrial Development Organization [UNIDO], 2011, p. 1). Value chain development interventions can vary quite considerably. Interventions can focus on improving business operations of an actor in the value chain (e.g. producer, processor, service provider, etc.) or the improvement of relations as well as the flow of knowledge, information and innovation between them to make all firms in the chain more productive.

Value chain development interventions can also foster the overall coordination of the value chain, the participation of the value chain (or certain actors of it) in other local, national or global value chains as well as the removal of entry barriers for new actors into the chain. Another goal of value chain development is to improve the share of value addition for certain actors in the chain, which is very often unevenly distributed and results in dominating power for certain actors (e.g. multinational processing companies) and the marginalization of others (e.g. the small-scale farmer producing the raw product). In addition to this, value chain development often tries to strengthen the weakest link in the value chain to address a possible bottleneck in it (International Labour Organization [ILO], 2011, p. 3).

In developing countries, working together with the lead firms within a value chain is considered the most promising and very often only realistic approach in value chain development. Given those companies bargaining power and their coordinating role in the chain, they are the most suitable starting point in the value chain to make any kind of change happening (ILO, 2011, p. 4). It is also important to not only look at the vertical linkages within a value chain (e.g. producer → processor → seller → service provider) but also at the horizontal linkages (e.g. between the different producers on the same level of the value chain), so that those actors can organize themselves and increase their bargaining power.

An example for a value chain development initiative is the "Agricultural Development and Value Chain Enhancement II (ADVANCE II) project implemented by ACDI VOCA in Ghana, where smallholder farmers are linked to markets, finance, inputs, equipment and information through larger commercial farmers and traders who have the capacity to invest in these chains (ACDI VOCA, 2014, Project Profile). Another example is the Cassava Value Chain Development Project by Common Fund of Commodities in Sierra Leone, where the focus lies on improving the productivity as well as the income of farmers, processors and local marketers involved in the value chain for Cassava (Maniok) (Sierra Leone Agricultural Research Institute/National Agricultural Research Centre, 2011, pp. 2 f.).

3.2.6 Promotion of foreign direct investments

There is a lot of evidence and a common acceptance in the international community of the fact that Foreign Direct Investments (FDIs) are a key ingredient to sustainable economic growth. Beyond the financing aspect of it, FDIs are often responsible for fast cross-border transfer of knowledge and best practices in doing business and it also proofed to be more stable than other forms of investments during a financial crisis and to bring a country back on track regarding economic growth (Sun, 2002, p. 1).

The pre-condition for the successful promotion of foreign direct investment is a favourable regulatory environment for investments from abroad as well as an adequate physical and social infrastructure within the country. From that point onward, the following main instruments are available to a country to promote FDIs from abroad:

- *Set-up of an Investment Promotion Agency (IPA)*: The role of an IPA can vary considerably, from being a mere information kiosk for foreign direct investors to being solely responsible for the relations with foreign investors, mediating between investors and various government ministries, or even directly negotiating incentives with foreign Multi-National Corporations (Zanatta et al., 2006, p. 6). In the second case, the IPA would serve as a “one-stop shop” where the investor can process everything at once without running back and forth to other government institutions (Morisset & Neso, 2002, p. 12).
- *Fiscal and financial incentives*: Governments can offer tax reliefs to foreign companies to increase the attractiveness for them to invest, like low income taxes, tax holidays, investment tax allowances and tax heavens or Export Processing Zones (Sun, 2002, p. 17). In addition, governments can allow foreign companies accelerated depreciation of their assets or exemptions from selected indirect taxes (Morisset and Neso, 2002, p. 13).
- *Investment Codes*: An investment code is an additional instrument to promote FDIs and has a large advantage for both the government and the foreign investor: The government can sum up its investment regulations in one legal document instead of creating multiple ones, and the investor can find all necessary information within one single document. The code should guarantee investors certain rights, like not being discriminated by the host state, that they will be able to transfer profits and dividends swiftly and that the foreign company will not be expropriated without appropriate compensation (Sun, 2002, p. 15-17).

A successful example for the promotion of foreign direct investments is India's "Foreign Investment Promotion Board", which is the only agency in the country dealing with FDIs in India (Foreign Investment Promotion Board [FIPB], n.d., About Us). It serves as a one-stop shop for foreign investors and is responsible for a considerable inflow of FDIs over the last two decades and was able to contribute significantly to the boost of India's economy during this time.

3.2.7 Industrial clusters

Clusters are defined as '*groups of companies and institutions co-located in a specific geographic region and linked by interdependencies in providing a related group of products and/or services*' and have three distinctive characteristics (geography, value creation, business environment) (Ketels & Memedovic, 2008, p. 378). The benefits of clusters are brought about by the enhanced productivity resulting from the combination of specialised knowledge, skills, infrastructure and supporting in one location. Cooperation of the companies in a cluster allows them to benefit from shared supplier relations, common labour market, knowledge spill-over etc. (Ketels & Memedovic, 2008, p. 378). Hence, possible modes of cooperation within a cluster are: between firms, between firms and supporting institutions, between private sector and public sector (Meyer-Stamer, 2002, p. 3).

Empirical evidences point out an impact of clusters on performance of firms, country´s competitiveness and economic development that in turn implies creation of new jobs (Rocha, 2004, pp. 365, 368).

The concept of cluster is not new. Hence, in the course of time, different configurations of clusters emerged. It is possible to distinguish the following types (Rocha, 2004, p. 369):

- a cluster as an accumulation of firms offering the same production,
- a cluster consisting of interrelated industries,
- network of firms and related institutions,
- a cluster of firms sharing the same technology.

Thus, while in developed countries, clusters do usually form spontaneously, their formation is often less advanced in developing countries. One reason is that supporting services which are a necessary for the formation of clusters are not sufficiently available. Also, companies in developing countries often compete by relying on cheap labour or abundant local natural resources while importing advanced goods such as machinery and technology (Ketels & Memedovic, 2008, p. 379). In other words, companies do not rely on cooperation for the production of their goods and services. Thus, the formation of clusters often requires some external policy intervention.

Clusters are an interesting target of policy interventions, as they go hand in hand or enhance the effectiveness of other policy measures, such as attracting FDI, formation of SEZ, skills-related programs or support for SME (Ketels & Memedovic, 2008, p. 389).

3.2.8 Special economic zones

The creation of Special Economic Zones is considered to be a powerful instrument for job creation. The term SEZ usually refers to a geographical area within a country, in which fiscal regime, administrative law, and applied regulations are different of those in the rest of the country. The general objective is to attract investment by providing a more liberal regulatory framework in particular regarding taxation, investment conditions and international trade (Woolfrey, 2013 p. 2).

In practice it is possible to distinguish different types of SEZ (Woolfrey, 2013, p. 3):

- *Free Trade Zones (FTZ)*: relatively small zones that are situated outside the customs of the host country. FTZ provide the possibility for duty-free import; include trade activity and light processing operations.
- *Export Processing Zones (EPZ):* like FTZ the EPZ is also situated outside the customs territory of the country. Unlike in FTZ the focus lies on the production of industrial goods destined for the export.
- *Free Enterprise*: is a separate enterprise that benefits from special incentives being not located in a specially designated area.
- *Freeports*: are the largest forms of SEZ. They may include entire economic regions, allow residence and all types of economic activities and usually benefit from a wide range of incentives.

SEZ might generate jobs in three different ways (Aggarwal, 2007, pp. 2-3):

- Direct employment for unskilled and skilled workers that are engaged in labour intensive activities and infrastructure within the zone.
- Indirect employment, i.e. in other sectors of the economy related to the SEZ such as transport and communication.
- Employment for women. Evidences confirm that the female labour force prevails in SEZ. In spite of low wages these jobs are an important source of income for women from rural and poor backgrounds.

Many developing countries have applied SEZ, in particular EPZ, as a part of their industrial policies. They are considered to be key not only in promoting exports but also in creating further economic benefits such as technology transfer and employment generation. One example of a successful creation of a SEZ is the garment sector in Bangladesh. Due to effective regulations and settings of incentives the SEZ attracted substantial FDI that stimulated domestic investors. In the year 2009, the SEZ accounted for a large share of country's investments and exports and offered 200’000 jobs (Shakir & Farole, 2011, p. 25).

However, the beneficial effects of EPZ on the economic development of a country are not uncontested. There are a number of studies that suggest that the standards ensuring a sustainable human development such as labour laws and health standards are often ignored (Aggarwal, 2007, p. 1). Therefore, if considering SEZ (and EPZ in particular) as a possible target for policy measures, special attention must be paid to ensuring that the SEZ indeed contributes to a sustainable development.

4 Case study: Tunisia

In this chapter Tunisia's development will be elucidated. First, the history and the current political context will be examined in order to understand the current situation in Tunisia. In the following the economic situation will be analyzed with specific focus on the industries and on the impact of foreign aid on the economy.

This summary is necessary because Tunisia's history explains several feature of its current society and economy. The legacy of its past civilizations is an important capital to tourism. Further, it explains the Arab and Muslim but also the French identity.

4.1 History

Until 1956 Tunisia was a colony and enjoyed only limited sovereignty. The society, however, is not new (Charrad, 2001, p. 17). It is a land of old civilizations: it was seat of the Carthaginian Empire followed by the Roman Empire, through which Tunisia became Latinized. In the 16th century it became part of the Ottoman Empire. In the 18th century the Husseinite dynasty of the local Beys took over to govern and reign Tunisia, unifying the country and defining the present boarders. During the ruling of the Beys, Tunisias foreign debt grew increasingly, which it was unable to repay. It therefore lost gradually its sovereignty which was the first step towards the Protectorate imposed by France in 1881 (Morrison et al., 1996, p. 20 f.).

During the nationalist struggle conflicts involving tribe based solidarities became violent outbreaks which were followed by its independence in 1956. The conflicts ended with the defeat of tribal-based coalitions (Charrad, 2001, p. 26). In 1957, one year after its independence, the new state of Tunisia became a republic with a presidential system. The constitution declared Tunisia as an Arabic-speaking country with Muslim religion, guaranteed the citizens fundamental rights, introduced the separation of powers while endowing the president with considerable power (Morrison et al., 1996, p. 21). The power distribution was in favor of national leaders that were interested in reducing political weight of social groups attached to tribes. This gave Tunisia a good opportunity to achieve autonomy from tribal groupings (Charrad, 2001, p. 26).

With the achievement of independence, the modern state challenged the authority of traditional structures and social control. These authoritative institutions were of two types: on the one side there was the tribe and on the other hand the Islamic community. Tribes were the basic community in the entire Maghreb region and it affected the society as a whole. Therefore, "tribal origins do not belong to a forgotten past" (Charrad, 2001, p.21) of Tunisia and go well into the 20th century especially in the rural areas. Further, Islamic law regulated life in Tunisia (Charrad, 2001, p. 26).

4.2 Recent Politics

4.2.1 Zine Ben Ali's regime

In 1987 Zine al Abidine Ben Ali assumed the presidency of Tunisia. He was the successor of Habib Bourguiba, which had been the president since Tunisia's independence from France in 1956. Zine Ben Ali removed Bourguida by placing him under house arrest. The change of government did not bring many violent reactions from the population. The United States government supported his presidency and increased funds for assistance to Tunisia in 1990 believing that Zine Ben Ali was revitalizing Tunisia and sparing it from difficulties. In the following years his government proceeded harshly against extremist groups and terrorism by using police action and sending their leaders into exile. In 1994 Zine Ben Ali was re-elected president (Encyclopaedia of World Biography). During his presidency Zine Ben Ali was specifically worried about two groups who could overthrow him: the military and the Islamists (Klaas, 2013). This led to the description of Tunisia as an island of secularism (McCarthy, 2015). In order to eliminate his potential rivals his government invented a conspiracy about a coup plot from the military, which supposedly worked with the Islamists. It is known as the "Barraket Essahel Affair", which took place in May of 1991. It was put as a coup attempt and as a victory of the Tunisian government over extremists groups and an uprising military with no evidence and with confessions of militaries under torture. Zine Ben Ali further ensured that the military stayed weak and incompetent and therefore ensuring the incapacity of the military to launch a coup d'état. This weakening of the military has consequences for the actual transition of Tunisia according to Klaas: "the weak military is] equally incapable of keeping Tunisians safe during today's tumultuous transition" (2013). Ben Ali's government restricted free expression and other political parties. Further, he manipulated Tunisia's image and facade as a modern, technocratic and tourist-friendly regime and travel destination (Anderson, 2011, p. 3).

4.2.2 The Arab Spring

The lighting up of a vegetable vendor in December 17th 2010 can be seen as the trigger for the protests against Ben Ali's regime (Klaas, 2013). The hopelessness of his economic situation and humiliation from the local authorities led the young Tunisian to this act of desperation (Rosiny, 2011, p. 2). What seemed to be only a protest against the local labour market situation developed quickly into a nationwide revolt against the authoritarian government of Ben Ali. This marked the beginning of the revolution and political change the Arab world knows as the Arab Spring. The so called '*Freedom and Dignity*'[1] (Arab: thawrat al-karãma) was supported

[1] Also referred to as 'Jasmine Revolution' in the media.

by a critical mass of young and educated citizens, which organized themselves through online communities such as Facebook and Twitter. But also the labour union “Union Générale Tunisienne du Travail” played an important role in the mobilization of the citizens (Preysing, 2013, p. 44) This demonstrated the power of the country’s labour movement (Anderson, 2011, p. 4). The growing movement demanded Zine Ben Ali to resign and to end nepotism. He tried to convince the citizens that he will reform the country, promising absolute freedom of the press and announcing that he will not candidate for another term in office among other reforms. But on January 14th 2011, a little over a month after the protest started, Zine Ben Ali fled Tunisia (Preysing, p.3, 2013). The fall of Zine Ben Ali’s regime happened relatively quickly compared to others and is responsible for only few victims (Preysing, 2013, p. 45).

4.2.3 Transition to democracy

The scale of corruption at the level of the elite was high but Zine Ben Ali's government did not depend on the accumulation of small bribes that undermined other bureaucracies in the region, for example Libya and Egypt. Tunisia’s public institutions were relatively healthy, offering good prospects for an efficient and technocratic government to replace Zine Ben Ali (Anderson, 2011, p. 3). But still, removing Zine Ben Ali from his presidency left all the institutions from his government behind. That is the reason why the first government after the fall of his regime established by the Prime Minister Mohamed Ghannouchi was similar to Zine Ben Ali’s regime Zine Ben Ali’s authorities were still holding on to major government posts, which led again to protests among the citizenry. Few days later, on January 27th 2011, these protests led to a second transitional government without some loyalists of Zine Ben Ali. On February 11th, the opposition, under great approval of the citizenry, built a national assembly in order to protect the revolution, which eventually led to the resignation of Mohamed Ghannouchi on February 27th. Benji Caïd Essebsi replaced him, a 84 year old who was minister under Habib Bourguiba before Zine Ben Ali’s regime. He had the difficult task to consolidate new and old political forces in order to ensure governability and at the same time demonstrate a clear cut from Zine Ben Ali’s regime. In the beginning of March he called the citizens to vote in October for a new constituent assembly (L’Assemblée Nationale Constituante, ANC), which had the assignment to design a new constitution and therefore abolishing the one of 1959 (Preysing, 2013, p.50 ff.).

Essential for a successful transition to a democracy was the legitimacy of the election for the constituent assembly, which was managed according to Preysing through the involvement of not only political parties but also labour unions, associations of local groups, women and youth movements and even the Tunisian Diaspora (2013, p.53 ff.).

The first election in October 2011 was won by the Islamist Ennahda party, which had no experience in governing. With this regime change the victims of the Zine Ben Ali regime are freed and speaking up about the past and this demonstrates, according to the author Brian Klaas, that Ben Ali's legacy continues to cast a long shadow over the transition to democracy (2013). Already in January 2015 the Ennahada party was forced out of power, to a large extent due to its security failings. Today, Béji Caïd Essebsi is president (McCarthy, 2015) with El-Habib Saïd as Prime Mister since February 6th 2015 and four different parties holding different Ministries (Jamaoui, 2015).

The consequences of the Jihadi Salafist attacks in March of 2015 in Tunis need to be followed carefully, they may release a wave of violence and political crisis in this venerable phase of democratic consolidation (McCarthy, 2015).

In spite of several challenges, such as the Jihadi Salafist, the al-Qaeda or the weak military, Tunisia remains the best hope for democracy among the countries involved in the Arab Spring in northern Africa but it still has a long way ahead.

4.3 Economic Situation

This chapter sheds light on Tunisia's economic situation. It includes the overall performance as well as an overview of its main sectors and branches and regional differences. Furthermore, Tunisia's former and current industry policies will be presented and evaluated.

4.3.1 General economic performance

Scholars, Western state officials, international institutions and the private sector often regarded Tunisia as a role model in its regional context. It not only acted as a pioneer in the social and political sphere, but also in the economic context (Erdle, 2011, p. 3).

The economic growth Model pursued by Tunisia since its independence and prior to the revolution in 2011 mainly relied on three pillars. Firstly, it opted for a strong state guaranteed stability, which was accompanied by corruption and high costs in terms of civil and political liberties. Secondly, it relied on active education and social policy, a progressive role of women in society and infrastructure development. Lastly, the economy was opened for trade and FDI in certain sectors, but with a state as the ultimate decision making power (Paciello, 2011; Hibou, 2011; OECD, 2015b).

In the early 1960s, Tunisia's economy was dominated by the agricultural sector. But since the early 1970s the country has shifted its focus and oriented its economic model toward exports and industrialization. At the same time, the government invested in physical and human capital and introduced policies in order to attract FDI through a law that favors exporting firms (Trape et al, 2014, p.13).

In contrast to other countries in the region, Tunisia was not only determined to transform its economy towards industry and services, but has also adopted and implemented the necessary policies on the ground (Erdle, 2011, p.3). Furthermore, it was among the first countries of the Middle East and North Africa (MENA) region to collabourate with major international donors like the International Monetary Fund (IMF) and the World Bank (WB) by concluding an Economic Recovery and Structural Adjustment Program (ERSAP), to ratify multilateral free-trade regimes (GATT, WTO), and to participate in several trans-Mediterranean cooperation initiatives like the Euro-Mediterranean Partnership (EMP), the European Neighbourhood Policy (ENP) and the Union for the Mediterranean (UfM) (Erdle, 2011, p. 3). Tunisia has also progressively strengthened its relations with the European Union, its main industrial partner and main client. An agreement on a free-exchange zone between the two sides took effect in 2008 for industrial products (Trape et al, 2014, p. 13).

Nowadays, Tunisia is defined as a middle-income country with a GDP per capita of 4'317 USD in 2013 according to the World Bank Databank. The services (59.4% of GDP) and industry (31.2% of GDP) sectors account for almost 90 percent of Tunisia's GDP in 2013, but agriculture still plays an important role, as the export share in foreign trade of processed agricultural products such as olive oil is notable at 10.5% (Trape et al, 2014, p. 3). Tunisia is ranked 60th in the Doing Business report 2015 by the World Bank, better than the average of the MENA region (rank 106).

But besides its positive image, Tunisia's economy seems to perform below its capacity. Although Tunisia experienced strong economic growth prior to the revolution in 2011 and outperformed its regional peers from 1990 to 2010, Tunisia's growth performance was weaker than the growth rate of other upper middle-income countries (OECD, 2015, p. 20). Whereas Tunisia grew on average at about 3.5 % in real per capita terms during 2000 and 2010, the upper middle-income countries grew on average 1.5 times faster over this period of time (World Development Indicators WBI, in: World Bank, 2014, p. 36).

Over time, major problems have built up according to the OECD (2015b, p. 2) and the World Bank (2014, p. 42f): a rising unemployment rate, widening regional disparities, low productivity, a growing current account deficit, unreported public-sector liabilities, poor lending standards in the banking sector and an increased use of price controls are weakening Tunisia's growth prospects.

Tunisia's economic growth is expected to decrease in the forthcoming years relative to growth in the previous decades due to the above-mentioned structural problems. Furthermore, political insecurity – due to the political changes the revolution in 2011 brought about and the effects of the ongoing economic crisis in the euro zone – (Tunisia's main trading partner) might affect economic growth negatively.

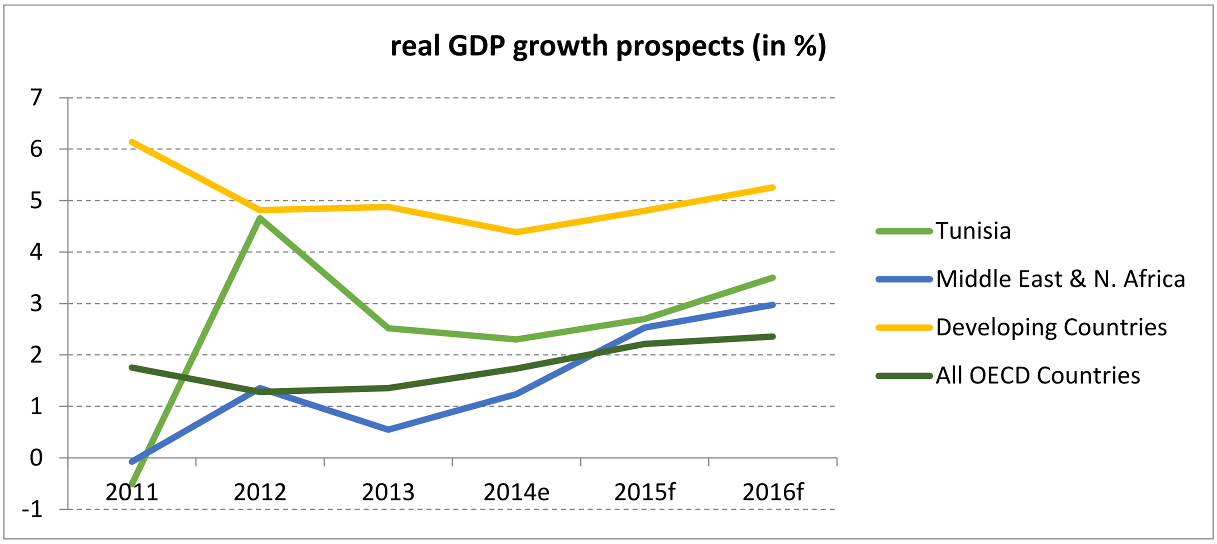

Illustration 3: World Bank, World Development Indicators, own illustration (source: World Bank, World Development Indicators, own illustration)

Labour market

A comparison among other countries reveals that Tunisia's working age population is younger than the average among OECD countries: over a quarter of Tunisia's working age population is between 15 and 24, whereas the average of all OECD countries is less than a fifth (OECD, 2015, p. 42-43).

Even though Tunisia's economy has been creating jobs for a growing labour force, there was still a net employment deficit of around 18'000 jobs per year between 2005 and 2010. Job creation mainly took place in low value-added sectors with a few exceptions like telecommunications and financial services. Sectors characterized by high informality rates such as construction, trade and non-financial services offer most of the jobs for low and semi-skilled workers (World Bank, 2014, p. 42). Most of the workers have fixed-term and short-term contracts, which results in high job mobility and, hence, insecurity (World Bank, 2014, pp.171-172). The reason for this is the rigidity of the labour market regulations, providing for high severance payment for wrongful dismissal (World Bank, 2014, pp.179-180).

The average unemployment rate is significantly higher than in most other emerging economies. Only Greece and Spain perform worse both in terms of employment and unemployment indicators amongst OECD countries (OECD, 2015, p. 43). In the wake of the global financial crisis and the revolution in 2011, conditions in the labour market deteriorated rapidly and stroke especially Tunisia's youth. The overall unemployment rate in the first quarter of 2014 stood at 15.2%, and the youth unemployment rate was particularly high (37.6%). Furthermore, men (12.7%) are less likely to be unemployed than women (21.5%), and also university graduates face challenges entering the labour market, as two in five female graduates and one in five male graduates are unemployed (OECD, 2015b, p. 28). According to the World Bank (2014, p. 38), the share of people with a tertiary education rose from 3.7% to 12.3% between 1990 and 2010, but many of these graduates could not be absorbed by the private sector, as it remained stuck in low productivity activities. As a result, the public sector had to step in and employed over 60% of the graduates by 2010 (World Bank, 2014, p.39). The reason for this can be attributed to mismatch between the educational system and the requirements of the private economy: e.g. Tunisian employers point out the inadequacy of technical and "soft skills" of Tunisian labour force. So there is an excessive supply of labour force in humanities and technical science, but shortage of specialist in telecommunication and financial services (World Bank, 2015, pp.173-175).

Another characteristic of the Tunisian labour market is geographical disparity. Geographically, unemployment is concentrated in the North West and the interior South of the country, whereas the unemployment level along the eastern coastal areas is significantly lower (World Bank, 2014, p. 39).

Productivity

An analysis by the World Bank (2014, p. 42 f.) shows that factor accumulation – labour contributing 35% and capital 36% to GDP growth – was the main driver of economic growth in Tunisia between 1990 and 2010. Improvements in Total Factor Productivity could only contribute by 22% to overall economic growth when controlling for human capital. Productivity improvements have therefore been very limited. But as pointed out in chapter 2 productivity and the following increase in FDI is one of the goals of the CIIP and will eventually contribute to job creation both in terms of quantity and quality.

As Hsieh and Klenow (2009) highlight, productivity rates in developing countries tend to differ not only across sectors, but even across companies. If large productivity gaps across sectors are prevailing, a reallocation of workers from low-productivity to high-productivity sectors could contribute to a boost in a country's growth rate, as shown by the successful rise of countries in Asia (World Bank, 2014, p. 44; McMillan & Rodrik, 2011).

As expected, Tunisia's economy is characterized by relatively large differences in productivity across sectors. Worth highlighting is the very small productivity gap between manufacturing and agriculture in Tunisia. Productivity in the agricultural sector is typically the lowest in most countries, but in Tunisia manufacturing is only slightly more productive than agriculture, and the textiles sector's productivity scores even below agriculture. This result is due to the fact that with few exceptions, Tunisia's manufacturing sector focuses on low value-added activities, generating low quality jobs (World Bank, 2014, p. 44).

With regards to labour productivity[2], Tunisia scores below most countries in MENA, emerging economies in the EU and also Asia. Average labour productivity growth between 2000 and 2010 was around 2.5% in Tunisia, whereas most comparable countries such as Jordan, Morocco, but also Bulgaria, Poland or Malaysia scored around 3-4% over the same period (World Bank, 2014, p. 44). The low value of this indicator reflects problems in Tunisia's production structure, where low value-added activities and low quality jobs remain dominant.

In 2009, around 77% of the workforce was employed in low-productivity sectors, including agriculture, textiles, most manufacturing sectors, commerce, public sector, construction and public infrastructure. Above-average productivity sectors like banking, transport and telecommunications could only employ 7.7% of Tunisia's workforce (World Bank, 2014, p. 45).

Furthermore, the World Bank's analysis (2014, p. 45 f.) also reveals that there has only been minimal reallocation of labour across sectors over time and it took mainly place from low-productivity agriculture to low-productivity manufacturing.

Most of the above mentioned labour productivity growth of 2.5% took place within sectors, contributing to 60% of real GDP growth per capita from 2000 to 2010. At the same time, structural change[3] contributed to only around 8% of real GDP growth per capita. These results have several implications: first, Tunisia's economy did not seem to have managed to reallocate resources from low value-added to high value-added activities. Second, it appears that the entire economy is still stuck in low-productivity activities and remains below its potential. Moreover, the expansion of the public sector distorts the value of productivity growth, implying that the increase in productivity is in fact partly only due to an increase in public expenditure. Additionally, a closer look at the particular sectors reveals that most of the sector level productivity increase took place in transport, telecommunications and commerce. But these sectors are characterized by barriers to entry, where only a few companies – mainly the ones favored by Ben Ali's clan – had the license to operate and could profit from the rents (World Bank, 2014, p. 48-51).

2 Calculated as growth of output per worker

3 defined as the reallocation of labour from low-productivity to high-productivity sectors

Exports

Tunisia has embraced an export-led growth strategy since the early 1970s, when a tax regime favoring exporting companies was established (World Bank, 2014, p. 50). At the end of the 1990s, Tunisia launched a national program for upgrading the industry, which enabled Tunisian industries to become more competitive in order to be better integrated into Global Value Chains (GVCs) (Trape et al, 2014, p. 13).

Trape et al. (2014, p. 13 f.) highlight two sectors in this regard. First, textile and clothing has been a major contributor to Tunisia's exports since the 1970s, although its importance seems to be declining due to increasing international competition, specifically from Asia. Still, in 2012 the textile sector accounted for 22% of exports. Second, more recently the electrical, engineering and electronics sector has grown significantly by an average annual growth rate of 18% between 2000 and 2012, contributing to more than 36% of Tunisia's exports in 2012. Furthermore, new information and communication technologies (ICT) have enabled the development of new service activities as well as a greater overall integration of Tunisia into GVCs, exemplified by the evolution of call centers and other forms of outsourcing like accounting services.

But this strategy also has its pitfalls. The incentives of the tax regime, which favors exporting firms, have created a tendency among Tunisian firms to divide themselves into two distinct entities, where one is dedicated to the home market and the other to an export strategy in order to profit from the tax regime (World Bank, 2014, p. 50). The so-called offshore-onshore dichotomy has a negative impact on the economy for several reasons, as the World Bank (2014, p. 50) points out. First of all, the dichotomy has weakened the dynamics between the domestic market and the export sector. The export industry could contribute to the development of a network of domestic suppliers and foster local innovation, but segmentation keeps the sector focusing on the home market stuck in low productivity and growth. Additionally, this segmentation has also a negative impact on the manufacturing sector, which is traditionally considered as a strong connector between sectors due to its strong backward and forward links, by weakening those links. Finally, the complex administrative procedures accompanied by the tax regime are prone to corruption.

Whiteshield Partners (2014, p. 20) identified Tunisia's solid and close partnership with the EU as its key competitive advantage. In 2013, the EU was both the main export destination (71.3% of exports) and also the main supplier (55.5% of imports) for Tunisia's economy (Trape et al., 2014, p. 6).

The majority of exporting enterprises are located closely to adequate infrastructure like ports and airports, which amplifies regional disparities and shows further limitations of the exports sector on the Tunisian economy. The impact is furthermore limited by the fact that the export sector is heavily involved in low value-added activities and has therefore mainly created jobs for unskilled personnel. Tunisian exports also import a significant portion of its inputs, although this varies according to the products involved, and the exports mainly consist of intermediary products (Trape et al., 2014, p. 14). Therefore, spill-over effects from the offshore-economy to the onshore-economy are limited.

Infrastructure

Compared to countries in the region, Tunisia's infrastructure is relatively strong. Basic services such as access to electricity and drinking water are available for 95% of Tunisian households. But with regard to trade and transport, Tunisia's infrastructure can be reinforced. Ports, railroads, roads and information technology have deteriorated recently, as the drop in the ranking of the World Bank's Logistics Performance Index from 60th to 118th between 2007 and 2014 suggests. Tunisia has experienced regional disparities in terms of its infrastructure development, favoring coastal regions and neglecting the hinterland. Also its connections with neighboring countries are relatively poor, exemplified by the delay of the construction of highways and railroads to Algeria and Libya. Moreover, some infrastructure has reached its capacity limits and requires upgrading, especially in the maritime sector (OECD, 2015b, p. 45).

According to Trape et al. (2014, p. 6 f.), Tunisia's trade performance is slightly better than in the entire MENA region, as it takes 13-17 days to export/import containers (compared to 20-24 days in the MENA region). Still, the deterioration of the infrastructure as well as the persistence of corruption in customs are criticized by the business community and diminish productivity (Trape et al., 2014, p. 7).

Thus, Tunisian companies are facing relatively high logistics costs. The equivalent of about 20% of GDP is spent on logistics costs, whereas the logistics costs as a share of GDP amount to less than 10% in some OECD countries (OECD, 2015b, p. 46).

Investment Climate

After the revolution in 2011, private investment levels were low and stagnating in Tunisia. Even before the revolution, private investment as a share of GDP decreased by 1.2 percentage points between 1990 and 2005, which makes Tunisia one of only three countries in the MENA region that experienced a decline in private investment (Kapstein et al., 2012, p. 7). Kaptstein et al. suspect that this negative trend even prior to the revolution and despite healthy rates of profit, reflects the concerns of the business community regarding the political climate.

Access to Finance

A well-established financial sector is essential, as its institutions have a large indirect impact on the economic performance of a country. Banks in Tunisia are providing for more than 90% of financial intermediation and are dominantly state-controlled, although there is also a significant number of private banks (OECD, 2015b, p. 23; World Bank, 2014, p. 201). Two institutions are mainly responsible for financing SMEs: the *Banque tunisienne de solidarité* for smaller loans and the *Banque de financement des petite et moyenne entreprises (PME)* for loans up to nearly 3 million USD (OECD, 2015b, p. 23).

There are some bottlenecks in the financial sector. Firstly, the banking sector has been suffering from cronyism and granted privileged access to finance for the cronies and people with the right connections (World Bank, 2015b, p. 206). Privileged access to credit can be illustrated with the tourism sector. Credit has been channeled to less productive entrepreneurs, most likely members of the ruling elite and their cronies, which has resulted in large debt (World Bank, 2014, p. 206).

Secondly, corporate governance of state-controlled banks is poor. This not only reflects cronyism, but also the drawbacks of the dominant role of the state. It is regulator, lender and consumer at the same time. As a result of these conflicting roles, state-controlled banks are less competitive than its private equivalents and have so far felt no serious pressure to improve their performance and governance (World Bank, 2014, p. 209).

Thirdly, access to credit is especially problematic for SMEs. The requirements for SMEs to get access to credit indirectly discriminate young entrepreneurs and start-ups, for example entrepreneurs have to put up 10% of the investment they applied for at the *Banque tunisienne de solidarité*. And the microfinance market as a potential alternative financing source not only for start-ups, but also for the entire informal sector, is still under-developed, although a new Microfinance Law passed in 2011, the creation of a supervisory body as well as an increase in the number of microfinance institutions might improve the situation (OECD, 2015b, p. 23 f.).

Fourthly, an overly long and sometimes duplicate bankruptcy process allows inefficient and crony firms to survive, even though restructuring or exit would make Tunisia's economy more efficient (World Bank, 2014, p. 2010). Instead, defaulters continue with their business and take away market shares of more competitive businesses.

Fourthly, bank lending as well as profitability is weak. Tunisia is lagging behind in terms of access to credit information compared to other countries and is suffering from high costs of intermediation (OECD, 2015b, p. 24). As a result, banks only lend to well-known customers. The lack of private credit bureaus, which are usually designed to collect and compile data on payment incidents as well as accumulated debts by (future) creditors, excludes young entrepreneurs or start-ups and agents from underserved regions from getting access to credit (World Bank, 2014, p. 2011).

4.3.2 Tunisia's industrial policies

The Strategic Social and Economic Development Plan 2012-2016 aims not only at upgrading its historical industrial sectors, including textiles and agro-food, but also at fostering the development of new and promising sectors such as electronics, aeronautics, pharmaceuticals, automotive and especially ICT (Whiteshield Partners, 2014, p. 26; Republic of Tunisia, 2011).

In 2008, the Tunisian government adopted a new strategy called *National Industrial Strategy for the years leading up to 2016* (in the following referred to as Horizon 2016) by the Ministry of Industry, Energy and SMEs in order to move toward higher-value added production and a knowledge-intense economy (Republic of Tunisia, 2009, p. 23).

The strategy has set four main objectives (Republic of Tunisia, 2009, p. 21). Firstly, it is gearing towards a doubling of exports and a tripling of investment in industry between 2008 and 2016. Secondly, it wants to shift Tunisia's industry from low value-added activities towards more complex ones. Thirdly, a diversification strategy is expected to help establish a balanced portfolio of activities for Tunisia, with stronger high value-added sectors complementing its traditional sectors. Lastly, new activities based on cross-overs between various sectors should be promoted.

In order to achieve its goals, the Ministry of Industry, Energy and SMEs (Republic of Tunisia, 2009, p. 23) wants to capitalize on the success of Tunisia's near shore production model for mainly European markets and promote foreign trade. It wants to foster innovation and position Tunisia as a platform for trade by setting up a hub integrated in the regional or global value chain. Furthermore, it wants to strive after knowledge-intensive, high added-value activities (Whiteshield Partners, 2014, p. 26).

From a vertical industrial policy perspective, the government has decided to focus on three main pillars of the traditional Tunisian industry: textiles, agro-food and mechanical, electrical and electronic industries. 76% of industrial companies, 87% of exports, almost 62% of FDI-inflows and 83% of all jobs are generated by these three sectors. Furthermore, ICT and Business Process Outsourcing (BPO) were added to the national industrial strategy as they are attributed to high potential. (Republic of Tunisia, 2009, p.5)

Although the focus lies on these three pillars, Tunisia's Industrial Strategy involves more branches, as the overall strategy is broken down into 12 target branches. Services to industry include ICT, BPO, logistic services and other services. From the emerging sectors the electronic industry, automotive and aeronautical industry, technical plastics and pharmaceutical and biotech industry are targeted. Furthermore, traditional sectors such as agro-food, textiles, the chemical industry and the mechanical and electrical industry are taken into account. The government also intends to promote various cross-overs between these branches. Overall, Tunisia's economy is expected to move to more complex activities, illustrated by the projected contribution to industrial exports: by 2016, emerging industries and services to industries are expected to have an equal share in exports compared to a ratio of 1:3 in 2006 (Republic of Tunisia, 2009, p. 24).

The export-oriented industries have been facing strong international competition from low labour cost countries in South-East Asia or Eastern Europe. In order to raise competitiveness and boost innovation of all export-oriented industries, including sectors such as textiles or electric and electronic industries, the government has introduced several instruments to support the private sector in these sectors mainly in three areas: R&D, innovation incentives to increase cooperation between the private sector and research centers and the creation of clusters/ techno poles (Whiteshield Partners, 2014, p. 26). In 2009, Tunisia has invested about 1.25% of GDP in R&D, a share slightly under the MENA average (World Bank, 2014, p. 2012). According to the World Bank (2014, p. 212), these government expenditures are channeled through various institutions; sectoral technical centers/ techno poles, research centers and several government agencies[4] and the capital risk companies. Additionally, various public programs[5] were launched to provide incentives for innovation, including upgrading and industrial modernization programs aimed at supporting investment in new technology and improving the organizational capacity of firms.

The entire offshore industry has been stimulated for decades and the government continues to do so. The Investment Incentives Code from 1993 aims at strengthening the offshore regime by granting firms engaged wholly in export several advantages[6]. As outlined in the previous section, this strategy has supported Tunisia's economic growth for several years, but seems to be increasingly inefficient, resulting in an onshore/offshore dichotomy (World Bank, 2014; Whiteshield Partners, 2014; Trape et al., 2014)

[4] Agency for the promotion of research, innovation and firm creation; agency for industrial promotion; agency for agricultural investment promotion

[5] Prime d'Investissement en Rechereche et Développement; Programme National de Recherche Intégrée; Programme de Valorisation des Résultats de la Recherche; Régime d'Incitation dans le Domaine des Technologies de l'information

[6] The Investment Incentives Code for fully-exporting companies includes advantageous taxation, ease of capital movement, ease of doing business, minimum requirements for opening business. For a full overview, see: Foreign Investment Promotion Agency: http://www.investintunisia.tn/site/en/article.php?id_article=789

The ICT sector received special attention within Tunisia's Industrial strategy. According to the Global Information Technology Report 2014 issued by the World Economic Forum (2014), Tunisia still ranks 87th and leads the ranking in North Africa[7], although its position has deteriorated (in 2012, Tunisia was ranked 50th). A number of policies have been outlined to boost growth in the sector, including the modernization of the digital infrastructure, support of the private sector, development of human capital by reforming education policies and supporting education and training opportunities within the ICT sector (Whiteshield Partners, 2014, p. 27).

The pharmaceutical as well as the automotive sector were identified as "infant industries" by Whiteshield Partners (2014, p. 27). In other words, the Tunisian government pursued a protectionist strategy in the past by having implemented import restrictions on passenger cars or pharmaceuticals. The governmental Pharmacy Centre controls all pharmaceutical imports and - until 2006 - had the option to ban the import of a foreign drug similar to the domestically produced one upon request from a domestic pharmaceutical manufacturer. Although the system was dismissed in 2006 by a decree, this decree has no retroactive effect, therefore several firms are still profiting from bans imposed prior to 2006. (Whiteshield Partners, 2014, p. 27 f.)

According to the World Bank (2014, p. 234f), Tunisia has not been able to achieve its goals set in its different industrial policies so far. The target of moving toward higher value added production and a knowledge-intensive economy could not be reached. A review by the World Bank (2010) revealed, that there are several inefficiencies in R&D and innovation financing and incentives. R&D spending is allocated to many different actors without any clear criteria and no alignment to performance indicators. The many different programs sometimes overlap, which creates waste and inefficiencies. At the same time, there is a lack of collaboration between the private sector and institutions receiving funds like research centers, due to firstly a limited demand from the private sector because of its specialization in low value-added activities, further a mismatch between demand and supply of public research and thirdly a very complex bureaucracy.

Overall, the industrial strategy neglects addressing some of the major obstacles to private sector development such as barriers to competitive pressures, excessive regulatory burden, corruption and policy-induced distortions (World Bank, 2014, p. 234). Moreover, instead of providing sector-wide support, some of the programs and instruments have been distortionary because they support only selected firms. Abundant duplication and overlap of programs are additional problems. But most importantly, Tunisia's focus on promoting specific sectors has proved problematic. Cross-cutting reforms and solutions for coordination failures receive too

[7] Egypt ranking 91th, Morocco ranking 99th, Algeria ranking 129th, Lybia ranking 138th

little attention, although empirical evidence suggests that reforms in the business climate, better access to finance, increasing provision of public goods and addressing coordination failures boost investment (World Bank, 2014, p. 234 f.).

As a result of the analysis conducted by the CIIP (see chapter 3.4 CIIP in Tunisia), Tunisia has published a new strategy for its Industrial Policy in September 2014 (Republic of Tunisia, 2014, p. 39). It is aimed to strengthen the competitiveness of the industry and the acceleration of the transformation and integration process in the global value chain. It includes both horizontal and vertical measures. One key element of its strategy is to create a network of technology centers and quality infrastructure to foster R&D, based on a sectorial and cluster focus. Furthermore, the Public Private Dialogues (PPD) initiated by the CIIP will be formalized and should become a permanent structure in order to monitor the implementation of all policies. Based on the results of the PPD, the government of Tunisia has identified specific measures in key sectors attributed to high growth potential, which are presented below (Republic of Tunisia, 2014, p. 39 f.).

- *Energy sector*: The government encourages and promotes investment in operations in the field of hydrocarbon and in the renewable energy sector
- *Agriculture and food industry*: The Tunisian government wants to reform the subsidiary system in this sector and redevelop its regulatory framework in order to boost investment, particularly in aquaculture industry, high value fresh fruits and vegetables.
- *Textile and Clothing*: Although the sector faces strong international competition, it is still believed to have a competitive advantage. Therefore, several measures are intended to support investment in the sector: first, incentives for new investments such as trade agreements with trade partners such as the US, Africa or the Gulf countries targeted on higher added value product lines are to be introduced. Second technical support will be granted and third, benefits provided to offshore companies will be extended to onshore firms to better integrate the two areas.
- *Electronic and automotive components*: This sector is identified as a potential high-growth industry and a power to transform the economy. In order to attract foreign firms to establish in Tunisia, the government wants to provide technical and commercial support by refocusing its current support structures. Additionally, it wants to improve the quality of training in this area in order to have a qualified work force.
- *Aeronautics industry*: this sector is currently booming and already has its own ecosystem including all activities of the aviation industry and supporting sectors and services. The government wants to encourage further development of this sector by implementing a DPP in order to identify the demand for incentives and measures.

- *Pharmaceutical industry*: to foster the sector, the government wants to liberalize pharmaceutical prices in the domestic market to encourage investment and exports, it wants to revise the procedures for obtaining authorization for registered drugs, review procurement procedures and reform compensation of imported products to encourage investment in the production of high value items and finally establish a legal framework for clinical trials and research laboratories.
- *Health services and medical tourism*: Tunisia is already a well-known destination for medical tourism due to its good private hospital infrastructure, qualified staff and a good price-performance ratio. The government has not yet identified specific measures, but wants to promote investment opportunities in this sector.
- *IT Services and ICT*: attributed to high growth potential, the IT sector will be supported by the government through several specific measures. Firstly, it wants to initiate the digitization program in the public sector and therefore offer business opportunities. Secondly, it wants to establish a legal framework to facilitate e-commerce and e-banking and expand and improve the quality of training for graduates in the sector. Additionally, it wants to foster offshoring, nearshoring and co-location of businesses between the country of origin and Tunisia for IT and IT enabled services. A program called *Smart Tunisia* is based on this idea and has already been implemented.

4.4 CIIP in Tunisia

This chapter summarizes the work of the CIIP in Tunisia by providing an overview of the key project components and outputs.

The CIIP has set up a project in coordination with the African Development Bank and the European commission to support the development of a package of reforms to promote exports and foster private investment (World Bank, 2014c, p. 29). The CIIP project launched sectorial Public Private Dialogues[8] on the four pilot sectors pharmaceuticals, medical tourism, garments and IT services. These dialogues are structured along three phases: first, diagnostics and prioritization of constraints, second elaboration and budgeting of sectorial action plans and third the establishment of implementation mechanisms and linkages to other World Bank projects in Tunisia. Although CIIP's focus is on the four pilot sectors, it has selected a long list of ten to twelve sectors. The remaining sectors will be analyzed along the same parameters, namely employment, competitiveness and exports. As the project now passes into its second phase, the project team already drew some recommendations from the analysis: Tunisia needs to tackle macro- and microeconomic constraints by introducing horizontal and vertical measures. Furthermore, Tunisia could build on cluster initiatives and sectors that have a high potential to

[8] Enterprises, the Civil Society, local experts and government bodies took part in these dialogues

pull the rest of the economy towards more sustainable and diversified growth. (CIIP, 2014, p. 1f)

The Swiss Cooperation Agency (SECO) has attended the CIIP Public Private Dialogue as an observer. Collaboration plans exist on replicating additional Dialogues in other sectors and on providing the CIIP team in Tunisia with expertise drawn from similar projects the SECO was involved in.

4.5 Measures recommended for Tunisia

In the following sub chapters we will present our industrial policy recommendations for Tunisia in order to create massive employment. The table below gives a short overview of the recommendations, which will be explained in detail later in the paper.

Instrument/ measure	Quality of jobs aimed at by the measure?	Specific sector targeted by the measure?	Covered by current CIIP efforts?
Regulatory reform	Both	No	No
Labour market policy	High-quality	No	No
Industrial clusters	Low-quality	Yes (textile)	Yes
Value chain development	Low-quality	No	Yes
Special economic zones	Low-quality	Yes (textile)	No
Strengthening SMEs	Low-quality	No	No
Formalizing the informal sector	Low-quality	No	No
Integrating education into industrial clusters	High-quality	No	No

Illustration 4: Recommended policy mixes, own illustration

4.5.1 General industrial policy measures

Based on the discussion of different IPs and on the analysis of the country-specific regulatory constraints, i.e. economic bottle-necks, in the following there will be identified measures of a general and cross-sectoral character that should be considered. These measures should have a positive impact on business climate and, hence, contribute to the successful implementation of the new industrial policy strategy (4.3.2).

As discussed in chapter 3.3.2, Tunisia failed to reach many of the objectives it set in different industrial policy initiatives. As the analysis reveals, the main reasons for these failures could be attributed to (1) a lack of collaboration between state and the private sector that resulted in poor coordination and inefficiency, (2) a mismatch between the public and the private sector, and (3) regulatory burdens and barriers to competition (4.3.2). Besides that the state bureaucracy and financial policy, which causes disparities among sectors, is a significant hindrance to the investment climate (AFDB, 2014, p.19), the development of the private sector, and, hence, the economic growth. Therefore, it is, first of all, necessary to have a close look at the general economic framework. As mentioned above, a set of cross-cutting reforms directed towards the improvement of the business climate (4.3.2) would be an important pre-condition for market growth. Such reforms could ease the burden on business, reduce the mismatch between public and private sectors, and, hence, reduce disparities between the different sector of the economy. In this context general regulatory reforms are a necessary instrument to correct market failures and distortions (3.2.1) and to create more a favourable business and investment environment, which could in turn lead to more successful implementation of further industrial policies (IPs) and the creation of new jobs.

It should be noted that the field for regulatory reforms is very wide and, as mentioned above the impact of the reforms on the overall business environment in developing countries can be very limited due to resistance of the local bureaucracy (3.2.1). In the following we can only discuss some of the issues that were identified as problematic with regard to the creation of employment. Input for additional need for action in different industry sectors might also come from the PPDs established or envisage by CIIP (4.3.2)

Based on the discussion above it is possible to identify key areas that should be reconsidered:

1. First of all, private investment (both foreign and domestic) in many sectors is still largely controlled by the state and is subject to strict limitations with respect to foreign investment (AFDB, 2015, p.19). This causes disparities between sectors (AFDB, 2015, p.19), the consequence being that private investment is allocated mostly into productions at the lower end of the value chain (4.3.1). Therefore the revision and liberalization of

investment rules could lead to more investment in companies that would boost economic growth.

2. Secondly, as discussed above, formalizing of business is an important instrument for job creation in the context of developing countries with large informal sector (3.2.3). In this respect reforming the registration procedure would be an important measure to ease the process. Therefore, existing registration procedures should be reviewed or replaced by more simple and less costly ones. In general, but in particular with a view to the establishment of complex business clusters that require a multitude of permits, registrations etc., it is of particular importance to clearly allocate competences and responsibilities of all state entities involved in the registration process. Also, procedural rules must ensure that all administrative orders (permits etc.) are formally and on the substance coordinated with each other. In the following chapter of this paper the formalizing the informal sector will be discussed in more detail as one of the instrument proposed for creation of low-quality jobs in Tunisia.
3. Another regulatory issue that has been identified as problematic is the tax system. Tunisia´s tax law currently favours companies in the export industries over companies producing for the domestic market (3.3.1). Removing this discrimination by adapting the relevant tax laws could result in higher investment into domestic industries, also, it could contribute to the better integration of domestic and export-oriented industries, thus removing the problem of onshore/offshore dichotomy (3.3.1). Ideally, this measure would allow to produce more sophisticated goods domestically. It should be noted however that taking measures to reducing the dichotomy might sets constraints to measures aiming at the promotion of export oriented industries.

4.5.2 Industrial policy measures to create low skilled employment

In the last sub-chapter, general measures have been presented which are required in a country's economy before going into more detailed industrial policy recommendations, like for example the improvement of the rules and regulations of the business environment. In this subchapter, industrial policy recommendations will be proposed which could potentially lead to massive job creation in the low productivity/low quality job sector.

An important industry in this sector is the textile industry. As mentioned above in chapter 3.3 in the analysis of Tunisia's economy and its industrial policies, the government is still convinced that Tunisia has a competitive advantage in the textile production and chose it as one of the three main sectors for its industrial policy implementation. Also within the CIIP activities in Tunisia, the garment industry has been selected as one as the four pilot sectors for Public Private Dialogues, showing its ongoing importance for the Tunisian economy. This is why the textile industry has been selected to propose policy recommendations to create jobs on a massive scale in the low quality jobs/low value added sector. This industry is already established and developed enough in Tunisia to serve as a starting point for large-scale job creation. Since the focus of the government is on this sector, it is likely that development programs in the textile industry have a high chance to get implemented seriously and therefore should eventually be successful. The grounds for the recommendation which are made in this sub-chapter are the types of industrial policies discussed in chapter 3.2 as well as Tunisia's economic situation, industrial policies as well the CIIP efforts in Tunisia discussed in chapters 4.3. and 4.4.

It is important to notice that this sector only serves as a starting point for massive job creation in the short and middle run. To really boost Tunisia's economy and to provide sustainable economic growth in the long run, the focus has to be shifted away from the low value added and low quality jobs sector towards high value added/high productivity sectors with high quality jobs, like for example the ICT or medical tourism sector. In addition, as already discussed above, Tunisia's textile industry is facing increased competition from countries in Southeast Asia which can produce at lower costs. So even though Tunisia still seems to have a competitive advantage in the textile sector, this suggests that the focus should not lie on this industry anymore in the long run. But in the short run, the textile industry can still serve as a strong provider of employment and economic growth as the industry is well-established and supported by both the government as well as through the CIIP.

IP mix I: Cluster building, Value Chain approach and Special Economic Zones

Since the 1970's, an industrial cluster for textiles is already existing within Tunisia. This cluster is called "Pôle de compétitivité Monastir-El Fejja" (mfcpole) and is mainly focusing on the production of intermediary and finished products. The area includes 40 % of Tunisian textile and apparel jobs and 40 % of national exports of the textile and clothing sector are produces in this area, showing its high relevance despite the increased competition from low cost countries in Southeast Asia (Texmedclusters, n.d., Central Tunisia (Sahel)). The mfcpole is also hosting development centers, start-up centers, congress facilities and show rooms (Benner, 2012, p. 14 f.). The cluster is also export oriented, as a large share of the produced textile products are exported abroad, which has already been discussed earlier in this paper. The cluster is also trying to consolidate the logistics chain of the textile sector, therefore aiming at improving the value chain of the whole sector. (mfcpole, n.d., la zone de finissage – les objectifs).

The example of the mfcpole shows that Tunisia already has a strategy and some positive experience regarding the establishing of an industry cluster (both vertical and horizontal) as well as the integration of strategies and policies aimed at improving the whole textile value chain, as all members of the value chain (from the cotton producer up to producer of the finished product) are located within the cluster zone, benefiting from the various services offered to companies. But so far, the mfcpole is not defined as a Special Economic Zone, which would be an additional point to consider by the Tunisian government. As already mentioned earlier in this paper, the textile industry is heavily export-oriented. In addition, the export-oriented sectors of the Tunisian economy is relying on importing a significant portion of its input. This both means that the textile sector would benefit from certain forms of special economic zones. Regarding the imports, a Free Trade Zone would ensure lower costs and better trading conditions, as it enables duty-free imports and exports and reduces the costs of importing products needed for production considerably. Regarding exports, an Export Processing Zone is the most obvious solution, as it is also situated outside the customs of the host country and focuses on the production of goods destined for the export. Those measures would reduce the production cost and increase productivity and would therefore lead eventually to job creation.

It is important to also consider the possible negative impacts of further boosting a specific industrial cluster like the mfcpole in Tunisia. As mentioned above, the country is facing a continuingly increasing onshore-offshore dichotomy, which leads to an ongoing separation between companies producing for the local markets and those producing for export. With the installation of Special Economic Zones which have their own rules and regulations compared to the rest of the country, this separation might aggravate. The risk is that an important economic sector loses its interlinkages and connections to the overall domestic economy.

This concern has also been identified by the literature. According to a World Bank report, the mfcpole serves very often as an example for an industrial cluster which remained an enclave within the overall economy of the country without having served as a trigger or catalyzer for dramatic structural economic change, even though the cluster was able to serve as a robust job-creating program within itself (World Bank, 2011, p. 4). This means that while the cluster itself can be considered successful in creating additional jobs, the rest of the economy has not really benefited from the economic performance in that specific zone. This does not only lead to an uneven economic development between sectors, but also between different regions within the country because export/import-oriented companies normally settle close to adequate infrastructures like ports and airports.

A possible strategy to fight this uneven regional development would be the promotion of clusters and Special Economic Zones in rural regions, as proposed by Benner (Benner, 2012, p. 15). As youth unemployment is most predominant in rural areas, the government should actively take a leadership role in establishing additional “mfcpole-like” clusters in there. A prerequisite for a successful cluster building is that the adequate infrastructure will provided, e.g. proper roads to reach ports and airports or the establishment of additional airports in more remote areas. Such clusters would lead to increased economic development and increased job-creation of other regions in the country as well, supporting a more even development among the different geographical areas.

IP mix II: Strengthening SMEs and formalizing the informal sector

It is widely accepted that SMEs are the backbone of a healthy economy, which is also the case for Tunisia. In 2011, 601’416 SMEs have been operating in Tunisia, employing 59 % of the total Tunisian workforce and accounting for more than 99 % of Tunisian companies (OECD/European Commision/ETF, 2014, p. 323). As already discussed in sub-chapter 3.2.4., the two major strategies in this regard are to improve the access to finance for SMEs and to establish Business Development Services specifically tailored to SMEs. Since the late 1990s, Tunisia has established numerous institutions in the public, civil and financial sector as well as international initiatives/programs to boost SMEs, for example the *Centre d’Appui à la PMI*, the *Sociétés d’investissement à Capital-Risque* or the *Integrated Support to SMEs in the Mediterranean Region* from the United Nations Industrial Development Organization (UNIDO) (Tomaso et al., 2001, p. 61 f.).

However, only little coordination and cooperation between those organizations and institutions seems to exist at either country or regional level. One recommendation regarding the strengthening of SMEs in Tunisia would be to create a coordination mechanism in order to increase the impact of those different specialized institutions. When it comes to promoting SMEs in Tunisia the public sector is the main actor and therefore this coordinating institution should be located within the national government to ensure that it becomes part of the national development strategy and that it gets the necessary attention.

In addition, coming back to the textile sector, institutions could be created which specifically deal with the textile industry. Those institutions could be integrated into the specific clusters, similar to the mfcpole. This would lead to a more direct interaction between the public and the private sector in this area and would lead to the improved integration of the cluster/economic zone into the overall economy, as they would get linked up with civil society as well as financial organizations.

But before too much time and resources are getting invested into the development of SMEs in Tunisia, the problem of the formalization of the informal sector should be addressed by the government. Research has shown that 85 % of the Tunisian enterprises and 42 % of the total workforce are employed in the informal sector (International Organization for Migration, 2013, p. 31). Given the insight from sub-chapter 3.2.3., formalizing the informal sector could boost employment considerably, as formalizing a business increases its chance to grow. To express it in a simple way, the benefits of formalization have to outweigh the cost of formalization.

As discussed earlier in this paper, the Tunisian government has a variety of instruments at its disposal to increase the percentage of formalized companies in the economy. This does not only apply for the textile industry, but for the private sector overall. First of all, information campaigns should be launched to make the employers/employees aware of what their status is and what it concretely means to be (in-) formal, as well as informing them about the benefits of legalizing their work. Otherwise, many people/businesses will remain ignorant of this and will not even consider changing the legal status of their business. After the benefits of formalization have been shown, another important step is to reduce the cost of formalization in an appropriate way. The registration procedures have to be simplified and its costs considerably lowered, which is part of the problem of the private sector suffering from an excessive regulatory burden (World Bank, 2014, p. 234). Only when the registration is fast, easy and affordable SMEs will register, otherwise they will stay in informality. In addition to this, the taxation system probably has to be adjusted. With a corporate income tax rate of 30 %, a lot of informal SMEs will stay away from formalizing their work as they would lose almost a third of their (sometimes already very humble) corporate income (World Tax, n.d., Tunisia). Only when all those measures are taken simultaneously, a considerable formalization of the informal sector has a chance for success.

4.5.3 Industrial policy measures to create high skilled employment

In order to ensure a sustainable economic growth it would be essential that Tunisia's economy shift towards more high-value added production and, thus, to the creation of high-quality jobs. The issue of high-quality jobs is getting all the more important, taking into account that Tunisia has an increasing number of workers with tertiary education (3.3.1), which are an important human potential for economic growth if properly trained and educated. In order to create high-quality jobs for this segment of the labor market it is important to remove existing barriers that prevented this so far.

According to the World Bank (2014, p.170) sound labour market policies are an important element for the development of high-quality employment. Indeed, as will be discussed below, the creation of stable employment conditions is a prerequisite for the development of high-quality jobs. Therefore, labour market policies need to be included in the policy mix aiming at the creation of high-quality jobs.

Apart from labour market policy it is important to target the existing mismatch between education on one hand and the needs of firms providing high-quality jobs on the other hand (4.3.1). One possibility, which is suggested in this paper, is to intensify the cooperation of private and public sectors with respect to education of students.

As mentioned above a majority of tertiary educated graduates are currently absorbed by the public sector. This is partly due to the relative attractiveness of public sector employments (3.5.1) and partly because the graduates skills do not match the needs of the private sector (4.3.1). Elimination of this mismatch between education and demand of the economy is a key issue, which is relevant for both, economic growth and fighting unemployment.

IP mix: Labour Market Regulations, Educational Programs and Clusters

As to the labor market, Tunisia recognized flaws in the current regulatory regime. It therefore embarked in 2013 on a process of so-called tripartite dialogue between government, unions and employers. The dialogue resulted in the conclusion of the *Social Pact* that provides the institutional framework for the preparation of policy reform projects in the field of the labor market and related areas, such as social insurance (unemployment insurance) and pension schemes. The overall objective is to align the regulation of the Tunisian labour market with international standards in order to provide companies more flexibility and, hence, competitiveness, while protecting workers´ rights (World Bank, 2014, p.187).

With regard to the creation of high-quality jobs it is of particular importance that labour market regulations are designed in a way that they support its stability. Only stable and long-term character of employment can motivate employers and employees to invest in education and in the development and maintenance of labour skills. Proper professional skill of workforce is, in turn a pre-requisite for the development of high-value added industries.

As discussed above, there is empirical evidence that reveals the correlation between the level of rigidity of the labour market and the level of employment (3.2.2).The current labour market regulations in Tunisia is considered to be too rigid: As a result, many companies prefer fix-term and short-term contracts over open-term agreements (4.3.1) That leaves employees with less job security and prevents the creation of stable working conditions (4.3.1). Therefore, it is recommended that the *Labour Code* is adapted so that the terminating costs of open-term contracts are lowered. In order to compensate for lower firing costs employees might be better protected by the creation of unemployment insurance as suggested by the World Bank (2014, p.188).

Providing for stable labour market conditions is a pre-requisite but not sufficient for the creation of high-quality jobs. Another problem affecting the Tunisian labour market is the quality of the labour force, which does not correspond with needs of the private sector. Therefore, mismatch between workers´ skills and demand of the private economy was identified as a significant constraint for economic development (3.3.1). Possible reasons for this mismatch can be both, the low quality of education and the fact that acquired competences do not correspond to the needs of the private sector (Angel-Urdinola et al., 2014, p.56). Another reason for this mismatch is the isolation of the private sector from the educational sector. This separation causes difficulties with respect to the exchange of information which would allow to adjust the quality of education to the demand of the economy (Angel-Urdinola et al., 2014, p.58).

In order to reduce this mismatch a series of labor market programs, financed by the National Employment Fund and managed by the ANETI, have been launched in Tunisia. Although their impact has not yet been properly evaluated, there is some evidence that they did not have much impact on the creation of new jobs. The main reasons for this failure were (1) a lack of coordination; (2) an overlap of the programs; (3) administrative burdens for companies to participate; (4) false incentives for business to invest in human capital; and (5) a lack of monitoring (Angel-Urdinola et al., 2014, pp. 68-69).

One approach to bridge the gap between the skills of high-qualified employees and the needs of the private industry is to bring students, educational facilities and industry together. Clusters, that form an integral part of Tunisia's IP (4.3.2),and that were identified as a key instrument for further growth (4.4.) could provide an excellent platform for the establishment of such a cooperation. The first step could be that students are offered an alternative to the curriculums of existing universities and instead are educated in educational facilities with practical orientation. Their curriculums should be developed in close cooperation with the enterprises and existing R&D facilities of the cluster. In order to increase students' practical orientation, educational programs that provide for practical work in turn with regular theoretical education (similar to the Swiss system of apprenticeship) might be envisaged. As starting point, priority could be given to educational programs in the sectors that were chosen by CIIP activities and included in the PPD, which have potential for economic growth and creating high-quality jobs (3.3.2), i.e. ICT and medical tourism. When implementing this instrument, the lessons learned from previous failures should be taken into account.

5 Conclusion

This paper provides an overview of possible solutions to the unemployment situation in Tunisia by recommending different industrial policy mixes.

By consulting existing literature about the history, political and economic situation of Tunisia and by analyzing already existing industrial policies implemented by the CIIP, the authors identified three main recommendations in order to promote massive job creation.

The first policy mix recommendation aims at the entire Tunisian economy and is necessary for a successful development of other specific industrial policies. The overall measures should build a strong and business favoring environment. The first policy mix should aim at reducing the demands, costs and complexity of formalizing and register businesses. Furthermore, private domestic and foreign investment should no longer be controlled by the Tunisian government, which should have a positive impact on the economic growth. Moreover, the business tax system should be revised in order to reduce the growing dichotomy between exporting industries and non-exporting industries.

Based on the overall policies changes, we chose the textile industry to propose further specific policy recommendations for creating low skilled employment on a massive scale. In order to reach this goal, the authors recommend building industrial clusters in order to increase efficiency in the value chain. Further, a Special Economic Zone should be established by the government to boost exports. Also SME's should be promoted. Because the promotion of low skilled jobs will not lead to a sustainable growth of the Tunisian economy and will not lead to enough jobs overall, it is important to notice that this measure mix is recommended only as a short to medium run remedy. In the long run, high skilled employment should be created in order to build up a lasting competitiveness, which does not only rely on cheap labour such as the textile sector. Therefore, a second specific mix of industrial policies is recommended, aiming at creating massive high skilled employment.

The industrial policies mix in order to create high quality jobs include in particular the integration of the educational system into an industrial cluster. The ultimate goal of this is to meet the industries' demand of skilled workers and to reduce the massive existing unemployment of university graduates, which are nowadays partly absorbed by the state. Further, reforming regulations including a labour market policy change is recommended. Security to both employers and employees must be increased in order to create a lasting, efficient relationship.

In conclusion, all three industrial policies mixes should be implemented. The authors are aware that the realization of these recommendations will be very resource intensive and will not necessarily have a massive impact in the short-term. But since the CIIP is a medium to long-term project, the authors believe that implementing all three industrial policy mixes in combination is more sustainable and fit with the program goals best. Nevertheless, the recommendations have some constraints, since corruption, nepotism and also political instability are still prevalent in Tunisia. The political instability and the feeling of political and economic change can also be seen as a unique opportunity and Tunisia has never been rated as a freer country than in 2015 by Freedom house (2015). Therefore, the authors see this a great and unique chance to start with such an ambitious project.

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