The Political Economy of Development Policy in Tunisia

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A. Introduction

Until the country's access to independence from France in 1956, Tunisia' s manufacturing remained artisanal in nature, based largely on agriculture, food processing and mining. Independence, a modernist leadership and political stability all helped to establish a new era of economic and social development. The declared economic policy of the last five decades, however, witnessed important changes from liberalism (1956-60), to socialism (1961-69), to a market economy with high protection (1970-85). And following a severe balance of payments crisis in 1986, Tunisia adopted a structural adjustment program under IMF guidance. The liberal policies implemented under this framework were boosted with the signing of an Association Agreement with the European Union in 1995, which provided for the establishment of a free trade area within 12 years.

The main features of the Tunisian development experience are: (1) a sustained growth of GDP at an average annual rate of about 5%, (2) a special focus on social modernization and population control, (3) a heavy involvement of the State in the economy, even after the abandonment of collectivism in the late 1960s, and (4) the adoption of an internally inconsistent development policy since the early 1970s, with an emphasis on private entrepreneurship and export promotion in tandem with an excessive protection of the economy.

The fact that the Tunisian growth rate since the 1960s was higher than that observed in most other MENA countries, means that, on the one hand, the country did not make huge mistakes such as running large macroeconomic imbalances or neglecting private sector and export activities. But, on the other hand, the fact that this growth rate was lower than what has been achieved in South East Asia and other fast growing economies, means that the country could have done much better. Hence, the relevant questions for the present Study are: how did Tunisia manage to achieve a robust growth over such a long period of time despite obvious inefficiencies? Why these inefficiencies were not corrected earlier? And in other terms why appropriate reforms were not undertaken when they were needed?

Our analysis of economic policy will focus on foreign trade, credit and foreign exchange regimes as well as on gender issues and population control, which played a crucial role in the improvements of per capita income in Tunisia. All these policy choices will be viewed first as an outcome of the interactions between institutions and interest groups. Furthermore, contracting problems will be analyzed to understand how and why groups failed to implement efficient policies.

The study is structured as follows: Section II summarizes the political economy approach, thereby providing the organizational framework for the country study. In Section III, we present the main policy episodes in Tunisia during the period 1956-2000. The initial economic conditions and the policy choices that were made during the early years of independence 1956-60, will be analyzed in section IV. Section V studies how the interplay between economic and political factors led to the adoption of central planning and collectivization in the mid-1960s. In Section VI, we conduct an interest groups' analysis of the newly adopted two-track strategy, which focused on export promotion, with the establishment of special processing zones, while protecting, at the same time, the local economy. The populist experiment of the years 1981-85 will be the subject of Section VII. The crisis-triggered reforms of 1986 will be analyzed in Section VIII. In Section IX, we analyze the policy uncertainties of the post-adjustment era (1992-94). The political conditions that led to the signing of the Association Agreement with the European Union will be the subject of Section X. Section XI contains the main conclusions.

B. The political economy approach to economic policy

Why do countries persist in adopting inefficient policies? One explanation is that these inefficiencies may benefit in fact some powerful interest groups. In what follows we present the theory of collective action, its limits, and the contracting problems that may be at the source of inefficiencies. This leads us to analyze the three institutional dimensions of governance, namely representation, coordination and commitment

1- Interest groups and collective action

The main thrust of the theory of collective action is that policy choices are in fact an outcome of interest groups' pressures and lobbying (for a survey on the subject, see for instance Nugent and Nabli ([989)] and Isfahani ([2000)]).

First, success in collective action is enhanced with the small size of the group and its geographic concentration. Otherwise it would be difficult to mobilize its members. Farm subsidies in developed countries, as an example, could be explained by the small number of farmers as a fraction of the total population, whereas farmer groups in the developing world are much larger in number and they are thinly spread in the rural areas, which makes it difficult for them to mobilize. Second, sector concentration helps to do away with free riders since a small number of large beneficiaries will be willing to undertake all the needed lobbying. Third, homogeneity of both background and goals enhances groups' focus on a specific set of policies. Here again, farm policy in developed countries fits the stereotype since farmers are a relatively homogeneous group whose main goal is either protection (the case of rice in Japan) or export subsidies (the US and the European Union).

This example shows clearly how lobbying is more likely to concentrate on the most beneficial claims. Likewise, in a situation of rationing, business groups would in general focus more on credit availability than on preferential interest rates. And, they may consider protection as more sustainable than subsidies, since it constitutes also an important source of revenue for the government. Finally, one should notice that conflict may arise when the influential members of a group are involved in several activities.

2- The limits of the theory of collective action in explaining reforms

Despite its appeal, the theory presented so far does not explain well the timing of reforms since it is unlikely that groups' influence would have changed dramatically at that particular period of time. We observe also that countries with similar economic conditions may adopt different policies. As an example, high inflation in Chile in 1973, led to radical reforms in that country, while even hyperinflation in other Latin American countries failed to produce similar actions.

Also, there are instances where influential groups opposed reforms that turned out to be beneficial for them. As an example, Rodrik [1998] argued that import-substitution industrialists in Korea and Taiwan resisted reforms that these countries introduced in the mid-1960s. This author explains the failure of developing countries to reform by the importance of redistribution generally involved, especially in trade reform. Politicians hesitate to reform when they perceive the 'political cost-benefit ratio,' i.e., the ratio of redistribution to efficiency gains, to be too high. In this case, only a severe crisis that makes the status quo unbearable will succeed in triggering a radical reform program.

Finally, governments might give up reforms if they perceive their administration costs to be important. In this respect, one should notice that as the bureaucracy gets used to a system, any reforms may be considered difficult to implement.

For all these considerations, countries will either fail to reform or they will follow a two-track reform strategy whereby new opportunities are created, but without unduly altering the old system. Examples include the promotion of a private sector while maintaining State-owned enterprises, the creation of special processing zones for exports, and allowing foreign banks to operate in activities that do not directly compete with the local institutions. The third possibility would be the adoption of a radical reform program.

3- The institutional dimensions of governance: Representation, Coordination and Commitment

A major limit of the theory of collective action, in fact, is its inability to explain why inefficiency prevails in the first place. Groups should have the incentives to claim for the removal of all inefficiencies in order to benefit of a larger surplus. Otherwise the persistence of inefficiencies may have its source in contracting problems (Castanheira and Isfahani [forthcoming]). The extent to which these problems could be reduced will depend on representation, coordination, and commitment.

Representation is required for two reasons. First, the government reeds to have relevant information about the needs of the society in order to make the appropriate trade-off between competing demands. Second, groups will cooperate better in implementing policies when they feel they are part of the decision-making process.

Likewise, coordination is needed in order to prevent excessive taxation, overspending or government provision of goods and services that the private sector can better provide. Cooperation of all parties is also needed to resolve conflicts. Trade unions, as an example, could play a very constructive role in wage negotiations and in ensuring social stability.

The extent of the trade-off between competing demands depends on the degree of government intervention in the economy. When the government plays an important role, regions will compete to attract public projects. And social groups will compete for subsidies, access to bank credit and protection. The first-best solution, in this respect, is to have an institutional framework that leaves most choices to the market. The adoption of vouchers in education and private sector financing of infrastructure, as an example, may dispense the government from having to make difficult choices about the location of public projects. Low taxes would also limit the amount the government will have to spend and, as a consequence, the coordination needed in that respect. And some ex ante rules could be helpful like the adoption of a Maastricht limit on budget deficit or a balanced budget law.

For a given level of taxes and government intervention, nevertheless, decentralization is an effective way to limit the coordination problems. Decisions that could be made at the city or the regional level should not be left to the central government.

As regards commitment, the ideal here is to turn announced policies into enforceable contracts. But this is particularly difficult to implement in developing countries. In this context, one possibility pointed out by Isfahani [2000], is that a dictator with a secured long-term position can have strong incentives to commit himself to efficient policies for reputational considerations. Also ideology could be helpful. The appointment of a conservative central banker a-la-Roghoff, as an example, may be an effective way to achieve price stability. Likewise, the selection of a pro-market technocratic team like the "Chicago boys" in Chile, could significantly enhance policy credibility.

C. The development policy episodes in Tunisia (1956-2000)

The main episodes of Tunisia's development policy since 1956 are summarized in Table 1. The first five years (1956-60) were generally considered a period of liberal policies. But the most important measures that were adopted, were all in favor of State intervention. Protection was prevalent, taking the form of prohibitive tariffs as well as quantitative restrictions. Monopolies in the main public utilities, inherited from the colonial rule, were consolidated. And credit policy was very selective, in favor of the public sector.

At the social level, a distinguishing feature of this period was the adoption of radical reforms of women status outlawing polygamy, fixing a minimum age for girls' marriage and providing them with schooling opportunities. Population control was integrated as part of the development strategy of the country. A modern educational system, based on the French curricula, was adopted; and the Zeitouna Mosque university was first marginalized then abolished altogether in 1962.

The second episode (1961-69) was inaugurated by the official adoption of central planning of the economy in 1962. This was followed by a collectivization drive of economic activity, starting in 1965. The public sector was also strengthened with the creation of 160 new State-owned companies during the decade. And, the predominantly government-owned banking sector continued to be regulated with tight control of credit allocation, interest rates and foreign exchange.

With the abandonment of collectivization in 1969, following a severe economic crisis and popular discontent, a ‘two-track’ strategy was inaugurated with the creation of an offshore industrial sector. But despite a new emphasis on private entrepreneurship and export promotion, public investment remained dominant, during this period, with the creation of one hundred new public enterprises. Moreover, the import-substitution bias increased. The financial sector remained dominated by State-owned banks. And a mild appreciation of the dinar occurred, which led to a black market premium in the order of 10% (Table 1).

Starting 1981, a newly appointed government had to deal with street unrest, a demanding trade union and Palace intrigue. The populist policies that were adopted ended up in a severe balance of payments crisis in 1986. Finally, the country had no choice but to sign a Stand-by Agreement with the International Monetary Fund and to adopt a stabilization-cum-structural adjustment program.

As a result, macroeconomic stability was immediately achieved, but institutional reforms remained hesitant and private investment failed to recover. Under these circumstances, the authorities decided to take a bold decision by signing an association agreement with the European Union in 1995, being the first country in the South-Mediterranean region to do so.

Benefiting of a financial support from the EU, a program to upgrade domestic industries with a competitive potential was launched, starting 1996. The program succeeded to modernize local industries, and it may have helped investors’ confidence. Some other reforms also followed suit, in particular in privatization. But reforms of the civil service, the labor code, and banking and telecommunications remained limited.

In the following sections, we analyze the role interest groups played in shaping the policy choices that have been made since Tunisia's access to independence and the way the three institutional dimensions of representation, coordination and commitment applied to the Tunisian context.

IV. Flirting with State Intervention: 1956-60

In addition to its agricultural potential, Tunisia succeeded for centuries to produce and to export some manufacturing goods such as textiles, ceramics, leather and other handicrafts. Production processes remained however artisanal in nature (Bellin [1989]). In the mid-nineteenth century, the establishment by Ahmed Bey of light weaponry and food processing plants gave a temporary boost to industrialization. But this attempt was halted by the French invasion of 1881, since the colonial strategy was to keep the country as a market for its manufactured goods. Hence, foreign investment during the Protectorate period was limited to agro-industry and minerals.

In 1904, a customs' union with France was established. This was an opportunity to create labor intensive industries in Tunisia. But the French authorities failed to provide the legal framework needed to encourage investment. The French State failed also to channel bank credit to industries with export potential.

An economic census that was conducted in 1956 showed that there existed 290 industrial enterprises in the country employing more than 50 persons. In the majority of them (257), foreign nationals hold virtually all the technical and managerial positions. Also, activities were concentrated in import-substitution and non-tradables. The rest of the economy was based on subsistence farming. As a result, there was no basis for a strong and effective lobbying in favor of free trade in Tunisia at its access to independence. This explains the fact that the policy debate of the newly independent State, focused mainly on a choice between a private sector-led economy or a State-led economy. In both cases, however, protection from foreign competition was expected to play a central role.

1- Political Set-Up and Interest Groups

After a long and protracted struggle, Tunisia won its independence from France in the mid-1950s. The process was gradual and, as a first step, France offered “internal independence” in 1955**.** The offer was accepted by the Neo-Detour leader Habib Bourguiba, but vehemently opposed by a nationalist wing of the Party, headed by its Secretary General Salad Ben Youssef. The conflict took a violent turn and brought the country to the brink of civil war. But an extraordinary congress of the Neo-Destour fully supported Bourguiba, and Mr. Ben Youssef was sacked.

One year later, in 1956, Tunisia was granted full independence. This event proved Bourguiba right and gave a final blow to the rebellion. In addition, the social transformation that was initiated by the new government enhanced greatly the historical legitimacy of the leadership. And Bourguiba’s hold on power will be strengthened with the co-option of the national trade union UGTT, the proclamation of the Republic in 1957 and the outlawing of all other political parties.

At the interest groups level, the entities that were expected to play a leading role in the policy debate in Tunisia, during this period, were producers’ associations, labor, and the ruling Party elite. Producers’ associations were limited to the ‘Union Tunisienne de l’Artisanat et du Commerce’ (UTAC, to become UTICA later on) for manufacturing and commerce, and the ‘Union Nationale des Agriculteurs de Tunisie’ (UNAT), for farmers. UTAC was founded in 1947, by the ruling Destour party, in reaction to the communist party’s ‘Federation des Artisans et Petits Commercants de Tunisie,’ which was created in 1945. But while UTAC’s leadership was elected during the colonial era, since independence, the organization’s president is handpicked by the authorities. In addition, UTAC was asked to encompass all types of industries, handicraft and commerce, as well as the service sector, since the mid-1960s. This strategy of amalgamation further weakened the organization’s ability in mounting collective action (Nugent [1989]).

And UNAT was in no better position. Large exploitations which were in the hands of European nationals became State-owned, following a nationalization decision. As a result, the union membership was thinly spread all over the country, making it difficult to mobilize. And the financially squeezed organization had no choice but to rely on staff hired from the Agriculture Ministry and on government handouts.

With their leadership neutralized, producers' organizations became mere instruments of State influence. This leaves organized labor and the ruling party elite as the only relevant players, with a potential to orient government policy.

The national labor union 'Union Tunisienne des Travailleurs de Tunisie' (UGTT) was created in 1946 by Farhat Hached, an emblematic figure who was later assassinated by the French. Its nationalist stand and large membership base made UGTT the only organization that was really in a position to challenge the Neo-Destour Party. Some UGTT activists started the ideological struggle before even the country's access to independence. Indeed, as early as in 1955, at a congress of the Neo-Destour that was held in Sfax to give its support to Bourguiba, a young UGTT leader, Ahmed Ben Salah, seized the opportunity to present an 'Economic Report,' which detailed the socialist development strategy that the newly independent state should adopt.

But, instead of confrontation, UGTT strategy attempted rather to infiltrate the ruling Party, in order to be in a position to orient economic policy from within. To this end, UGTT leadership called in 1956 for an "organic union" with the Neo-Destour, with the declared aim to turn the latter into a labor Party. But, ironically, it is the co-option strategy adopted by the government that allowed the trade union leadership to join the ruling Party. This became clear at the first legislative elections in independent Tunisia when a "National Front" was constituted, including UTICA, UNAT and UGTT, under the leadership of the Neo-Destour. UGTT benefited mainly from this decision since it succeeded in securing 35 seats in the new Parliament, out of a total of 98.

As regards the Neo-Destour, it was mostly inclined to adopt a liberal economic policy. Its membership base came mainly from the rural areas, where the basic activity is subsistence farming. And in urban areas, merchants constitute its main support. Furthermore, the market economy is the natural choice of its western-educated leadership. Indeed, even before the country's access to independence, Habib

Bourguiba expressed on many occasions his apprehension about UGTT-advocated socialism.

2- Representation, coordination and commitment

Tunisian's hardly won independence raised expectations about a better representation. The President generally referred in his speeches to the importance of the fact that Tunisians are now able to rule themselves for the first time in their long history. And the debates that took place at the National Assembly, during the post-independence era, reflected to a large degree the concerns of the population, and gave the appearance of a representative rule.

But real power was concentrated in the hands of the Neo-Destour's leader Habib Bourguiba. First, at the suggestion of UGTT secretary general Ahmed Ben Salah, Habib Bourguiba was appointed Prime Minister by the Bey. And on July 25, 1957, Bourguiba led the Parliament to declare Tunisia as a Republic. The marathon discussions at the Parliament during that day all centered on the deficiency of the Husseinite rule and the decision itself was not submitted to a popular referendum.

Bourguiba's hold on power was made easier by the largely shared feeling that genuine representation may constitute a threat to "national unity." Moreover, the bold decisions that Bourguiba took in favor of women, education, and overall development raised his popularity. As a result, Bourguiba may have seen himself as having a better grasp of the country's priorities than elected representatives. And the co-option of both labor and business associations will help insure coordination.

As regards commitment, one should notice that once Bourguiba's position was secured for life, the President has obviously strong incentives to commit himself to successful policies in line with his modernist agenda.

3 - Technocratic inefficiencies

While the political leadership ably provided the general framework for the social and economic development of the country, technical skills were needed at the implementation level. These were obviously in short supply in the newly independent State. Given the failure of the Zeitouna Mosque to modernize, Tunisian reformists created a new model of French-based curricula schools. But the number of Tunisians who graduated from French universities remained limited, especially in the field of economic management. As a result, the country lacked the technocratic team needed to successfully implement a coherent development strategy for the country. Indeed, the failure of the liberal wing of the Neo-Destour to come up with a master plan for economic development explained to a large extent the chaotic situation that prevailed in the late 1950s and, at a later stage, the shift towards central planning.

As a result, the economic policy of the late 1950s was characterized by ad hoc decisions, most notably:

1-The establishment of government control of what used to be public monopolies established mostly for tax purposes under the French rule (seaports as well as tobacco, salt and alcohol trading boards) and utilities such as railways and electricity.

2- The creation of the Central Bank in 1958, in addition to two commercial banks, and a development bank, all of which were publicly-owned.

3- The adoption of regulations, some of which were inherited from the colonial era, such as loan guarantees for industry and generous tax holidays.

4- The consolidation of the protective regime that Tunisia inherited from France with some tariffs set at prohibitive levels.

There was obviously no shortage of arguments in favor of these interventions. For it was argued that: (1) the private sector was, at that stage, in no position to own and manage large units like public utilities, (2) the government is in a better position to allocate the scarce resources to priority sectors, and (3) "the need for the State to establish itself" as Grissa [1989] had put it, would require State ownership in order to be in a position to provide jobs and distribute rent. Public-sector banks enhanced also the government's ability to allocate credit to favored groups, thereby helping to consolidate the authority's grip on power.

This orientation benefited also UGTT since its presence is stronger in public enterprises. In addition, this association viewed the existence of a strong public sector as a first step towards the establishment of socialism.

While making political sense, these interventions sent a very strong signal about the threat, by one form of government intervention or another, to private activity. As a result, private investment collapsed. Indeed, this policy-induced uncertainty resulted in business taking refuge in real estate speculation such as buying abandoned French properties and adopting a wait and see attitude. This proper response to the prevailing set of incentives at that time was, however, mistakenly perceived by some observers as a proof of the 'parasitic nature' of the Tunisian private sector and its disappointing response to the needs of the country (Bellin [1989]).

4- The role of social modernization

While on the economic front the situation was confused, at the social level, President Bourguiba took the lead by adopting some extremely bold measures in favor of women rights. In August 1958, he promulgated what would be considered by far the most progressive reform of women status in the Islamic world, except Turkey, by outlawing polygamy, and fixing at 18 the minimum age of marriage for girls. As early as 1956, Bourguiba took the initiative to set up a special commission to review the status of women. When the latter failed to reach a consensus on the need to outlaw polygamy, the President took the matter in his own hands by introducing the needed changes to the draft law.

For these reforms to be effective, however, Bourguiba knew that he has to use his prestige, historical legitimacy and oratory gifts in an attempt to change people's attitude. Indeed, the issues of women, girls schooling and population control became a recurrent theme of his regular speeches to the nation.

The scope of social modernization brought about, at that early period, was mainly due to the secular and modernist leadership, a feature that distinguished Tunisia from the revolutionary regimes of pan-Arab and Islamist backgrounds in other MENA countries. Several factors explain this Tunisian exception. First, as early as 1934, the traditional leadership of the Destour Party was neutralized when Habib Bourguiba took the initiative to create the Neo-Destour. This decision marginalized the Zeitouna mosque establishment altogether. Second, the pan-Arab movement, which seized the so-called Arab street in the 1950s was of no particular appeal to Tunisians, especially since the Neo-Detour scored a historic success in 1956 when the country was granted full independence. And, thirdly, Bourguiba's move was so swift that the religious establishment was kept off balance.

As social modernization was making progress, Burguiba's popularity soared, especially among women. Reversal became very unlikely. And policy credibility was enhanced.

V. The rise and fall of socialism: 1960-70

Interestingly enough, the new management team called upon to correct the perceived failure of liberalism, did not come from the civil service or other groups that have some management experience such as business, lawyers or banking. Instead, Bourguiba entrusted the former secretary general of UGTT Ahmed Ben Salah with the task, by appointing him Minister of Social Affairs and Economy, in 1961.

Bouguiba's appointment of Mr. Ben Salah as a Minister made political sense. The move was meant to defuse the threat of a unified leadership of labor, which would include three emblematic figures: Habib achour, Ahmed Tlili and Ahmed Ben Salah. And things worked out much better than what Bourguiba would probably have expected. For once Minister, Ben Salah used his insider knowledge of UGTT, and with the help of some of his former comrades, succeeded to neutralize it (Khiari

[2000])). This was a milestone in Bourguiba's quest to destroy any potential source of organized resistance to his leadership.

One should notice, however, that this "co-option" strategy had also a major drawback. Isfahani [2000] pointed out how politicians would create groups to be in a position to lead them. In the case of UGTT leadership, nevertheless, their integration in the Neo-Destour gave them a precious opportunity to position themselves as the leaders of the development process in the country.

The adoption of central planning

With Bourguiba's blessing secured, Ben Salah had obviously no reason to please himself with an executive role. Soon, he will succeed to shift policy towards central planning, which was introduced in 1962 with the publication of the 'Perspectives Decennales.' During the same year, the Communist Party was outlawed and the one-Party rule was formally established. As a result, representation weakened even further, but central planning strengthened coordination.

The economy showed signs of an impending crisis as soon as in 1963. The adoption of a populist policy led to a large increase in wages. The fiscal deficit widened and a balance of payments crisis erupted in 1964. This led to the adoption of a stabilization plan and the first devaluation in the history of the Tunisian dinar.

Under a system of a parliamentarian democracy or an enlightened despotism alike, one would expect the 1964 debacle to lead to the fall of Ben Salah. The failure to prevent the crisis was a sufficient reason for that. However, the economic mess was presented to the President as a technical matter that will be corrected with the adoption of appropriate stabilization tools. And Bourguiba bought the argument. So much so, that as soon as the economy showed signs of recovery, the President gave practically a "carte blanche" to Mr. Ben Salah to go ahead with the collectivization of the economy. An adventure that would only end with an economic collapse that was threatening Bourguiba's own hold on power.

Different reasons explain Bourguiba's failure to remove Ben Salah at an early stage. First, with the absence of a technically competent counseling team, with a solid base in economics, the President himself may have been quite confused about what was going on. Second, and more importantly, from a political point of view, such a removal would open a breach with UGTT where Ben Salah still has some followers. Bourguiba may have sensed that the timing was not right for that. Especially that during the same period, he had to face with the aftermath of the decision he took to outlaw the Communist Party, which increased discontent among leftist groups known to be active in the trade unions.

Population control and family planning

The revolutionary measures that were promulgated in the late 1950s, were further consolidated, by setting up a family planning program, which was integrated to the National Development Plan, starting 1962-63. To this end, an "Office National de Planning Familial " (ONPF) was created to disseminate information. And important investments were made in reproductive health. A better incentives system was also structured so that social security benefits became limited to a maximum of three children per family.

Tunisia's firm stand on the use of population control as an integral part of its development strategy remained an exception in the Arab and Islamic world, where the policy faced opposition from both islamists and Arab nationalists. In a 1973 International Population Conference, as an example, the Algerian government blamed population control as an imperialist plot aimed at weakening the developing world (PRF [2000]).

Population control is obviously a long-term endeavor. Nevertheless as early as in 1970, Tunisia's total fertility rate (the average member of births per woman), declined to 6.4, compared to 7.0 in Morocco and 7.4 in Algeria (Table 2). Meanwhile, Tunisia boosted the highest rate of girls education at the primary level, with 61.9%, compared to 49.4% for Egypt and 33.9% for Iraq. And during the same year, women participation in the labor force reached 24% in Tunisia, higher than all other Arab countries, except Egypt and Morocco.

In fact, population control allowed Tunisia to enter a “virtuous circle” with population control enhancing socio-economic development, and socio-economic development, in turn, enhancing population control. This “Tunisian exception” will later on explain the country’s status as a top performer in terms of GDP per capita growth, in the region.

The shift to collectivism

As soon as the economy was stabilized, following the devaluation of the dinar, Ben Salah started maneuvering to introduce collectivism. But there has to be a political decision. This came at the Neo-Destour Congress in 1964, when the ruling Party changed its name to become the Socialist-Destour Party. The resolutions that came out of the Congress called also explicitly for the coexistence of three sectors: public, cooperative and private.

Ben Salah scored undoubtedly a new success. This owes much to his personal qualities, particularly his dynamism, relative integrity and commitment. Nevertheless, it is our contention, that all these qualities would not be enough, had Bourguiba had a proper counseling. Indeed, as a veteran politician with a clear modernization agenda, Bourguiba did not have an economics background himself, and did not seem to have a genuine interest in the technical aspects of economic management. In addition, the liberal wing of the Neo-Destour failed to present any credible alternative strategy for development.

For the implementation phase, however, the authorities had to take into account the positions of key interest groups. Indeed, as it was correctly pointed out by Nugent [1989, page 295] “cooperativization of private property would not have been possible if producer organizations had been strong.” In fact, these organizations were all but decimated, following the policies of neutralization, co-option and the amalgamation of the diverse activities into an overall umbrella type of organizations, which was particularly the case for UTICA.

With their associations in shambles, the only way producers would be able to effectively voice their concerns, is outside the official organizations, either in a disorganized manner or by creating illegal ones. Both options were extremely difficult to implement. The government's intolerance of any type of dissidence was made very clear by its decision to disband the communist party and by responding with overwhelming use of force to quell the violence which erupted in the town of M'Saken and other regions in the mid-1960s to protest against cooperatives. This does not mean, however, that producers' interests were irrelevant to the government. Interestingly enough, the weakest groups in terms of collective action were the first to be targeted for collectivism (farmers, transportation, and local commerce).

The fall of collectivism

After four years of collectivism, Bourguiba dismissed Ben Salah and abolished the cooperatives. It was an abrupt move that changed dramatically the way Tunisia will develop during the following decades. Bourguiba's decision followed a World Bank Report on Tunisia in 1969, which focused on the severe fiscal crisis that the country was facing. The experience of the year 1964 showed, nevertheless, that an economic crisis by itself was in no way sufficient to bring down the government, and it is even less likely to engineer a radical shift in policy. The difference this time is that the crisis was aggravated by popular discontent about expropriation, shortages, and a severe drought for three years in a row. But, one could still argue that similar problems were also encountered in other countries in the region, without having the same impact.

In order to explain the decision to abandon collectivism, we need to look at the pillars of the civilian regime in Tunisia. An ailing Bourguiba could hardly afford the consequences of a forced collectivization. The large popular discontent and especially the violence that continued to erupt in different regions of the country would require a strong response from the security apparatus and, eventually, a need to call in the army. The latter option would have been particularly horrifying for Bourguiba, given his well-known distrust of the military, at least until he fell to total senility in the 1980s.

Ideology seemed also to be an important factor. For the western-educated, liberal-minded Bourguiba (at least as long as his own grip on power is not concerned), the puzzle remains his adoption of the socialist orientation in the early 1960s, not its abandonment in 1969. This is indeed in contrast to many other Third World countries, where socialism was implemented by dogmatic socialist leaders.

As soon as Ben Salah was dismissed, the government started a reversal of the most damaging and unpopular aspects of the former policy, namely cooperatives. Private initiative was reinstated and hailed as en engine of growth. This was obviously a great relief for the population. Indeed, as the system was collapsing, even the supposed winners like the public sector employees and urban consumers, had to face for widespread shortages. Except some leftist groups that continued to explain the abandonment of socialism in terms of class interests, almost every body else welcomed the change.

VI. A Two-track Strategy: 1970-80

Following Ben Salah's departure, Mr. Behi Ladgham, a long-time companion of the President and a genuinely popular figure, continued to head the government. For the implementation of his grand scheme for economic reconstruction, however, Bouguiba needed new competencies.

In 1981, the then Governor of the Central Bank, Hedi Nouira was appointed Prime Minister. The most decisive factor in Nouira's appointment seemed to be his commitment to private initiative as well as his financier's background.

The system that Mr. Nouira is now in charge of, had suffered greatly at the representation level. The disastrous adventure of the previous decade showed clearly how the leadership was not immune from making terrible mistakes. As a result, a crisis of confidence reached the ruling party itself where an opposition emerged between a technocratic wing headed by Prime Minister Nouira and a liberal wing headed by the interior minister Ahmed Mestiri. The latter was claiming the need to accompany economic liberalization with political openness. But Bourguiba sided with the Prime Minister and Mestiri was sacked.

In the economic sphere, however, the government's credibility didn't suffer as much. Prime Minister Nouira came up with an economic program that puts emphasis on export promotion and the need to attract foreign investment, and he succeeded to set up a homogeneous technocratic team to implement it. Coordination, during this period, kept relying on the central planning mechanisms that were established during the pervious decade. New institutions were created to respond to the needs of the new development strategy. And, good luck played a helpful role for the new government, with the end of drought and the event of the first oil shock.

With collectivism dead, the alternative could be either the adoption of laisser-faire or a hybrid system combining both private initiative and government intervention. In practice, the Nouira team implemented a two-track strategy. The idea here is to create new opportunities but without unduly destroying the pillars of the old system (Lau and al. [2001]). In China, as an example, the system was very successful in agriculture where the old rules continued to be enforced (farmers had to supply a given quantity of produce at a pre-determined price), but at the same time, farmers were allowed to sell any extra in the free market. In the same vein, public sector enterprises were maintained while private entrepreneurship in new ventures was encouraged both in the mainland and in the "Special Economic Zones."

In Tunisia, the experiment started with the adoption of the 'off-shore companies' Law in 1972. This regime granted exporting projects (irrespective of whether they are local or foreign-owned) the ability to freely import the needed equipment and other inputs, and it exempted them from paying taxes (to be limited to a period of ten years, since 1994).

The experiment that Mauritius carried out during the same period may have served as a model for the Tunisian decision-makers. Indeed, the following analysis of Mauritius' economic processing zones (EPZs) by Wellisz and Saw (quoted in Rodrick [1998, page 1994]), could apply to Tunisia as well:

“A completely outward orientation was politically unfeasible in the 1970s since protection was the key to prosperity of the import-substituting industry [which] constituted a powerful lobby. But [import-substituting industrialists] were not disturbed by the formation of an export-oriented enclave: on the contrary, they welcomed it as another potential source of profits. Mauritian labor also favored economic segmentation: the high-wage sector -sugar and import-substituting industries- constituted a male enclave. The EPZ industries employed women, whose earnings supplemented family incomes and who did not compete with the men. For the export-oriented industries, too, the enclave solution had obvious advantages in that the quasi-extraterritorial status provided a degree of protection against the government’ s dirigiste tendencies.”

As far as local investment is concerned, licensing was consolidated with the creation of the ‘Agence de Promotion de l’Industrie’ (API) whose agreement was required for bank financing of any private sector industrial project. This licensing system resulted, however, in red tape, cronyism and lack of competition. In the same vein, a center of export promotion (CEPEX) was created to help exporters’s access to foreign markets and a small and medium size enterprises credit scheme (FOPRODI) was set up to develop local entrepreneurship.

Government intervention increased. Price controls became prevalent with the implementation of the so-called ‘systeme d’homologation des prix.’ According to this system, the Ministry of the Economy had to handle the prices of thousands of items. And firms need the Ministry’s approval for any change in prices.

Protection was also consolidated. Indeed, the available evidence shows that the import bias became even stronger in the 1970s (Nabli and al [1999]). But exports didn’t suffer, since most manufacturing exports would come from the off-shore companies, whose special status protected them from the restrictions faced by the local sector.

At the financial sector level, low interest rates and overvalued currencies were prevalent in developing countries, during this period. The rationale for this policy is that an overvalued currency provides for relatively cheap imported inputs and equipment while low interest rates provide affordable credit to firms as well as to the government. In Tunisia, however, while interest rates were kept at below-equilibrium levels (Bechri [1989]), the exchange rate was corrected on a regular in order not to inhibit exports.

According to the available estimates, reported in Table 1, the equilibrium exchange rate of the dinar appreciated mildly, during the 1970s, at an average annual rate of 0.5 percent. And the black market premium was limited to 10 percent, which was a sign of no significant overvaluation of the currency.

As regards bank credit, it was argued that rationing at below-equilibrium interest rates provides, among other benefits, a stimulus to private investment and an affordable source of financing for the government. Also, in the same vein, it was argued that some priority activities like exports and agriculture deserve a preferential interest rate. However, since the early 1970s, economists in the Mckinnon-Shaw tradition argued convincingly that financial repression was extremely costly in terms of financial sector development, savings mobilization, and resource allocation.

The development strategy that Tunisia adopted since the early 1970s, was viewed by some economists as fundamentally inconsistent (Moussa [1994]). In what follows, we analyze these inconsistencies in terms of interest groups preferences.

The role of interest groups

In order to assess this role, we start with an assessment of groups' <u>expected</u> success in collective action, followed by an estimate of their <u>actual</u> success.

Expected Success

Producer groups are classified in the three following categories: (1) nontradables, (2) import-substitution, and (3) exportables. Based on the theory of collective action presented above, the expected degree of success of these groups in the Tunisian context, is presented in Table 3 below (low: L, medium: M, and high: H).

As regards non-tradables, one should notice that construction is not threatened by foreign competition. Moreover, this activity is dominated by a small group of large entrepreneurs established in the main cities. As a consequence, one would expect this group to be very successful in collective action, especially by concentrating on a small set of objectives such as obtaining bank credit and benefiting from preferential tariffs for imported equipment. Indeed, the elimination of rent control, since the early 1970s when price controls of other goods and services were prevalent, is testimony to this group's success. But non-tourist services are expected to be hindered by large number and lack of concentration.

Within import-substitution, collective action differs according to the type of activity. Agriculture for instance, is important in terms of its share in the labor force. Also more than half of the total population was living in rural areas during this period. However, from the theory of collective action's point of view, the predominance of agriculture constituted rather a major source of weakness for this group. Most Tunisian farmers were involved in subsistence activities, thinly spread all over the country, without either realistic possibilities of success in or the motivation for collective action. The attractiveness of the 'exit solution', moreover, contributed greatly to this weakness. This 'exit' took the form of migration to wage jobs in urban areas, whereas for the wealthy landowners, it frequently took the form of investments in more profitable activities, such as commerce, tourism and industry.

Furthermore, the homogeneity of goals such as the claim for subsidies and higher prices for their products, contributed to the development of a free-rider mentality wherein small farmers could expect to rely on their large urban-based counterparts for leadership in accomplishing these objectives. Not surprisingly, therefore, the presence of UNAT is largely confined to the big cities where its main source of support is a minority of large agro-industrial farmers (Bechri [1989] and Nugent [1989]).

The remaining import-substituting activities are food processing, wood and paper industries and construction products. These activities are expected to be successful in collective action given their limited number and geographic concentration. These industries concentrated on a set of limited goals, especially the need for protection from both domestic and foreign competition as well as better availability of credit.

Finally, the success of construction products is due to the fact that some large units, like cement factories, are publicly owned, which further enhanced their lobbying.

Export-oriented industries are a priori in a good position to influence policy since they help achieve an important government objective. A particular success in this respect was scored by the “mechanicals and electricals” sector. This activity started as an import-substitution aimed at absorbing local demand. But, the establishment of foreign companies including some multinationals’ subsidiaries demonstrated to Tunisian business the existence of opportunities in exports for products like auto-parts, cables, and batteries. As a result, the sector shifted gradually from import-substitution to exportables. In addition, expected success for chemicals and mining was enhanced by the fact that these activities are mainly State-owned.

However, not all exportables were expected to be as successful. Indeed, the main activities of textiles and leather, and also tourism, are less concentrated and they may be hindered by heterogeneity of goals. The “Textiles Federation,” as an example, has to take into account conflicting demands from import-substitution activities like spinning and weaving and from exportable activities like clothing.

In addition to this heterogeneity of goals, UTICA’s aging leadership was losing its legitimacy with the passage of time. This led the government to make the payment of dues compulsory since 1976. A decision that saved UTICA from bankruptcy, but it also made it totally dependent on the public purse.

Actual success

The indicators generally used to assess actual success are the effective rate of protection and the access to bank credit (Nugent [1989]). Estimates for Tunisia are reported in Table 4. A comparison with sectoral averages provides an estimate of the actual strength of each activity in collective action (High: H, Medium: M, Low: L).

The comparison between actual success (Table 4) and expected success (Table3), shows some differences. Non-tourism services, textile and leather and tourism turned out to be more successful than expected, during the 1970s. Data reported in Table 4 show that this result is due to a high effective protection rate for non-tourism services. Textile and leather finished products were also highly protected from foreign competition. And the activity's access to bank credit was higher than average. This is not surprising since the sector was boosted by the off-shore company Law, and it became the main exporting activity in manufacturing. Tourism was also successful in its access to bank credit for similar reasons.

For some other activities, however, actual success turned out to be lower than expected. This is the case of construction, food processing, wood and paper, mechanicals and electricals, chemicals, and mining. This result is surprising for construction since this activity is of low risk for banks and it enjoys a natural protection from foreign competition. But during this period, the financing of this activity was entrusted to the "Caisse Nationale de l'Epargne Logement" (CNEL). And regulation prevented other banks from financing real estate projects. In addition, some State-owned companies were very active in this sector, and their reliance on government made them less dependent on credit.

The weakness for food processing and wood and paper is due to low access to bank credit which, as mentioned above, was administratively allocated to export-oriented activities. In addition, food products enjoyed less protection so they could be provided at an affordable price to consumers.

As was mentioned above, mechanicals and electricals continued to develop during the 1970s as an import-substitution activity. The sector enjoyed relatively low protection but it had the highest ratio of access to bank credit, among all economic activities (Table 4). Both conditions were instrumental in the sector's successful transition to become an exportable. The exposure to foreign markets left no choice to companies but to modernize in order to be able to compete internationally. And bank credit provided the needed funds for the industry to expand.

As regards chemicals and mining, the public sector has a predominant role in these activities. The main units in chemicals are joint ventures between the Tunisian government and foreign parties, using the locally produced phosphate as an input.

Their access to bank credit was enhanced by their export orientation. And mining activities were a monopoly of the “Office des Mines,” which has a privileged access to government funds.

The role of ideology

In addition to the role of interest groups, ideology may also have been an important factor in explaining the policy choices that Tunisia made since the early 1970s. On the one hand, the establishment of the free processing zones was unique to Tunisia in the whole MENA region, since even the liberal regimes in countries like Morocco and Jordan failed to adopt it. But on the other hand, distortions increased in the 1970s.

Tunisia’s failure to radically reform the system as Chile successfully did in the mid-1970s, was probably due to the fact that Chile’s reforms were generally met with suspicion in the rest of the world, at that time (Edwards [1998]). As a consequence, they could easily be discarded as extremist or irrelevant in the Tunisian context, if they were at all contemplated. Also, the absence of an economic team capable of providing a coherent and consistent master plan may explain the contradictions of the strategy. Unlike Chile’s ‘Chicago boys’ or Indonesia’s ‘Berkeley Mafia,’ the members of the Nouira team in Tunisia were mostly of legal, engineering or public administration background. Hence, they lacked a formal training in economics in the Anglo-Saxon tradition that favors market mechanisms. Also, the oil boom of the 1970s, allowed the Tunisian authorities to cover up for huge inefficiencies in the public sector and to delay many actions deemed necessary in a competitive market economy.

But despite its pitfalls, the two-track strategy succeeded to a large extent, as far as employment and foreign currency earnings are concerned. New job opportunities were created for non-qualified labor. And offshore companies became the main source of exports in manufacturing.

The economic success allowed major stakeholders to develop vested interests in the system. The expansion of FORRODI developed a whole new class of entrepreneurs.

Public-sector employees benefited from the increase in the number of public enterprises, the expansion in the civil service and better wages. And farmers benefited from the liberalization of agricultural prices and the general economic boom. But all these gains do not exclude the existence of conflict of interests. Indeed, a major crisis erupted in January 1978 when the ruling party conservatives felt threatened by the increasing influence of UGTT and resorted to violence to keep their hegemony.

With the passage of time, some drawbacks of the strategy became also increasingly clear: a lack of integration between the onshore and offshore sectors, serious misallocation of resources, technological backwardness, poor productivity and lack of consumer choice. Government incurred also revenue losses due to the tax holiday enjoyed by the offshore sector. But, as long as the two-track strategy seemed to work, we presume that the authorities wouldn't even see the point in a policy shift to a more liberal regime.

In 1981, the architect of the liberalization program had to be replaced. The new government had no choice but to maneuver in a difficult situation of political unrest aggravated by the deterioration in Tunisia's terms of trade. The new policies were mainly populist in nature and dictated by the need to accommodate public pressure. The episode ended up in a severe balance of payments crisis in 1986, followed by the adoption of structural reforms.

G. Economic Populism in Action: 1981-85

The change in government that took place in 1981, was mainly dictated by the deteriorating health conditions of Prime Minister Hedi Nouira. The President appointed Minister Mohamed Mzali, a close confidant, as the new head of the government. However, a literary critic, Mr. Mzali lacked obviously the management experience of his predecessor. And with the memories of the 1960s still present, Bourguiba couldn't afford to neglect the economy once again. To that end, he instructed the appointment of Mansour Moalla, a man regarded as a particularly competent banker, to the position of Finance and Planning Minister.

With a rigorous management of the economy secured, Bourguiba may have thought that Mzali would be able to take care of the rest. But he was wrong. A demanding national trade Union, political unrest led by the islamist movement, and Palace intrigue, all left their toll on what turned out to be a lame-duck government.

The political set-up

Mr Mzali had first to face with political realities. To gain credibility, he needed to get out of jail the UGTT leadership and other political activists from leftist and islamist groups. This was obviously no easy task, given the President’s increasingly volatile character. Step by step, however, Bourguiba’s amnesty was secured for all of them.

But this was not enough. With no political power base of his own, Prime Minister Mzali was vulnerable from the beginning to all sorts of interferences, especially from the Palace and the national trade union. Soon, freed UGTT leader Habib Achour will withdraw his membership from the ruling party and refuse to cooperate on the issue of food subsidy reform. The crisis of confidence ended up in a violent confrontation in 1984 with the eruption of the so-called “bread riots.” Meanwhile, Palace intrigue continued unabated and culminated in undermining the government efforts to re-establish law and order.

The economic set-up

The economy inherited by the new government was in a relatively good shape, thanks to Mr. Nouira’s rigorous management. It became more diversified and export-oriented. But the data reported in Table 4 show that non-tourism services, wood and paper and construction products became less protected, while food processing and mechanicals and electricals enjoyed much more protection. These changes resulted in large scale distortions. Available estimates for this period show that 65.5% of total private investment in Tunisia was allocated to non-tradables, 20.6% to importables and only 13.8% to exportables (Bechri and Lahouel [1999]).

As regards access to bank credit, there was a noticeable decline for exporting activities of textile, leather and tourism. This may be an attempt by banks to diversify by allocating higher credit to promising activities like food processing, chemicals and mining. Moreover, one should notice that both coordination and commitment suffered under the Mzali government. Policy coordination weakened due to conflicting demands. The UGTT leader's close connections with Bourguiba's influential wife Wassila Ben Ammar (Khiari [2000]), strengthened his negotiating position with the government. And conflicts among the Ministers themselves sent a strong signal about the inability of the government to commit to policy.

Ultimately, Mr. Mzali had no choice but to give in to 'macroeconomic populism' with the redistribution of income having the upper hand on stability conditions (Edwards and Dornbusch [1990]). In 1982, the government decreed a wage increase, which was particularly unwarranted from an economic point of view since productivity was declining at that time. As a result, inflation reached 14% during the same year. It was the first time since the crisis of 1964 that Tunisia experienced a double-digit rate. And, both the fiscal and current account deficits increased dramatically, reaching alarming levels of 6.6% and 7.1% of GDP, respectively, in 1985. Tunisia's terms of trade started also to decline in 1983, and fell by 6.2% in 1985 and 13.8 % in 1986. Despite the gravity of the situation, however, the government failed to respond even with limited corrective actions, such as a devaluation of the dinar and fiscal discipline.

With an overvalued currency, stagnating manufacturing exports, and the dire conditions of public finances, the need for an immediate correction should have been evident. But the presence of two antagonistic points of view within the government itself, made any serious action impossible. 'Super' Finance and Planning Minister Mansour Moalla, who owes his position to the President not to the Prime Minister, was pressing for the elimination of food subsidies. But another wing, headed by Mr Azzouz Lasram, the economics Minister, favored a gradual approach. For the sake of his own political survival, Mzali sided with the latter. With the so-called 'bread riots' erupting in other countries in the region, he should have been well aware of how risky the elimination of food subsidies would be for his government.

It is only when public finances reached alarming levels, did Mr. Mzali consider reform. Despite its seriousness, the decision could be implemented without constituting a major threat to the government. For if the removal of food subsidies was accompanied by a proper compensation (social safety nets targeted to the poor, wage increases for the public sector employees, etc…), this would allow the authorities to contain disruptions. Indeed, according to (IMF [2000]), the risks of social disruptions in a period of food subsidies reform, could be minimized if the authorities: (1) adopt a gradual approach, (2) choose the appropriate timing, (3) provide an adequate compensation for the poor, and (4) succeed to launch a public relations campaign to sell the idea to the public.

The decisions that were announced on January 1984 were, however, just the opposite. First, the price increase (of more than 100 percent for bread) was particularly high. Second, political tensions were rising at that time, which saw demonstrations by leftist groups and by islamists who became emboldened by the success of the Iranian revolution. In addition, the co-option of the labor organization by the ruling party came to an end with the resignation of UGTT leader from the Neo-Destour. Third, there was no compensation for the poor since the announcement that was made, in this respect, lacked credibility. And fourth, the campaign that was launched to explain the change in policy to the public was unsuccessful. But it could never be over-emphasized that the failure to fulfill these prerequisites, was the responsibility of the political circles (the ruling party and the political advisors of the government) and not of the economic team.

When the price increase was finally announced in January 1984, riots erupted immediately. And Mzali's opponents' next move was to sabotage public security. The then interior minister Driss Guiga, saw always himself as a potential future Prime Minister, thanks to his close ties with Bourguiba's wife. When rioters took to the street, they were immediately quelled by the police. During the following days, however, security forces were no where to be seen, especially in the capital city.

Bourguiba’s immediate reaction to the street violence was to cancel the price increase, blaming once again members of the government for bad counseling. But he renewed his support for the Prime Minister. The anti-Mzali clan has failed.

The return to square one was met with an apparent relief, especially by the poorest strata of the population, which would bear the full brunt of the price increase. The rich wouldn’t bother much about the whole thing. And the middle class was the main loser, since it had to pay a disproportionate share of the subsidies.

Meanwhile, maintaining food subsidies was unquestionably bad news for macroeconomic balances. Both the fiscal and the current account deficits widened. Following a presentation on the alarming state of the economy, the President decided to appoint a new Prime Minister in the Summer of 1986.

The appointment of Mr Rashid Sfar as the new Prime Minister was testament to Bourguiba’s ability to take appropriate decisions, even at an advanced age. Mr. Sfar was a man of integrity, with a long experience in the Tunisian Administration. More importantly, his financier’s background should have been of a primary importance to the President. But he arrived too late. In addition to the economic mess it inherited, the new government (like the previous one) had to take into account the conflicting demands from Bourguiba’s entourage and to deal with street unrest.

Meanwhile, the Central Bank’s foreign reserves fell to a critical level, which sent the government begging the International Monetary Fund (IMF) for help. The reform package to be adopted following the signing of a Stand-by Agreement with the IMF will soon reach the political arena. In a situation of total chaos, the interior Minister was appointed to head the government. The latter took immediately advantage of the situation to grab power. On November 7, 1987, President Bourguiba was removed. The official reason invoked was senility.

H. 1986-91: The crisis-triggered economic reform

According to Bates and Krueger [1993] (cited in Edwards [1998]) "there is no recorded instance of the beginning of a reform program at a time when economic growth was satisfactory and when the price level and balance of payments situations were stable. Conditions of economic stagnation… or continued deterioration are evidently prerequisites for reform efforts." In this respect, Tunisia and other MENA countries fitted well the stereotype. Indeed, as indicated in Table 6, all adjusting MENA countries adopted reforms only in a crisis situation. In Tunisia and Morocco both the budget and current account deficits reached alarming levels of more than 7% of GDP in the pre-adjustment period. In Jordan, the current account deficit was 10,5% of GDP and inflation rose to 25.7% in 1989. And in Egypt, the budget deficit reached 5% of GDP while inflation reached 20% in 1991. One should also notice that Tunisia started relatively early its adjustment program, which made it a regional leader in many respects.

Three months after Tunisia adopted the structural adjustment plan, a change of the head of the State took place. The peaceful transition provided ideal conditions to go forward with economic reforms. Indeed, most of the 16 hypotheses about reforms listed in Isfahani [2000], were observed in the Tunisian context at that time. The crisis of August 1986 was a powerful trigger for radical reforms. A general consensus emerged about the need to take bold action. The emergence of winners, especially in export activities, enhanced the sustainability of reforms. The International Monetary Fund was ready to provide the external support needed. The newly established regime benefited of an exceptional honeymoon period, and it managed successfully to domesticate local opposition, especially the national trade union. Finally, several attempts were made to compensate the losers.

One should also notice that the new President was in a privileged position, at the Interior Ministry, to follow up the deteriorating situation of the country since the early 1980s. Once in charge, he should have been aware of the need of institutional arrangements to ensure better governance. First, he turned down suggestions to create a new political party, preferring instead to "rejuvenate" the Neo-Destour. Second, a

"National Chart" was promulgated in 1988 to which adhered all major political parties, including islamists. Moreover, coordination was strengthened with centralized power, a domesticated trade union and co-opted business associations.

As regards credibility, the country lacked institutional enforcement mechanisms. Nevertheless, the general consensus to open up the economy, the appointment of a pro-export leadership at UTICA, and the signing of the Stand-by Agreement with the IMF in 1986, all made the return to protection unlikely.

The Stabilization program succeeded rapidly. The main actions to be undertaken were a strong devaluation accompanied by restrictive monetary, fiscal and income measures. As a result, the nominal devaluation translated into a real depreciation of the dinar by 14.5% in 1986 and an additional 8.6% in 1987. Also, the current account turned into a surplus in 1988, followed by moderate deficits for the subsequent period.

Structural reforms were also adopted to liberalize the price, investment and trade regimes. Prices were liberalized at both the production and the retail trade levels. Investment licensing by API was eliminated, even though API agreement is still required for projects that need government subsidies. Import licensing was gradually reduced to 60% of tariff lines and 70% of imports, in 1991. Import duties were reduced from an average of 41% in 1986 to 33% in 1987 and to 29% in 1990. Their dispersion also narrowed, with the maximum tariff brought down from 200% to 43%. Furthermore, by joining the GATT in 1990, Tunisia took tariff-binding commitments, covering about a third of its industrial imports. As a result of these measures, private investment shifted at the expense of non-tradables to exportables (especially manufacturing) and to a lesser extent to importables (Bechri and Lahouel [1999]).

Institutional reforms were however hesitant and, in some instances, they were clearly lacking, especially in critical areas like public administration, education, banking, telecommunications and the labor market (Bechri [1999]).

The severity of the 1986 crisis choked off the main interest groups as it did to the rest of the country. With UGTT leadership in jail, the only associations left are producers' organizations UTICA and UNAT. These business groups long used to protection realized that they have no other choice but to adapt to the new orientation. Indeed, the newly appointed President of UTICA as well as the other Bureau members were among the most successful Tunisian exporters. This came as no surprise since export activities are expected to benefit from a more favorable exchange rate and the opening of the local market to offshore companies. But these same exporters could also be involved in import-substitution and non-tradable activities. This dual status may be a reason behind renewed business attempts at re-establishing protection.

As indicated in Table 4, effective protection rates declined from 1986 to 1990 for all activities, except construction products and mechanicals and electricals, but their levels remained high compared to other developing countries. In addition, there was no noticeable shift of bank credit to exportables after 1987 as one would expect.

Also, the authorities could have advanced more rapidly in the so-called 'second-generation' reforms whose ultimate aim would be a reinvention of the State itself. Unfortunately in this respect, the government was extremely hesitant. Indeed, it even endorsed reversals like the establishment of temporary tariffs, starting 1992.

I. The politics of reform uncertainty in the post-adjustment era (1992-94).

The pace of economic reforms started to slow down since 1990. Delays were particularly important in reforming the public administration, the labor code, State-owned companies and banking. Also, the private sector remained completely excluded from crucial activities like telecommunications and infrastructure.

There has also been some policy reversals, mainly in foreign trade. Temporary surcharges were established in 1992, on some manufactured consumer goods like clothing and footwear. In addition, effective protection rates rose as a result of the decline in tariffs on intermediate goods. Other restrictive measures on imports took the form of technical control under the so-called 'Cahiers des Charges' regime. In this respect, tariffs as well as local taxes were levied on an administratively assessed value of imports that applied to roughly 25% of import lines, and constituted yet another protectionist device. All these reversals sent obviously a wrong signal about the government’s commitment to reforms by indicating to the private sector that protection can always take place by one type of restrictions or another. Needless to say that these reversals took place despite the fact that Tunisia’s commitments under WTO provided for tariff rates bounds that were relatively high compared to similar economies, especially in manufacturing (Bechri and Lahouel [1999]).

These conflicting measures explain, to a large extent, why despite some improvement at the institutional level, such as the adoption of a unified investment code in 1993 and the removal of import licensing in 1994, private investment failed to recover and FDI outside the energy sector remained weak. Under these conditions, the authorities realized that additional and particularly bold measures are needed. And in 1995, Tunisia was the first South-Mediterranean country to sign an Association Agreement with the European Union, which provided for the establishment of a free trade area.

J. The Association Agreement with the European Union (1995-2000)

The signing of partnership treaties with the South-Mediterranean countries was a strategic option for the European Union (EU), as it was clearly stated by its Council in 1994. From the Tunisian point of view, however, the bilateral relations were scheduled to be re-examined in 1995, and the Tunisian authorities were particularly concerned that the EU may ask for reciprocity, since Tunisian goods benefited already of a preferential access to Europe, according to the bilateral agreement signed in 1976.

The official rationale seemed to be that the first signatory from the South-Mediterranean region will benefit the most from: (1) EU’s financial support, (2) industrial relocation, (3) enhanced credibility by locking the economy into an irreversible set of reforms, and more generally (4) coming in first will give Tunisia an advantage in terms of determining the content of the agreement (Bechri [1999]). But, one should notice that this rationale might also be valid for countries like Egypt, Morocco and Jordan, which were hesitant to sign a similar agreement with the EU at that time. Some differences in interest groups characteristics may explain the Tunisian decision.

First, the three decades old export-oriented strategy in Tunisia ended up creating a new constituency, which has a stake in exports. According to the most recent available estimates for the textiles and clothing sector, as an example, out of a total of 1,540 exporting firms, only a third (536 firms) are foreign-owned, 333 firms are partnership companies, and the remaining 671 firms are locally-owned. Other activities, like mechanical and electrical, shifted gradually from import-substitution in the 1970s to exports starting the late 1980s. This is a sign of a better performance, but it also means that these activities are now more interested in export promotion than in protection. This is a major difference between Tunisia and the other countries in the region that failed to develop an export-oriented manufacturing sector. The above-mentioned change in UTICA leadership, after 1987, where exporters had clearly the upper hand, strengthened the business association's support to the government's decision to sign the free trade agreement with the EU. Industrialists expected, indeed, to benefit primarily from the immediate elimination of tariffs on imported equipment, the decrease of tariffs on imported inputs and the financial support of the European Union.

The second major difference relates to the domesticated labor union. In Tunisia, the newly established authorities agreed to free UGTT leadership and allowed the organization to renew its activities since 1988, but under the condition that the latter selects a new and cooperative leadership. As a result, strikes and violent protests became rare and UGTT leadership went along with all major decisions taken by the government. This does not mean that unions should be repressed for reforms to go on. Argentina during the 1990s, as an example, implemented radical reforms in a democratic setting where unions constituted in fact a pillar of the Peronist Party of President Carlos Menem. Nevertheless, a less cooperative UGTT leadership would have made reforms more difficult to the government in Tunisia. Indeed, it may even succeed to block the signing of the Association Agreement with the EU.

UTICA and UGTT were well concerned about the costs of adjustment. These concerns explain why Tunisia chose a long implementation period of 12 years for tariffs removal. The opening up of Central European countries like Poland and the Czech Republic took much less.

So far, the implementation of the association agreement is proceeding as planned and without major disruptions. A technological upgrading program ‘Programme de Mise de Niveau’ (PMN), funded by the European Union, started in 1996. As of April 2003, upgrading was approved for 1,448 firms with investments amounting 2.4 billion dinars, of which 24 percent was allocated to agri-business, 20 percent to construction products, 18 percent to textiles and clothing, 14 percent to mechanicals and electricals, 8 percent to chemicals, 4 percent to leather, and the remaining 13 percent to unclassified activities. Food processing was the primary beneficiary of the program due to the fact that food exports to the EU needed to respond to strict quality standards. The second sector is construction products. Its modernization indicates the important demand from the real estate and tourism as well as an attempt to reach to foreign markets. The textile and clothing sector is the main exporter in manufacturing. But its obsolete equipment and lack of qualified staff made it a prime candidate for the program. And the same is also true for the promising activity of mechanicals and electricals, which already made Tunisia an exporter of auto-parts, cables, and other electrical items to Europe, during the recent years.

From a labor point of view, things went also smoothly. No major bankruptcies took place. Dismissal of labor was limited. And there has even been reported instances where restructuring led to job creation.

But one should notice that the long implementation period of the free-trade agreement between Tunisia and the EU had also major economic drawbacks. First, by announcing the opening up of the economy to European competition by 2008, the agreement sent a wrong signal to business about the need to adjust. As a result, restructuring in import-substitution activities remained limited. This is harmful to consumers and it does not bode well for the competitiveness of these industries. Second, the bureaucracy and other entrenched interests (especially protected business and trade unions) succeeded to postpone badly needed reforms in crucial activities like the trading boards, telecommunications, and banking.

Trading boards in Tunisia have a monopoly on foreign trade in specific products like edible oil, cereals, tea, coffee and sugar. The ‘Office de l’huile’ was considered responsible for Tunisia’s failure to export well-packaged olive oil. Its monopoly power on olive oil exports was lifted, in the early 1990s. And the institution itself has now outlived its usefulness.

The ‘Office des Cereales’ has a monopoly on the imports of cereal products. But despite the inefficiencies observed, the Board is unlikely to be eliminated as long as the food subsidy system is in place. At this stage at least, it may be easier to tackle first the issue of the ‘Office du Commerce,’ which has a monopoly right on the imports of sugar, coffee and tea, especially that sugar is now withdrawn from the list of subsidized items.

As regards telecommunications, the sector used to be managed by the bureaucracy until the mid-1990s. This resulted in poor quality of services and high costs. In an attempt to modernize the sector, the authorities created Tunisie-Telecom, as an independent entity from the ministry. However, this public monopoly failed to respond to the needs of the country. And Tunisia ended up lagging behind countries like Morocco, which successfully liberalized its telecommunications during the recent years. In 2002, a second license for GSM services was granted to the Egyptian company ORASCOM and further opening of the sector to competition is now expected.

As regards banking, the sector is still dominated by State-owned institutions. As a result, costs for banking services remain high by international standards and non-performing-loans (NPLs) remain a major source of fragility of the system. Despite their decline following the introduction of prudential regulations in 1992, their share remain higher than 20 percent for all major banks, compared to an international standard of 6 percent. There has also been attempts at mergers and a public bank UIB was lately sold to the French Societe Generale. But these attempts remain insufficient if the sector is to be able to withstand the opening to international competition.

XI. Conclusion

During the last five decades, Tunisia outperformed most MENA countries despite its lack of a representative democratic rule. The Tunisian experience proved that a visionary leadership with a historical legitimacy, with the help of a technocratic team, can indeed successfully implement a development strategy.

The Tunisian experience proved also how crucial social modernization could be in isolating traditional groups and in rallying the support of women, trade unions and the liberal fringes of the population, as well as in improving the standard of living. Indeed, by lowering its population growth to 1.2 percent, Tunisia increased its annual income per capita growth rate by about 2 percentage points, during the recent period. And, an educated labor force to which women participated in increasing numbers, strengthened growth, enhanced income distribution and became a factor of political and social stability.

This success requires, nevertheless, a broad action and the right timing. Islamic countries that waited until the recent years to decree women rights (minimum age for girls' marriage in Morocco, women's rights to vote in Kuwait, etc...) failed miserably. Bourguiba's swift move in the late 1950s owes much to his ability to seize on the enthusiastic mood of the population, in the post-independence era and the weakness of the traditional establishment thanks mainly to his early strike of 1934 when he created the Neo-Destour.

The Tunisian case shows also the clear dangers of co-option. In the case of the trade union, the ruling party ended up adopting UGTT policies not the other way around. One should notice that some aspects of this policy such as government monopolies and labor rigidities continue to hinder the attempts at establishing market mechanisms until this day.

As regards producer groups, the adoption of the two-track strategy was a very convenient wary to create new opportunities in exports. Business with a stake in these activities provided a strong support to openness. But MENA countries that are willing to adopt the same strategy need to prevent the excessive protection of the on-shore sector, which was a main drawback of the Tunisian experiment.

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