





## Opening Markets: Creating an Environment for Investment and Jobs Creation

# 02



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## Opening Markets: Creating an Environment for Investment and Jobs Creation

**T**his chapter reviews the status of competition policies and their effectiveness in promoting functioning markets and more efficient resource allocation in Tunisia<sup>1</sup>. The previous chapter has highlighted an economy with stunted structural evolution where productive capacity is centered mainly on low value added activities and most of the jobs created offer low wages and limited job security. Firms are stagnating in terms of growth, jobs creation, and productivity; and the persistent lack of firm growth, combined with low exit rates, is indicative of limited competition in Tunisian markets. This lack of structural change and “creative destruction” is at the root of the weak economic performance of Tunisia and the insufficient rate of jobs creation. This chapter discusses the barriers to the efficient operation of Tunisian markets. It also presents an analysis of the expected benefits of increased market rivalry on productivity of Tunisian firms and highlights that Tunisia would reap large gains (in terms of faster growth and greater jobs creation) by allowing greater competition in the markets<sup>2</sup>.

The economic benefits from competition on growth, productivity and job creation are well documented by the international empirical evidence (box 2.1). Firms operating in a competitive environment are more likely to innovate and to increase their productivity and create jobs. Competition boosts investment, generates employment, and ultimately speeds up economic growth and improves overall welfare. Competitive pressure in input (upstream) markets, such as transportation, financial services, energy, telecommunications, and construction services, is a key driver of efficiency and productivity growth in downstream sectors—the users of these inputs. Increased international competitiveness is another important and positive effect associated with increased competition in domestic markets. Finally, consumers benefit from lower prices, direct savings, and improvements in the variety and quality of goods and services. Consumers also find enhanced job opportunities and additional income as investors.

As discussed in this chapter, Tunisia’s economic environment is not based on competition. It is not an environment in which the most productive firms can succeed, grow, and create jobs. A key reason for the status quo is the absence of a competitive environment in which successful firms thrive and grow and in which less productive firms eventually are pushed out of the market with the resources they employ easily reallocated toward new, more productive activities. This is largely the result of a regulatory environment that does not support competition—based instead on restrictions to entry that, as will be discussed in Chapter Three, breed rents-extraction and cronyism—and on the preponderant role state-owned enterprises (SOEs) play in the economy which also distorts competition as SOEs receive unfair advantages from the state.

### **Box 2.1: International Experience on the Impact of Competition on Growth, Productivity, and Job Creation**

The economic benefits from competition are well documented. Firms operating in a competitive environment are more likely to innovate (Bassanini and Ernst, 2002; Bloom, Draca, and Van Reenen 2011) and to increase their productivity (Acemoglu et al. 2007; Aghion and Griffith 2005). Competition boosts investment (Alesina, et al. 2005), generates employment, and ultimately speeds up economic growth and improves overall welfare. Competition in input (upstream) markets, such as transportation, financial services, energy, telecommunications, and construction services, is a key driver of efficiency and productivity growth in downstream sectors—the users of these inputs. Empirical evidence strongly supports the positive effects of competition policy enforcement on productivity growth (Voigt, 2009; Buccirossi, et al. 2009). Tough enforcement against the practices of cartels, based on well-designed anti-cartel laws, for example, constitutes an effective tool to reduce negative impact of anticompetitive behavior (Symeonidis 2008; Alexander 1994). Increased international competitiveness—and therefore more favorable terms of trade—is another important and positive effect associated with increased competition in domestic markets. Finally, consumers benefit from lower prices, direct savings, and improvements in the variety and quality of goods and services. Consumers also find enhanced job opportunities and additional income as investors.

Anti-competitive practices also result in welfare losses for the economy as a whole. Price-fixing agreements among competitors impose significant costs on society. Connor (2010) examines studies and judicial decisions on 381 cartelized markets worldwide and estimates a long-run median overcharge of 23.3 percent of prices above competitive levels. Estimations from the European Commission (2008) suggest that average productivity would fall by 13 percent in the presence of market-sharing cartel agreements among member states. A recent study of the international market for coffee beans finds that the cartel's breakdown explains 49 percentage points of the 75 percent drop in the real coffee price between 1988 and 2001 (Igami 2011). Apart from increasing the cost of goods and services to conduct business, cartels are also associated with low labor productivity and reduced incentives to innovate (Broadberry and Crafts 2001; Evenett, Levenstein, and Suslow 2001; Symeonidis 2003). In a study of 42 countries, Kee and Hoekman (2007) found that, in industries where competition rules were actively enforced, antitrust enforcement increased the number of domestic firms by 7.2 percent. Similarly, a 20 percent increase in an index scale—roughly equivalent to moving from the level of competition rules enforcement in the Czech Republic to that in the United Kingdom—resulted in faster total factor productivity growth of 1 percent.

International experience shows that the introduction of a comprehensive national competition policy framework can bring substantial economic gains. Australia is one of the countries that serve as an example of successful implementation of a national competition policy framework. Estimates suggest that competition policy reforms boosted Australia's GDP by at least 2.5 percent or US\$20 billion due to their effect on increased productivity and lower prices during the 1990s. Likewise, conservative estimates for the United Kingdom suggest that direct consumer savings resulting from the enforcement of competition law are worth US\$112 million a year. In the case of the Netherlands, the positive impact of the competition agency's actions on Netherland society is estimated at US\$426 million (a 3-year rolling average). Finally, recent studies also provide evidence that budgetary commitments to competition agencies and institutions yield economic benefits in terms of improved economic growth since they are associated with higher levels of per-capita GDP growth.

It is also important to highlight that there is a close connection between the discussion in this chapter on opening markets and the discussion in the previous chapter on jobs and productivity. In fact, the existence of monopolies and oligopolies (which may result from unnecessary barriers to competition) raises the costs for the rest of the economy, reducing the payoff to (job-creating) investment and productivity improvements. Further, the results shown in Chapter One have highlighted that removing restrictions to entry directly increases employment growth—because in Tunisia employment growth largely comes through creation (that is, entry) of new firms, such that restrictions on entry undermine jobs creation.

## **2.1 / How Open Are the Tunisian Markets?**

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**S**ince the 1970s Tunisia adopted a public sector-led development model that saw the state play an active role in strategic sectors and in imposing barriers to entry into large segments of the economy. Tunisia developed well during the 1970s as limited steps were taken to open up the economy, notably with the inception of the “offshore” regime (see Chapter One), coupled with proactive government industrialization policies. By the 1980s, however, the limits of the state-led economic model started to emerge as Tunisia was impacted by a severe economic crisis. Parts of the economy were liberalized in the late 1980s and 1990s with the consolidation of the “offshore” sector and as part of a process of greater integration with the European Union (EU). However, the core thrust of the economic model remained fundamentally unchanged because the state retained close control of most of the domestic economy. As a result, by the late 1990s the economy increasingly struggled to advance and economic performance remained insufficient<sup>3</sup>.

In fact, as discussed below, today over 50 percent of the Tunisian economy is still either closed or subject to entry restrictions, and numerous government regulations and interventions are distortive of market development and generate unintended barriers. Specifically we find that markets in Tunisia are not well functioning due to: (a) the existence of restrictions to the number of firms allowed to operate in the market, restrictions towards private sector activities, including restrictions to foreign investors, and prevalence of statutory monopolies; (b) the lack of a level playing field and of non-discriminatory treatment across firms; and (c) controls on prices and other market variables which increase business risk and reduce ability of firms to compete<sup>4</sup>. We discuss each of these three areas in turn below.

### ***Widespread Restrictions on the Number of Firms, Restrictions on Private Sector Activities, Especially for Foreign Investors, and Prevalence of Statutory Monopolies Hinder Competition in Tunisia***

In Tunisia, widespread restrictions on the number of firms allowed to operate in the market are coupled with many legal (public) monopolies and undue regulatory constraints in network sectors. Regulatory barriers discourage investors, both Tunisian and foreign, from creating new companies and expanding existing companies, and therefore hinder them from hiring more people (see box 2.2 and box 2.4). In fact, sectors in which investment faces restrictions account for over 50 percent of the Tunisian economy, whether through the Investment Incentives Code, the Commerce Code, the Competition Law, or specific sectoral legislation regulating services sectors—notably telecommunications, health, education, and professional services. The number of competitors is explicitly restricted by law or regulation in some markets (for example, water, electricity, telecoms, road transport, air transport, railways, tobacco, fisheries, tourism, advertising, health, education, vocational and professional training, real estate, agricultural

extension services, retail and distribution, and so on), such that several of these sectors at present remain de facto closed to competition. The operation of markets in Tunisia is also constrained by regulatory limitations on the number of competitors in network industries and other business activities and services, which restrict free entry. Network sectors such as gas and electricity; water

### **Box 2.2: Banking on the Future: Mobile Technology Meets Complex Regulations in Tunisia's Financial Sector**

TUNIS-It has been an uphill struggle for returning Tunisian expatriate Ramzi El Fekih to get his mobile-phone banking system, Viamobile, off the ground. First, he had to find a local bank to team up with. Under current Tunisian legislation, mobile banking can still only be provided via a bank.

Unlike in Europe, or even in the Arab Republic of Egypt, Jordan, or Morocco, the legal framework in this respect lags behind technological developments, El Fekih argues.

Viamobile allows clients to open accounts that they can access from their mobile phones. As well as busy urban folk, it hopes to attract people living in rural areas who are opening a bank account for the first time. Where it has been implemented, mobile banking has been beneficial for consumers and retailers especially in rural and remote areas, among the least served by traditional banking models.

Its distribution network would not ideally be through a standard brick-and-mortar bank, El Fekih says. "A mobile payments system has to be present everywhere—which is not the banking model. Our prices are cheap, and the only way we're going to be profitable is if we have volume."

However, having secured Banque Internationale Arabe de Tunisie (BIAT), one of the country's leading private-sector banks, as a partner, El Fekih's company Creova prepared to launch the service in 2009. The planned launch may have attracted the attention of Sakhr El Materi, son-in-law of then-president Zine el Abidine Ben Ali.

Word in Tunisian financial circles was that El Materi planned a mobile banking service for his own Banque Zitouna.

Three weeks before Viamobile was due to launch, BIAT was notified by the central bank that it should not proceed until further notice. No reason was given, El Fekih says. "We'd done everything by the book, so there was no reason to stop it. We knew something was going on."

The central bank repeatedly promised a clarification, which was never given. It was only after the 2011 revolution abruptly ended the influence of business circles close to the Ben Ali family, including the confiscation and sale of Banque Zitouna, that the central bank finally gave Viamobile the green light.

However "The distribution channel is a big hurdle still. It's our biggest complaint from users," says El Fekih. In 2012, officials from the technology ministry and the central bank got together to find a way forward for mobile payments. One idea was to put distribution and sales in the hands of approved individuals who would be certified as agents, said El Fekih. But, once again, there has been no update on official thinking, and he is not sure how things stand.

Société Monétique de Tunisie, which is owned by the country's leading banks and has a monopoly on processing credit card payments, should not see its revenue undermined by Viamobile, El Fekih says. "I see Viamobile as a complementary service, because users have access to a credit card issued by BIAT."

He estimates that Creova's sales, at less than one million dinars (about \$625,000) in 2013, could have been double that had the distribution issue been resolved. Indeed, financial-sector experts estimate that the potential of mobile banking in Tunisia is large and in three to five years could reach one million unbanked people and account for over \$1 billion in transactions.

"The regulations haven't changed since the revolution. The will to change is lacking. Things are still stuck."

*Source: Interview with Mr Ramzi El Fekih, Tunis, May 2014.*



collection, purification, and distribution; and rail transport (infrastructure operation, passenger and freight transport)—as well as other sectors such as the tobacco supply chain—are legal/state monopolies. In addition, regulatory barriers to international telecommunications and air transport entail de facto monopolies or oligopolies also in those sectors. It is not unusual across the world to see (public) monopolies in basic network utilities, notably water, gas, and electricity (although in some countries even some market segments of these utilities have been opened to more operators). In Tunisia, however, even the segments of transport and telecommunications services where private sector participation is common remain closed compared to comparator countries.

The telecommunications sector is characterized by low levels of competition due to restricted entry and regulations that do not promote competition among incumbents and that result in very high prices for Tunisian firms and consumers. The state-controlled operator, Tunisie Telecom (TT), holds a monopoly on fixed-line telephone communications, one of the three cellphone and 3G licenses in the country. In the national market, all operators use Tunisie Telecom's national connection infrastructure (backbone), including the administration and private companies. Tunisie Telecom also owns all the landing stations of international submarine cables and enjoys de facto a quasi-monopoly position in the sale of national and international leased lines. There are two more cellphone and 3G operators, namely Ooredoo Tunisie (which until April 2014 was called Tunisiana) and Orange. As of 2012 Ooredoo held approximately 53 percent of the mobile market, while Tunisie Telecom held approximately 36 percent and Orange held the balance of 11 percent. In practice, the telecommunications market can be characterized as a duopoly. In fact, given the restrictive regulatory environment that limits competition, it will be several years before the third cellphone operator, Orange, can compete on an even footing with Tunisie Telecom and Ooredoo<sup>5</sup>.

In the international telecommunications market, only the same three operators (Tunisie Telecom, Ooredoo, and Orange) are allowed to offer international voice communications in Tunisia. By contrast, Eastern Europe has, on average, 10 facilities-based international communications operators. Further, when it comes to international voice communication, the three operators offer international communications services only to their own access clients (that is, Ooredoo is not allowed to offer international communications services to subscribers of Orange or Tunisie Telecom, and so on)<sup>6</sup>. Good practice calls for liberalization of this segment (since a large number of operators typically operate in this segment) and allowing operators to address the whole access subscriber base in a given country<sup>7</sup>.

As a result of the limited competition in most segments of the telecommunications market, Tunisian consumers pay very high prices, which also damages Tunisian firms' competitiveness (box 2.3)<sup>8</sup>. It should be clarified that, while some segments of the telecoms market suffer from restrictions to entry notably in international telecommunications, other segments—for instance cellphone telecommunications—are naturally limited by the small size of the Tunisian market. However, even when the number of providers cannot be increased, it is important to regulate these markets so as to foster competition (for instance among the three providers in the cellphone market) and to remove the scope for oligopolistic profits (which are extracted at the expense of Tunisian consumers, firms, and the economy at large).

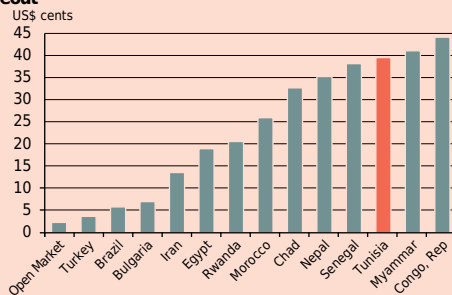
### Box 2.3 Comparative Snapshot of the Telecom Sector Performance in Tunisia

Whereas Tunisia aims to become an internationally competitive player in the global market, Tunisian consumers and private sector face some of the highest costs for communications in the world. A benchmark on “Skypeout” calls (which generally reflects the most competitive prices for international telecommunications) shows that an incoming international call to Tunisia costs \$0.40/minute—nearly twenty times the international market price and approximately twice the price paid in neighboring MENA countries (Morocco is at \$0.25; Algeria, Egypt, and Libya are between \$0.15 cents and \$0.20; Turkey is at \$0.04; France is at \$0.02; see figure B2.3.1). For instance a phone call from Paris to Tunis is 11 times more expensive than a call from Paris to Istanbul (Turkey being a model of successful reform). Prices of outgoing international calls are slightly cheaper but remain more than ten times the international prices. As a consequence, Tunisians avoid communication via international calls: Tunisia’s per capita international calling minutes amount to merely half the Arab Maghreb Union (AMU) average, they are 7 times fewer than the MENA average and 3 times fewer than Eastern European average international calling minutes (see table B2.3.1). Moreover, Tunisia’s international communications are stagnating, while other countries are increasing and using them as natural tools for a better integration of their economies into the global market. Again, the main reason is the high cost of international calls due to the monopoly in Tunisia, whereas MENA and AMU started liberalizing the sector in 2006. Similarly, despite the high prices charged to consumers for ADSL (Asymmetric Digital Subscriber Line, ADSL) services, the coverage remains limited and of weak quality, which has constrained the development of ADSL (World Bank 2012a; Gelvanovska et al. 2014). Even with much lower per capita income than Tunisia, Egypt and Morocco are better positioned to become regional hubs in the sector, with three and seven operators respectively. These numbers are still much lower when compared to more integrated countries such as in Eastern Europe (10 providers per country on average) (see figure B2.3.4). High communications prices discourage foreign direct investment (FDI), trade, and regional integration and are particularly damaging for the competitiveness in information and communications technology (ICT) and offshoring services—they also bear social costs for Tunisians at home and overseas.

**Table B2.3.1: Comparative Statistics on International Communications**

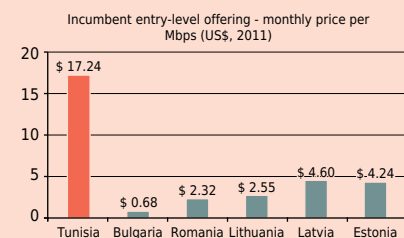
	Year of Liberalization	Per capita communication in 2010 (minutes)	Cumulative growth 2004-2010
MENA average	2006	181	10%
AMU average	2006	48	11%
Eastern Europe average	2002	73	8%
Tunisia	Not yet	25	1%

**Figure B2.3.1: Cost of Calls from the U.S. to Countries Using Skypeout**



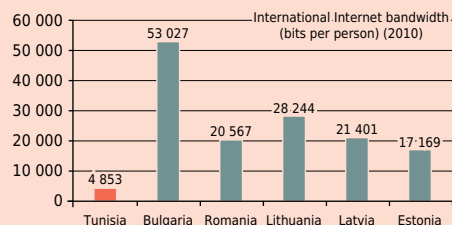
Source: Gelvanovska, Rogy, and Rossotto (2014).

**Figure B2.3.3: Entry Ticket for International Connectivity (\$/Mbps/month), 2011**



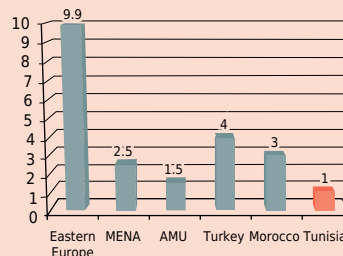
Source: Telegeography Globalcomms Database, Sep. 2011 and WDI

**Figure B2.3.2: International Internet Bandwidth Usage**



Source: Telegeography Globalcomms Database, Sep. 2011 and WDI

**Figure B2.3.4: Number of Providers of International Bandwidth, 2011**



Source: Gelvanovska, Rogy, and Rossotto (2014)



#### Box 2.4: Enabling Technology to Save Taxpayers Money

TUNIS-It was with a sense of another opportunity lost that managers at NGI Maghreb read in early May that thousands of official cars provided to ministerial staff and senior civil servants would be replaced by allowances. As part of the cost-cutting, gasoline vouchers issued to officials would likewise be replaced by more modest cash allowances to cover purchases at the pump, the cabinet had decided.

"Instead of simply cutting all the cars, they could have used our fleet management services to monitor mileage, location, and gasoline consumption," said Mohamed Chouchane, the company's associate manager. This was a clear example of how technological solutions developed by the private sector could promote efficient allocation of public resources, he argued.

NGI Maghreb, which employs 70 people at its Tunis offices, is the local operation of Groupe NGI, of France. It offers a range of location-based services (LBS), and is keen to start bidding for the public-sector contracts that are key to its growth strategy in Tunisia.

The company estimates that, on average, the use of its fleet management services results in an 18 to 20 percent reduction in fuel usage (which is the easiest saving to track). They see the possibility of making enormous savings, at Tunisia's Ministry of Agriculture, for instance, which has a fleet of over 8,000 vehicles of various kinds.

Tunisian legislation has failed, however, to keep pace with technical developments in this fast-evolving field, Chouchane says. With a new legal framework still under discussion, any ministry thinking of launching a tender for a private-sector operator to provide it with location-based services has to put that idea on hold for now.

As discussions proceed, Chouchane is concerned that a framework that might include official input on the pricing of LBS services could "prevent companies from coming up with solutions at costs that are in line with those elsewhere in the world."

NGI Maghreb is not new to administrative hurdles. Before the 2011 revolution, it had to overcome the intensely security-minded mentality of the era when in partnership with mobile phone operator *Tunisiana* it launched *Weenee* (meaning "Where am I?" in Tunisian Arabic). *Weenee* was to be the first GPS service marketed to the Tunisian public.

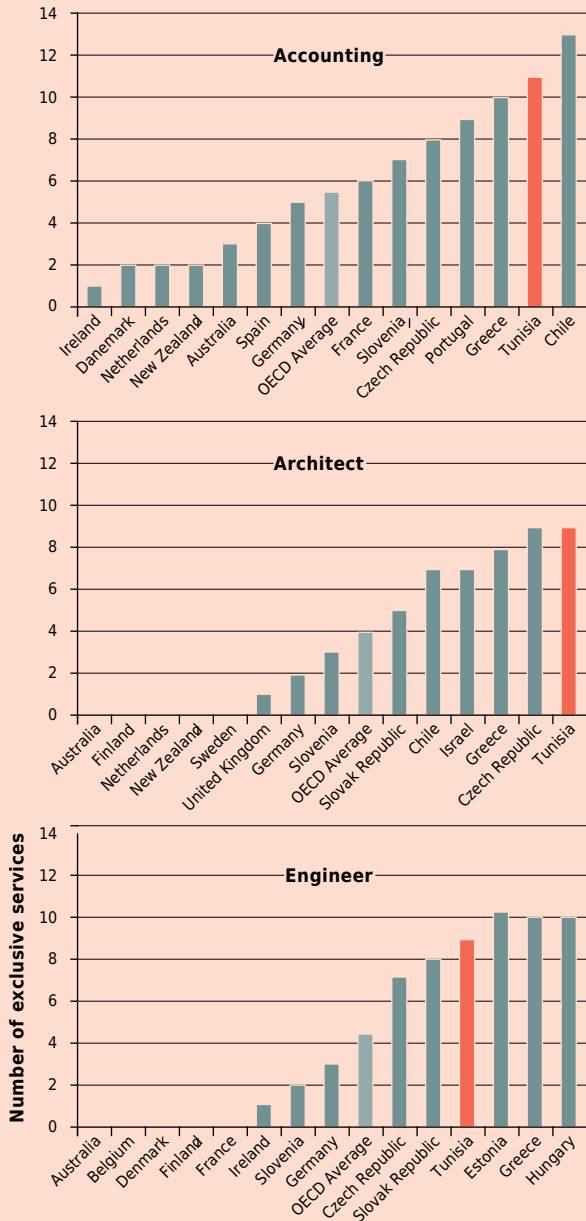
Its launch was delayed for some months in 2008, after the infrastructure ministry secured an injunction blocking it on grounds of national security. Chouchane recalls explaining to the ministry that imaging of the presidential palace, for example, was already available on Google Earth. It was only after NGI Maghreb successfully challenged the injunction in the courts that the launch was able to go ahead as planned.

*Source: Interview with Mohamed Chouchane, Tunis, May 2014.*

In the retail sector, several regulatory restrictions distort market conditions. The retail sector seems to be polarized and includes numerous micro shops and three large outlets<sup>9</sup> (the latter have around 16 percent of the market share and are distributing mostly food products, reaching around 62 percent of their sales); food prices distributed by large outlets seem to be on average lower by 10-15 percent than those in other shops, given economies of scale (Boughala 2013a)<sup>10</sup>. In an attempt to maintain a balance between large commercial outlets and small retailers, the regulatory framework introduces an additional authorization by the *Commission Nationale de l'Urbanisme* (CNUC) (as specified in the *Code d'Urbanisme*) for the opening of large outlets (above 1500 square meters) and commercial centers (above 3000 square meters) and additional administrative requirements for foreign investors (*carte de commerçant*)<sup>11</sup>. While the CNUC's role is to ensure observance of legal provisions on urban planning and environmental issues, the procedure to obtain such an authorization is burdensome and creates unnecessary hurdles to entry<sup>12</sup>. A further restriction in the same regulation obliges suppliers to sell their products through wholesalers or large outlets that act as wholesalers and retailers, limiting incentives for suppliers to expand their activities and obtain higher margins. In some instances, producers can distribute their products, but only upon approval by the Ministry of Commerce. Moreover, as discussed further below, some agricultural products (for example, cereals and imported meat) may be distributed only by state entities (*Offices*) at controlled prices<sup>13</sup>.

When compared to international best practice, Tunisia also imposes severe restrictions to competition in the professional service markets. Both self-regulation and state regulation of professions have the potential for creating anti-competitive effects that do not benefit or protect consumers. There is a general consensus that professional regulations that create anticompetitive structures or permit anticompetitive behavior should be eliminated<sup>14</sup>. Specific structural and behavioral restraints on professional practices should be eliminated

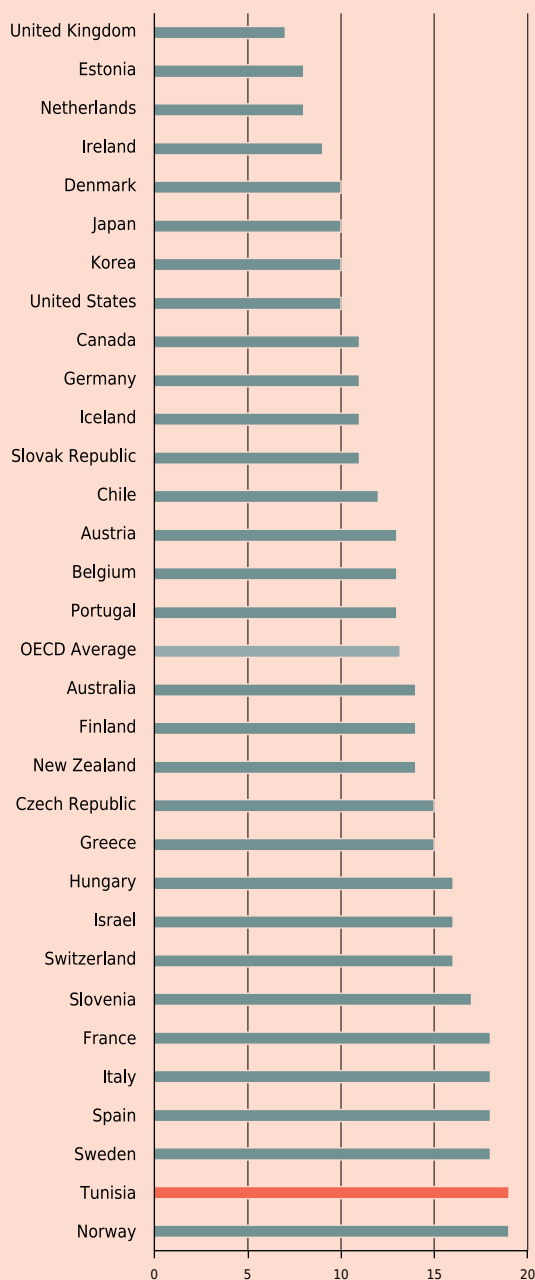
**Figure 2.1: Number of Exclusive Services by Profession in Tunisia: Comparison with OECD Countries**



Source: Data for Tunisia are from a 2012 survey carried out by the World Bank following the OECD PMR template; data for other countries is from the OECD PMR database for from 2013, except for Poland for which the latest available PMR data is from 2008.

Note: (i) Top five performing countries are those OECD countries (out of 34 OECD countries) with no or minimal regulatory limitations in this area. Typically, regulatory limitations for liberal professions are designed to ensure a certain standard of service quality and not to impose restrictions on market variables (such as prices or number of service providers). (ii) The exclusivity of legal services is more or less similar to the other OECD countries. Therefore, we have not included it in the figures, focusing instead on the three professional categories (services) where exclusivity is more problematic.

**Figure 2.2:** Number of Sectors with at Least One SOE in Tunisia Compared to OECD, non-OECD, and Central and Eastern Europe (CEE) Countries



Source: World Bank 2012 PMR survey for Tunisia; OECD 2008 PMR database for Brazil, Italy, Japan, Luxembourg, Mexico, Poland, Republic of Korea, Turkey, and United States; OECD 2013 PMR database for all other countries.

because they have no demonstrable consumer welfare benefits, or the benefits do not outweigh the costs. In many countries, professional self-regulations have the direct or indirect effect of restricting competition in these markets, raising the price and limiting variety and innovation in professional services. Elimination of regulations that facilitate coordinated behavior will reduce the costs of professional services. First, all professions enjoy extensive exclusive rights on service provision and only Tunisian firms can provide these exclusive services (except investment advice which can be provided by foreign operators). Further, there is a complete prohibition of advertising for all four professions (architects, engineers, legal services, and accountants). For some professions, prices are also regulated. It should be noted that, although it is not unusual that EU/OECD governments endow selected professions with the exclusive or shared exclusive rights to provide specific services, Tunisia appears to be much more restrictive and protective of professional privileges (figure 2.1). The majority (more than 60 percent) of OECD and EU countries do not have any regulations of prices in these professions.

Openness to FDI is particularly constrained in Tunisia, and regulation does not guarantee a level playing field across domestic and foreign firms. Statutory or other legal limits to the number or proportion of shares that can be acquired by foreign investors are frequent in Tunisia (see also Chapter Four). For 49 sectors (which account for 38 percent of the economy), investment projects are subject to the authorization of the High Commission of Investment when foreign ownership exceeds 50 percent. As mentioned above, foreign ownership restrictions also exist for all liberal professions (legal, accounting, architecture, engineering), which makes it difficult for foreign investors to enter this market. Also, wholesale trade is only permitted to Tunisian firms. In the road transport sector, foreign companies are subject to the authorization of the High Commission for Investment when foreign ownership exceeds 50 percent. More generally, foreign firms cannot have redress through private rights of action in Tunisia<sup>15</sup>.

Beyond entry restrictions and public monopolies, state-owned enterprises (SOEs) still play a dominant role in Tunisia, with the government controlling firms in markets that are typically open to private sector participation. SOEs account for approximately 13 percent of GDP (UNCTAD 2006) and almost four percent of total employment in the country (box 2.5). According to the information available, the government controls at least one firm in 19 sectors compared to an OECD average of 13 sectors and an average of 8 sectors in the top five performers among OECD countries (figure 2.2)<sup>16</sup>. In the infrastructure sector there are an

estimated 32 SOEs<sup>17</sup>. In comparison in EU countries there are on average nine SOEs in infrastructure/network industries (OECD PMR database). The state is active especially in the field of public services (electricity, water, sanitation, passenger transport) as well as in the import of some basic products considered sensitive, such as cereals, tea, coffee, vegetable oils, iron, and pharmaceuticals (ACRLI 2008). In Tunisia, SOEs hold between 50 percent and 100 percent of the markets of gas, electricity, railroad transport, air transport, and fixed-line telecommunication services; and many SOEs act as monopolists in the production, import, and distribution of various goods (for example, cereals, olive oil, meat, and sugar) (figure 2.3)<sup>18</sup>. It is important to clarify upfront that there is no problem with state ownership of these companies in itself. In terms of the efficient operation of markets, however, what is important is that these firms are forced to operate efficiently by introducing adequate corporate governance rules (which include independence from the government and the public administration), and also that these public companies do not benefit from unfair privileges from the state (see below)<sup>19</sup>.

What is unusual is that in Tunisia the presence of SOEs is relatively large in sectors such as manufacturing, transport, tourism and recreation, and other services that are key for private firms. Although the presence of SOEs is not unusual in certain segments of network industries, the Tunisian government is also present in various sectors in which it is difficult to justify (as there is no clear rationale for the state to be involved). The government controls firms in many manufacturing and service subsectors, such as hotels, restaurants, and other business activities. Further, there are three SOEs providing golf facilities and 12 SOEs in the real estate sector. SOEs' presence in these sectors is contrary to international practice and lacks any economic rationale.

### **Box 2.5: State-Owned Enterprises (SOEs) and Public Banks in Tunisia**

The role of SOEs in Tunisia has historically been and remains very significant in terms of their contribution to economic activity, employment, and the provision of vital services. As of the end of 2011, there were 104 public enterprises in the government's portfolio, in 14 sectors, for total employment estimated at almost 120,000 (or almost four percent of total employment). Beyond public utilities, the main sectors in which SOEs' presence is strong are currently transport and infrastructure, industry, and banking.

Public enterprises tend to be ripe with governance problems and cronyism. SOEs' performance in Tunisia highlights that in general Tunisian SOEs suffer from problems related to their internal and external governance.<sup>i</sup> As a result, in Tunisia the privileged access to state-owned assets was an important target for rent-seekers, as also described at length in the report of the Commission nationale d'investigation sur la corruption et la malversation (CNICM) published in November 2011.<sup>ii</sup>

On the whole, SOEs usually underperform, and many also incur financial losses despite protection from competition and significant government support. In recent years budgeted annual transfers to loss-making SOEs amounted to 0.8 percent of GDP on average. Additional losses were financed by access to loans by SOEs (or were carried forward), but no accurate estimates of such liabilities exist. Further these financial costs should be augmented by the many implicit transfers benefiting SOEs, for instance in terms of monopolistic position in the market, which allows them to extract rents from the economy and populations (for example, the exorbitant cost of international calls to and from Tunisia, and the high cost of air travel to and from Tunisia), or in terms of below-cost access to natural resources (see below). As discussed in the main text, in Tunisia these generous subsidies imply that SOEs enjoy anti-competitive advantages, such that the management of SOEs in Tunisia results in an uneven playing field that reduces competition and penalizes the most efficient firms, hindering their growth (and therefore jobs creation). In addition, as also discussed in Section 2.3, SOEs impose severe economic costs to the economy, both directly and indirectly. Inefficient provision of critical inputs and services increases costs for local business, limits expansion, and hampers competitiveness and growth.<sup>iii</sup>

Beyond official transfers to SOEs, hidden cross-subsidies mask the ineffectiveness of some of the SOEs, at an enormous cost to the country. For instance, in the energy sector, the national oil company, ETAP, imports oil and gas on behalf of the refinery of the country, the STIR, and the company responsible for the production of electricity, STEG. ETAP imports crude oil and sells it at less than a third of the international market price. Hence, ETAP profits (and revenues for the budget) are lower because of this hidden transfer to STIR. The amount of hidden transfer is even higher for natural gas, which is sold to STG at 10 percent of the international price. Overall the full amount of hidden subsidies to STIR and STEG was estimated at approximately 2.2 percent GDP in 2009 (or TND 1.5 billion). In addition, because production is insufficient to satisfy internal demand, a large share of domestic consumption of LPG, petrol, and diesel is imported (as much as 72 percent by volume in 2008). The costs are covered by the state, but no one has full knowledge of the effectiveness of procurement procedures for imports and effectiveness of the company. This model seems expensive and not transparent, as the financial losses do not appear explicitly.

Similarly, in Tunisia State-Owned Banks (SOBs) have been accumulating large liabilities and now require a massive transfer from the state budget. Ben Ali's circles used public banks to obtain privileged access to credit at advantageous conditions. In addition, public banks gave loans to SOEs to finance their activities, thus masking their operational losses, and the SOEs were unable (or unwilling) to repay the loans. These governance failures have prevented the financial sector from channeling resources to the most economically rentable projects and have undermined the stability of the financial sector, such that it is now in need of a large recapitalization (see Chapter Six). The 2012 Bank/IMF FSAP report estimates that the SOBs require a recapitalization of the public banks on the order of three to five percent of GDP, under the baseline scenario.

Source: World Bank (2013e). *La nécessité d'une meilleure gouvernance des entreprises publiques en Tunisie*. Report N.78675-TN, Washington DC.

Notes: i Notably, limited transparency and weak accounting, reporting, and budgeting functions; weak ownership function of the state; weak internal corporate governance, characterized by weak boards; proliferation of controls but with limited efficiency.

ii Several practices were recurrent regarding SOEs: (i) access to public land at non-market conditions, which was very lucrative in a context of booming real estate sector; (ii) use of insiders' information on assets to be privatized and restructured to acquire stakes at non-market terms; (iii) abuse of public services and assets for private purposes, like Karthago Airlines, which used Tunisair maintenance and catering services without paying; (iv) share takeovers in strategic sectors such as privatized banks and use of utilities to give ruling family companies a comparative advantage in some sectors. Moreover, the former president's circles used public banks to obtain privileged access to credit at advantageous conditions. Overall, during that time, it was well known that appointments of CEOs were "politicized" and large amounts of public resources were transferred to cronies.

iii Sekkat (2009) demonstrated for Egypt that the importance of an SOE in a given industry was negatively correlated with total factor productivity explaining mainly this by the fact that SOEs enjoy a rent irrespective of their productivity performance.

Figure 2.3: Extent of Public Ownership in Gas Sector and Air Transport in Tunisia



Source: Data for Tunisia are from a 2012 survey carried out by the World Bank following the OECD PMR template; data for other countries is from the OECD PMR database for from 2013, except for Poland for which the latest available PMR data is from 2008.

Note: In the gas sector, for Tunisia the figure shows only the gas importer that is an SOE.

Market segments of transport services that may be supplied by private operators are still serviced by dominant SOEs with market shares larger than 50 percent. Two dominant SOEs provide maritime transport services and also operations in ports, respectively. The *Compagnie Tunisienne de Navigation* (CTN) ensures passenger transport through the Goulette port (merchandise transport in this port is limited to break bulk cargo), while STAM is a de facto monopoly that ensures freight forwarding, operations, and maintenance in the port of Rades. The latter is the most important port for merchandise transport—95 percent of containers go through the port of Rades—but its infrastructure is not adequate for container transportation, and maintenance of port infrastructure requires improvements. It also has substantial pricing power because tariffs are reportedly 30 to 50 percent higher than those of its competitors. Similarly, in air transport, the national incumbent, Tunisair, combines several functions: air transport services as well as cargo and handling services in the airport. Most passenger transport is provided by Tunisair on international regular and chartered routes—it accounts for about 63 percent of all offered seats in the market. Tunisair also dominates cargo and handling services. Besides Air France, which is a shareholder of Tunisair, the market remained relatively closed to other airlines<sup>20</sup>. The regulatory framework protecting Tunisair prevents other airlines from offering viable transport alternatives, resulting in higher prices and lower quality services for Tunisian consumers; creating negative repercussions on many key sectors, notably on tourism; and hampering competitiveness and job creation across the entire economy. Contrary to many OECD countries, Tunisia has no regional agreement in air transport with other countries from the region, nor did Tunisia sign an EU—Tunisia open skies agreement (see box 2.6).<sup>21</sup>

### Box 2.6: Open Skies—Greater Economic Outcomes than Challenges for Incumbent Firm

Historical experiences on Open Skies agreements demonstrated their significant economic contribution at multiple levels: on the number of air passengers, on jobs creation and competitiveness in the air transport industry and related activities, and on tourism and on related activities. While pre-negotiation talks on Open Skies with the EU were initiated before the revolution, discussion was put on hold, partially for political reasons, but also due to the concerns about the competitiveness of Tunisair compared to its potential competitors, European low-cost operators. Liberalization of air services could be socially challenging because it would require Tunisair to implement further restructuring.

An Open Skies with the EU could, however, lead to significant jobs creation across the economy, notably in tourism. For instance, Morocco has successfully boosted its tourism sector and its airline since reaching an Open Skies agreement with the U.S. in 2000 and with the EU in 2006. The Open Skies agreements boosted international traffic: the number of passengers almost doubled between 2006 and 2011, the number of tourist arrivals increased by more than 42 percent, and tourism receipts increased by 32 percent. In addition, the annual growth of frequencies attained 12 percent during 2003 and 2010, such that Moroccan companies gained 402 additional frequencies in seven years while foreign companies gained 241 additional frequencies. And of course consumers (and the tourism sector) benefited enormously as increased competition pushed the fares down significantly. In contrast, Tunisia increased the number of passengers by only 33 percent, the number of tourist arrivals by 5 percent, and tourism receipts by 16 percent between 2006 and 2010 (see figure B2.6.1).

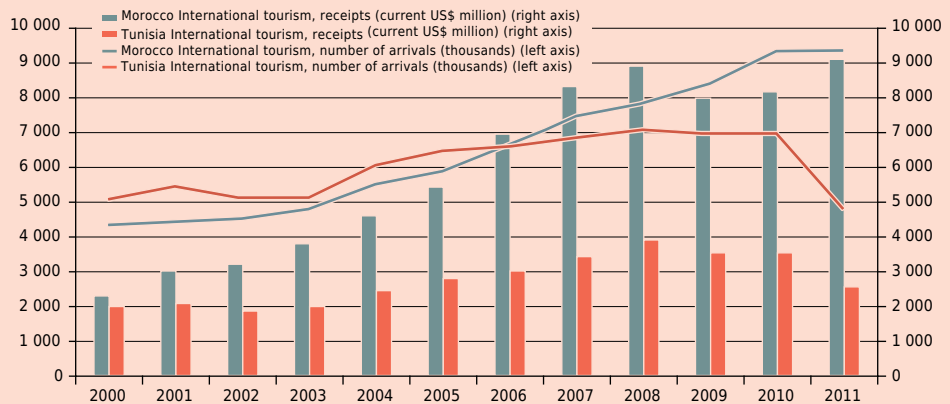
Further, the Open Skies agreement with the EU has considerably increased competitiveness of Royal Air Maroc (RAM), which is almost entirely government owned. RAM still dominates the market with over 50 percent market share, despite entry into competition of 22 foreign companies (of which 19 are European) in the market since 2004. (In addition to the five local companies, three new Moroccan low-cost airlines were set up and four new licenses were issued for handling services in the airports.). European low-cost carriers increased their share in the EU-to-Morocco market, from 12 percent in 2006 to 40 percent in 2011. Interestingly,



however, the decrease in the market share of RAM from 60 percent in 2004 to 53 percent in 2010 was accompanied by a dramatic increase in the volume of passengers transported—from 820,240 during 1998 and 2003, to 8.6 million during 2004 and 2010. In fact RAM has continued to remain competitive and has kept the highest share of the number of passengers between Morocco and Western Europe.

Encouraged by the successful outcomes of the EU-Morocco Open skies agreement, Jordan signed an Open skies agreement with the EU in 2010. Similarly, an Open Skies agreement between Turkey and the U.S. in 2000 has contributed to boost air traffic and tourism in Turkey, with 4.4 times the number of passengers in 2011 than a decade ago, 3.2 times the number of tourist arrivals, and 2.8 times the number of tourism receipts.

**Figure B2.6.1 Tourism Receipts and Arrivals in Morocco and Tunisia, 2000-2011**



Source: World Development Indicators

Perhaps most important, it is not unusual in Tunisia for SOEs to receive special treatment in various forms, and as such a level playing field is not guaranteed among all market players, resulting in distortions and economic losses. SOEs regularly benefit from state aid (that is, any aid granted by a government entity which distorts competition by favoring certain markets or firms)<sup>22</sup>—such as capital injections and guarantees for SOEs in financial difficulty or preferential loans from state-controlled banks or the state itself. As discussed in box 2.5, the Tunisian government often bails out loss-making SOEs at the expense of the state budget. These various forms of government support are granted through an ad-hoc process instead of clearly defined criteria. Best practice requires instead that, where the Tunisian government directly participates in markets, it is important to guarantee that competitive neutrality principles are in place. Competitive neutrality requires that no entity operating in an economic market is subject to undue competitive advantages or disadvantages<sup>23</sup>. Controlling state aid and ensuring competitive neutrality will help avoid favoritism and ensure a level playing field among public and private companies. In Brazil, for example, the constitution expressly prohibits granting of fiscal privileges to SOEs if such advantages are not available to the private sector as well. In Australia, the dimensions of competitive neutrality include taxation, debt, and regulatory neutrality as well as the application of commercial rates of return as justification for asset retention in the case

of public enterprise and no cross-subsidization or hidden subsidies to SOEs from public funds. In Hungary, statutory regulations have been adopted to observe competitive neutrality principles in the field of finance neutrality, relating to “the transparency of the financial relationships between general government organs and public enterprises and the financial transparency within enterprises.” (Capobianco and Christiansen 2011).

In addition, extensive price controls and other market variables increase business risk and reduce the ability of firms to compete in Tunisia. Price controls exist in Tunisia at all levels of production and distribution for a wide range of food and non-food products and services. Similarly, distribution margins for many products are subject to state control (see table 2.1). An UNCTAD peer review indicates that in the production sector, the prices of 13 percent of products are still regulated, as compared with 20 percent in the distribution sector—the report concluded that a non-negligible part of the Tunisian economy is not open to free competition and there are no signs of improvement in this respect (UNCTAD 2006). The sectors where prices are controlled at all levels of distribution are also associated with significant SOE presence accounting for at least 55 SOEs<sup>24</sup>, compared to at least four SOEs in the sectors where prices are controlled at the production level and at least 12 SOEs in sectors where distribution margins are controlled<sup>25</sup>.

Marketing boards for agricultural products also continue to interfere with the operation of markets, undermining local production and investment. There are several agricultural-sector SOEs that hold monopolistic positions along many agriculture value chains in the domestic market as well as in the import-export segment. The state intervenes in the agriculture sector in various ways beyond the subsidy programs (which target bread, grains, couscous, pasta, oils, UHT milk, and tomato concentrate), namely through the operation and control of production, distribution, and marketing of various agriculture products. For example, the *Office des Céréales* intervenes in the collection and transport of cereals as well as imports; the *Office du Commerce* has a monopoly over imports of sugar, coffee, and potatoes; and the *Office National des Huiles* imports oils and exports olive oil (bulk, unrefined)—it has no exclusive rights on the exports of olive oil but controls access to EU quotas (especially for the unrefined oil). In some cases, such as for the *Office des Huiles*, the market share the state controls is fairly small, but the Offices have other levers through which they can influence the markets, for instance through market regulations or the issuance of quality certifications to private exporters. Also, for products whose prices are typically determined by demand and supply (vegetables, poultry meat, beef, lamb, and eggs), price interventions can occur indirectly—for example, through imports, price stabilization funds, and other market operations. It is a matter of the extent and type of intervention beyond subsidies. A unilateral decision by the government to scale down market operations or interventions of marketing boards would provide a positive signal to private investors in this sector.

**Table 2.1:** List of Products Subject to Price/Margin Controls

Products and services whose prices are controlled at all levels of distribution	Products and services whose prices are controlled at the production level	Products subject to control of the distribution margins
<ul style="list-style-type: none"> <li>. Subsidized bread</li> <li>. Subsidized flour and semolina</li> <li>. Subsidized couscous and pasta</li> <li>. Subsidized edible oils</li> <li>. Subsidized sugar</li> <li>. Papers, textbooks and notebooks, subsidized school exercise books</li> <li>. Tea</li> <li>. Drugs and medical procedures</li> <li>. Fuel</li> <li>. Electricity, water and gas</li> <li>. Passenger transport</li> <li>. Subsidized regenerated milk</li> <li>. Postal and communications services (rates for communication services that fall under universal</li> <li>. telecommunications services framework cannot exceed maximum ceilings)</li> <li>. Tobacco, matches and alcohol</li> <li>. Harbor services</li> <li>. Hot drinks (coffee and tea) served in coffee shops and bars</li> </ul>	<ul style="list-style-type: none"> <li>. Bakers' yeast</li> <li>. Beer</li> <li>. Barrels and metallic packaging</li> <li>. Motor vehicles</li> <li>. Lime, cement and reinforcing bars</li> <li>. Compressed gas</li> </ul>	<ul style="list-style-type: none"> <li>. Rice</li> <li>. Fruits</li> <li>. Vegetables, plants and condiments</li> <li>. Poultry</li> <li>. Eggs</li> <li>. Bran and derivatives of milling</li> <li>. Roasted coffee</li> <li>. Butter</li> <li>. Tomato paste</li> <li>. Sugar cubes</li> <li>. Yeast</li> <li>. Beer</li> <li>. Tobacco</li> <li>. Salt</li> <li>. Artificial cement</li> <li>. White cement</li> <li>. Reinforcing bars</li> <li>. Metal cans</li> <li>. Auto vehicles</li> <li>. School ink</li> <li>. Compressed gas</li> <li>. School paper</li> <li>. School text books</li> <li>. Lacteal powder for children</li> </ul>

Source: Government of Tunisia, Decree No. 31-1996 of 23 December 1991 (modified by Decree 95-1142)

In sum, Tunisian markets are characterized by multiple restrictions to competition that result in an environment in which firms are unable to compete and cannot grow based on their productive capacity and/or the quality of their services. Our findings highlight that competition is severely restricted in Tunisia due to a combination of regulatory barriers and statutory monopolies, privileged support to SOEs, and extensive price controls. As will be discussed in Chapter Three, firms survive by twisting the regulatory environment to their advantage at the expense of consumers and overall economic performance. In fact these barriers result in higher prices for consumers and firms: for example, the price of bananas and the price of roasted coffee beans in Tunisia are both roughly twice as much as in the international market, the price of car tires is 30 to 50 percent higher than the international price, the price of international telephone calls is 10 to 20 times the international market price, the price of air tickets is estimated at 30 to 50 percent higher than elsewhere, and so on. It is worth noting that most of the barriers to entry and competition concern the onshore sector; however, the offshore sector—while more successful than the onshore sector—also suffers from the impact of these regulations (albeit indirectly). The low efficiency of these onshore sectors, especially the backbone services, negatively affects the competitiveness of the offshore economy, condemning it to low value added activities, which largely rely on cheap labor (for assembly of intermediates purchased abroad). Hence the impact of these barriers to competition is at the core of the shortcomings of Tunisia’s economic model.

It is worth highlighting that these barriers to competition are at the heart of the crony system of rents-extraction and social exclusion which afflicts Tunisia. As will be shown in Chapter Three, the existing regulatory architecture is itself a product of cronyism—which resulted in the proliferation of regulations and restrictions. In this context, the removal of barriers to competitive pressure and the simplification of procedures are not only necessary to achieve a more efficient allocation of resources but also required to ensure a more equitable access to opportunity for all Tunisians. In fact, as will be discussed in Chapter Three, a byproduct of the system of pervasive regulations and restrictions to market access is the insider-outsider culture. This system allows a great deal of scope for administrative discretion, which has been palpably abused in Tunisia to award privileged access and advantages to those within the inner circle of the political and administrative powers.

## ***2.2 / Is Tunisia’s Competition Policy Framework Effective in Combating Market Distortions Associated with Anticompetitive Behavior of Firms and in Removing Anticompetitive Regulation?***

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**D**espite successive improvements, Tunisia’s Competition Law still faces fundamental shortcomings. The Competition Law in Tunisia is ineffective because it excludes key markets from its application and provides for administrative price control of a wide range of food and non-food products and services (well beyond products of first necessity). Against best practice (including in other OECD, MENA, and Central and Eastern European (CEE) countries), the Competition Law in Tunisia is not applicable to key markets, restricting its ability to deter anticompetitive behavior. Major exceptions to the scope of application of the Law include products that: (a) are considered of first necessity; (b) face long lasting difficulties of supply due to legal/regulatory barriers (such as dates and other vegetables used during religious holidays); or (c) are provided by a monopolized sector<sup>26</sup>. In fact the list of products excluded from the Competition Law in Tunisia is very broad compared to in other countries<sup>27</sup>. Further, Tunisia’s Competition Law also does not apply to legal monopolies, limiting the effectiveness of competition in key sectors such as agribusiness inputs, mining, and construction materials<sup>28</sup>.

Tunisia's regulatory framework hampers the Competition Council's ability to address anticompetitive practices and regulations. Effective enforcement of competition policy and rules can gradually transform the competitive environment by triggering positive changes in market structure and reducing concentration. Addressing and tackling cartel behavior is key to deterring most harmful anticompetitive behavior. Effective control of mergers can prevent concentrations that stifle competition, and meaningful enforcement of antitrust law toward dominant firms will discourage behavior that hampers competition. Against best practice, however, the current competition framework and its implementation do not tackle cartel agreements. In fact, the Competition Law provisions may even encourage the creation of further cartels instead of encouraging their disappearance. The Tunisian merger control regime also requires several improvements<sup>29</sup>. In addition, the advocacy competences of the Competition Council appear to be weak. Besides effective antitrust enforcement, advocacy mechanisms are key to minimizing anticompetitive regulations, including minimum and maximum prices and unnecessary price controls<sup>30</sup>.

As part of the obligations under the Association Agreement with the EU, Tunisia is required to implement a state aid framework. Currently, in Tunisia the scrutiny of state aid, grants, and subsidies is not consolidated under a specific law or authority<sup>31</sup>. In Tunisia, each ministry can approve, ad hoc and without planning, their own state aid (that may be granted through various instruments or objectives). The Ministry of Finance participates in each sectoral commission where state aids are decided<sup>32</sup>. State aids can take various forms in Tunisia, including: (a) fiscal advantages; (b) capital transfers; and (c) guarantees for SOEs in financial difficulties. Fiscal advantages take the form of direct tax exemptions and indirect imports with reduced VAT and tariffs or customs duties. Capital transfers can take the form of injections dependent on strategic outlook and sectoral focus granted by the *Comité Général du Budget*. At the same time, government-controlled firms may receive financing (for example, loans guaranteed by the state, preferential loans from state-controlled banks or the state itself, and so on) which is not available to private companies. Finally, the General Directorate for Debt grants guarantees to SOEs in financial distress as permitted under the Association Agreement with the EU of 1998. The introduction of a comprehensive state aid legal framework could ensure a level playing field for companies and avoid the use of public funds toward objectives that will discourage expansion and entry of new investors.

### ***2.3 / Would Tunisia Benefit from Increased Competitive Pressures in the Markets?***

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**T**he lack of competitive pressure entails significant costs for the Tunisian economy. The previous sections highlighted that barriers to competition are pervasive in Tunisia, partially as a result of a weak regulatory and legal framework. There is overwhelming empirical evidence that the lack of competition results in severe economic losses in an economy because markets are unable to function and allocate resources efficiently. As summarized in box 2.1, firms operating in a competitive environment are more likely to increase their productivity. Stronger incentives to innovate due to high competitive pressure affect industry-wide growth of productivity. Competition boosts investment, generates employment, and ultimately speeds up economic growth and improves overall welfare. Competitive pressure in input (upstream) markets, such as transportation, financial services, energy, telecommunication and construction services, is a key driver of efficiency and productivity growth in downstream sectors—the users of these inputs. On the contrary, anti-competitive practices result in welfare losses for the economy as a whole. Price-fixing agreements among competitors impose significant costs on society. Apart from increasing the cost of goods and services to conduct business, cartels are also associated with low labor productivity and reduced incentives to innovate.

In this section we quantify the implications of lack of competitive pressure on labor productivity growth in Tunisia and find that greater competition would result in substantial gains for Tunisians. It has been empirically shown that the level of competition intensity affects firms' decision to innovate and therefore boosts productivity growth (Aghion, Harris, and Vickers 1997; Aghion and Griffith 2005; and Aghion, Braun, and Fedderke 2008). In this section we apply the empirical framework proposed by these studies, which is based on Price Cost Margins (PCMs) as a measure of competitive pressure in markets<sup>33</sup> (Annex 2.2; for details see DPR background report on "Opening Markets to New Investment and Employment Opportunities in Tunisia," World Bank 2014a). Higher margins signal a lack of competition as they reflect the market power of the firm to charge higher prices. Our analysis then estimates the effect of competition intensity on labor productivity growth<sup>34</sup>.

The results show that, on average, a five-percentage-point decrease in the price cost margins of a sector (that is, an increase in competitive pressure) is expected to increase labor productivity by five percent. The econometric analysis using annual data from 2000 to 2010 for more than 90 different sectors of the Tunisian economy highlights that higher PCMs (implying lower levels of competition intensity) are significantly associated with lower growth of labor productivity in the following year (table 2.2). Overall, the results show that a five-percentage-point reduction in price cost margins of a sector is expected to generate additional growth in labor productivity of five percent, on average. Productivity growth may accelerate to a much larger extent in individual sectors. This result is robust to various specifications of the analysis (for details see DPR background report on "Opening Markets to New Investment and Employment Opportunities in Tunisia," World Bank 2014a).

These results suggest that greater competition in Tunisians markets would result in significant benefits in terms of higher growth and faster jobs creation. In terms of economy-wide benefits, our results imply that a reduction of the price-cost margin of five percentage points in all sectors of the economy (would boost labor productivity growth by five percent on average and) would translate into additional GDP growth of around 4.5 percent per year and approximately 50,000 new jobs per year<sup>35</sup>. For manufacturing sectors and sectors without SOEs, the results suggest a six- and a 6.5-percentage-point increase in growth of labor productivity, respectively. As discussed in Chapter One, the average annual growth in productivity across sectors over the last ten years was approximately 2.5 percent. This highlights that the magnitude of the expected changes in growth of labor productivity is large relative to Tunisia's usual growth rates, indicating how much Tunisian markets are being affected by lack of competition<sup>36</sup>.

Further, the effect of very fierce competition dampening productivity growth (denoted in Chapter One as the "Schumpeterian effect") cannot be identified in Tunisia<sup>37</sup>. Less market power seems always to provide firms more incentives to innovate and stimulate productivity growth, with no evidence of a nonlinear relationship between PCM and labor productivity growth (table 2.2). One potential explanation of this result is that the initial level of competition in Tunisian markets is so low that any increase in the intensity of competitive pressure leads to significant productivity gains.

These results suggest that the distance of Tunisian firms with respect to the technology frontier is still large and that there is ample space to escape from competition through innovation. These results are consistent with the findings presented in Chapter One, which highlight that the correlation of labor productivity growth and Total Factor Productivity (TFP) at the firm level is high in the manufacturing sector in Tunisia (calculations based on firm-level data collected for 1997-2007)-which is an indication that firms' investment in physical capital has been limited and market pressure on firms' performance is weak. This finding also mirrors limited investment in innovation—according to ITCEQ (2010), the R&D expenditure in Tunisia accounted for around 1.2 percent of GDP in 2009, whereas OECD countries spent on average 2.3 percent of their GDP on R&D.



The presence of SOEs appears to undermine competitive pressure and dampens the beneficial impacts of competition on productivity growth. It is worth noting that the muted relationship between productivity growth and PCMs in sectors with high SOE presence likely reflects the drag these public firms have on the economy. This hints at the paralyzing effects of state presence, which as discussed is usually associated with high regulation and uncompetitive practices (notably in the use of state aids)<sup>38</sup>. In fact, as discussed above it is not the public ownership in itself but is rather the competitive structure of the sector that matters and dampens the beneficial impacts of competition on productivity growth.

**Table 2.2:** Relationship Between Competition (PCMs) and Labor Productivity

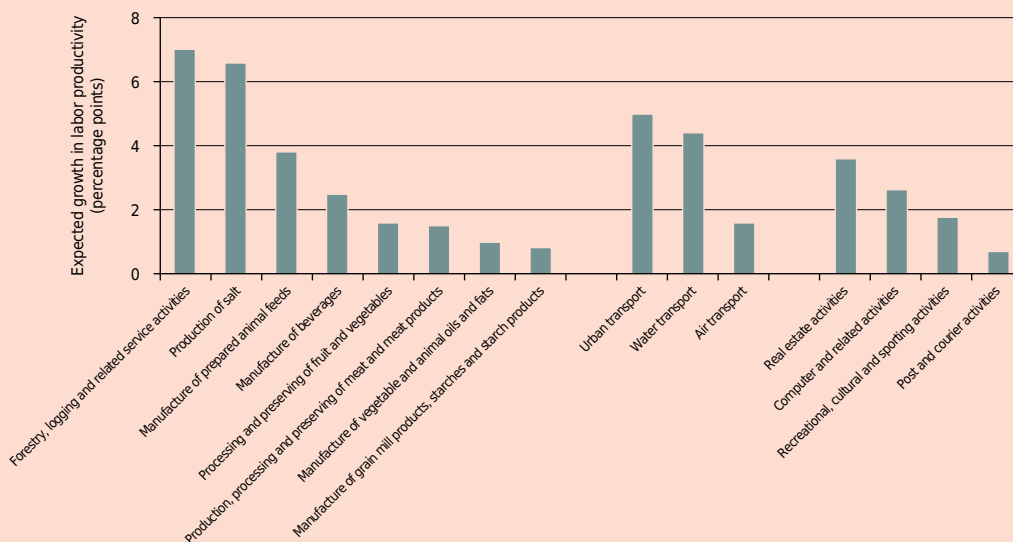
	Baseline- all sectors		Manufacturing sectors		Sectors without SOEs	
	linear (1)	non-linear (2)	(3)	(4)		
PCM[t-1]	-0.98	*** -1.24	* -1.15	*** -1.25**		
†	0.00	0.05	0.01	0.02		
PCM[t-1] <sup>2</sup>		0.53				
†		0.53				
constant	0.63	*** 0.59	*** 0.19	*** 0.35***		
†	0.00	0.00	0.00	0.00		
Number of Observations	888	888	455	528		
R-squared adj	0.08	0.09	0.12	0.09		

Source: Authors' calculations

Note: Regression Results with Dependent Variable: Growth in Real Labor Productivity (percentage changes).

Note: † p-values in second line below coefficients, standard errors clustered by sectors; all regressions with year and sector-fixed effects.

**Figure 2.4:** Expected Gains in Labor Productivity Following a Five-Percent Decrease in PCMs (Relative to the Median 2003-2010 by Subsector)



Source: Authors' calculations

Note: The figure shows conservative estimates of the expected growth in labor productivity (in percentage points), following a decrease in PCMs of 5 percent relative to the median 2003-2010. Given that some of these results present large confidence intervals, the values presented here refer to the conservative estimate of the average expected increases in the growth of productivity in each sector compared to the growth rates in the reference sector (e.g. pipeline transport). All reported interaction effects are significantly different from zero (at the 1% significance level).

Productivity dividends that result from an increase in market rivalry in Tunisia are particularly high in some sectors. The expected impact of a change in market power has been evaluated for particular sectors (at the 3-digit level) in Tunisia (figure 2.4). Unsurprisingly, even minor relative changes in the mark up of sectors that notoriously suffer from competition constraints in Tunisia (such as the agriculture and the agribusiness sector) are expected to add significantly to sector-wide growth. Many of the sectors that would benefit most are backbone services (such as transport services or professional services) that are particularly important for the overall competitiveness of the economy. Increased competition also constitutes a significant opportunity for productivity growth in key upstream sectors, namely urban, water, and air transport as well as real estate, postal, and other business services<sup>39</sup>. It should be noted that these results represent a very conservative estimate of the potential additional growth in productivity.

## **2.4 / A Reforms Agenda to Increase Competition in Tunisia: Opening Markets to New Investment and Employment Opportunities**

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Three key axes of reform are required to bring competition to Tunisian markets and firms, namely to remove barriers to entry, improve the governance of SOEs, and strengthen the legal framework for competition. First, the removal of most sector-level barriers to entry and competition is a prerequisite for faster economic performance (see Chapter Four). As mentioned above, over 50 percent of the Tunisian economy is subject to entry restrictions, including in backbone services sectors (such as telecoms, air and maritime transport, professional services, commerce and distribution, and so on)<sup>40</sup>, which determine the competitiveness of the entire economy, and also in high potential growth sectors (such as health services, education services, and so on). At present these barriers exist through several pieces of legislation, notably the Investment Incentives Code, the Commerce Code, many of the sectoral legislation regulating services sectors, and are also permitted by the Competition Law. It is worth highlighting that, first and foremost, these barriers limit investment and economic initiative by Tunisians. Most of the barriers pertain to the entry into (or operations in) onshore sectors. However, as will be discussed in Chapter Four, it is worth reiterating that the low efficiency in the onshore sectors (and particularly in the backbone services) also negatively affects the competitiveness of the offshore economy, condemning it to low value added activities which largely rely on cheap labor (for assembly of intermediates purchased abroad). In other words, the limited competition across the economy, and notably in the onshore sector, is at the root of the scarcity and low quality of jobs available to Tunisians.

Beyond removing the barriers facing domestic investors, Tunisians would benefit from opening up the economy to foreign investors, allowing for more investment; faster jobs creation; and increased know-how, efficiency, and quality standards. As discussed in Chapter Four, the barriers to entry largely limit foreign investors only to the offshore sectors—in fact this investment policy has failed to attract investors other than (energy and) low value added and assembly type activities. Further, as also elaborated in Chapter Four, the segmentation between onshore and offshore has limited the opportunity for backward-forward links in production and sale of intermediate inputs.

Second, reforming the governance of SOEs and the use of state aids is also critical. It is important to clarify that improving the operation of markets does not require privatization of public companies. There is no need for the state give up the ownership of the companies; however, it is important to ensure that the governance of the SOEs enables them to operate on a par with

private companies and that they are exposed to competition from other private firms. This also entails the need for a comprehensive state aid framework to ensure a level playing field for firms and avoid the use of public funds to distort competition, which would discourage the entry of new investors. Reducing the direct involvement of the state (through SOEs and other operations) should also be considered especially in typically competitive markets where there is no clear rationale for the state to be present, notably in manufacturing, transport, tourism and recreation (hotels and restaurants, golf facilities), and the real estate sector.

Third, improvements in the legal framework for competition are also warranted. A more effective competition policy framework could be achieved by (a) increasing the efficiency of antitrust enforcement; (b) pursuing advocacy activities to minimize anticompetitive regulation; (c) adopting best practices for state aid control; and (d) guaranteeing competitive neutrality between private and public companies and among private firms. Such reforms would also foster a more predictable and transparent business environment. As highlighted below, key aspects of these legal and institutional reforms would accompany and reinforce the removal of barriers to entry and improvements in the performance of SOEs:

- Remove regulatory barriers to boost competition: Reducing restrictiveness of product market regulation requires sustained reforms aiming principally at: (a) reducing the involvement of the state through SOEs and other operations particularly in typically competitive markets—this will also promote a more effective use of public funds to alternative policy goals; (b) minimizing the scope of administered prices at all levels of the product value chains and eliminating caps on distribution margins both for food and non-food products; and (c) eliminating discriminatory treatment of foreign investors vis-à-vis the domestic ones as well as among domestic investors in sectors where such regulatory restrictions create an uneven playing field. There is an opportunity to boost competition, and thereby productivity, by reducing restrictive product market regulation and introducing adequate regulatory oversight in key sectors. It is critical that the government eliminates distortive government interventions and promotes a more competitive environment particularly in sectors with spillover effects on the overall Tunisian economy. This report has highlighted that competition is especially restricted in transport services (airlines, railroads, maritime, road); network services (notably electricity and gas); the telecommunications sector; professional services; and in the tourism and the agriculture sectors. Detailed assessments of these sectors and policy recommendations to address the specific barriers to competition for each of these sectors are discussed in the DPR background report on “Opening Markets to New Investment and Employment Opportunities in Tunisia” (World Bank 2014e).
- Mainstream competition and competitive neutrality principles within government policies: In the medium term, the Tunisian government could evaluate the design and adoption of a comprehensive regulatory framework to achieve competitive neutrality among all market players.
- Increase the effectiveness of the competition framework and its implementation by amending the Competition Law: Specific amendments to the Competition Law should be primarily aimed at (a) limiting exceptions of anticompetitive practices; and (b) applying competition rules to all market participants, be they private or public. These should be complemented by the elimination of undue price controls and distribution margin caps. There is also a need to strengthen merger review and to strengthen the advocacy mandate of the Competition Council. Annex 2.3 presents a detailed list of required amendments to the Competition Law and the institutional set-up for competition enforcement (and see also the DPR background report on “Opening Markets to New Investment and Employment Opportunities in Tunisia,” World Bank 2014e).

- Pursue advocacy activities to minimize anticompetitive regulation: By strengthening its advocacy mandate, the Competition Council will be able to prevent and to address any potential competition distortions in key sectors of the economy (such as infrastructure or professional services) and open markets to competition. The Competition Council could also help to deter the enactment of anticompetitive regulation by increasing the awareness of other government agencies and regulators on the distortive effects of specific regulatory provisions. Working closely with other sectoral regulators will also avoid overlap of competencies in the competition space and more effectively tackle anticompetitive regulation.
- Create an inventory of state aid and develop state aid provisions to minimize potential distortive effects on competition: The introduction of a comprehensive state aid framework could ensure a level playing field for firms and avoid the use of public funds to support distortive state aid schemes discouraging the entry of new investors. Implementation of such a framework would promote a shift of state aids toward horizontal objectives that could benefit entire industries instead of specific firms. This approach would redirect aid to economy-wide objectives, such as R&D and innovation, start-up and risk capital, training, renewable energy and climate change, and other measures for the protection of the environment. Setting up a state aid inventory will help ensure transparency and accountability in the use of public funds, while applying best practice criteria to grant state aid would minimize distortive incentives granted to specific firms.
- Revise the rules on government procurement to increase competition and efficiency, notably in the engineering and construction sectors: These reforms should aim at increasing the efficiency, transparency, and accountability of public procurement (see World Bank 2012e, for a detailed discussion of public procurement reforms in Tunisia).

It is important to emphasize that to transition to a more open and competitive regime will be very challenging. It will be important to develop a concrete sequenced strategy as to exactly which entry barriers to dismantle and which FDI restrictions to eliminate. With such high unemployment and recent unrest, exposing on-shore firms to more competition and encouraging entry into previously protected sectors must be carefully executed. If not properly sequenced, reforms could result in job loss and policy reversals. Issues that could be considered as part of this strategy include:

- Entry promotion without privatization: As indicated above the key objective is not to privatize but rather to improve the performance of SOEs and to level the playing field. As an example, encouraging partnerships between foreign firms and SOEs has been actively pursued in China for more viable firms with excellent effects on performance. This approach minimized the job losses that could have accompanied a large-scale privatization episode.
- Phased-in competition: Lowering entry barriers and eliminating regulatory barriers could be gradually phased in with a pre-announced sequencing; in fact the priority should be to increase competition in sectors that provide services to firms (and to Tunisian citizens)—such as telecoms, air and maritime transport, commerce and distribution, and so on—since these services affect the competitiveness of the entire economy. It is also equally important to remove barriers and allow greater investment in sectors which have high potential growth and job creation prospects in Tunisia—such as health services, education services, and indeed the telecommunications and ICT services (see Chapter Eight).
- Starting with opening to regional competition: Eliminating regional barriers to competition would allow on-shore firms to adjust to competition by focusing on regional rivalry first, before moving to the global market.

- Avoiding a convergence of regulations that increase barriers instead of removing them: Particularly in the areas associated with labor market reform, there is the risk that the convergence could lead to an increase in regulation.

## 2.5 / Conclusions

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**P**ervasive lack of competitive pressure characterizes the economic environment in Tunisia—and is at the root of the failures of the current development model, notably the lack of good jobs. The pervasive barriers to market entry and contestability impede the structural transformation of the economy and stifle economic growth by hampering private initiative and discouraging innovation and productivity. The restrictions to market access (introduced by the Investment Incentives Code; the Commerce Code; and other sectoral legislation regulating services sectors, notably telecommunications, health, education, and professional services, and encouraged in some cases by the Competition Law) and the prevalence of statutory monopolies have closed the domestic economy to competition and have created an onshore environment which stagnates in terms of productivity, as good firms are unable to grow (see Chapter One). This results in higher prices for consumers and firms: international telephone calls are 10 to 20 times more expensive, and airline tickets are 30 to 50 percent more expensive. The business environment rewards rent seeking and cronyism to the point that, as will be discussed in Chapter Three, the heavy state regulation has become a smokescreen for crony practices, severely hampering the performance of the private sector and the entire economy, excluding those without good connections to politicians or the administration. In turn, the inefficiency and rents-extraction by cronies in the onshore economy also undermines the competitiveness of the offshore sector, which as a result has remained largely limited to low value added and assembly-type tasks. The economic costs of this economic model, which dampens competition and promotes rent seeking, are therefore enormous.

There is significant scope to achieve efficiency gains from pro-competitive sector policies and more effective economy-wide competition policy enforcement in Tunisia. The empirical evidence from across the world documenting the benefits arising from greater competition is overwhelming—as firms are stimulated to invest more, innovate, and improve their efficiency. Ultimately, competition generates employment, speeds up economic growth, and increases overall welfare. Consistent with this, the empirical analysis presented in this chapter has shown that the gains from higher competitive pressure in Tunisian markets would be considerable—this result is not surprising since economic regulations have systematically stifled competition in Tunisia. Focusing narrowly on labor productivity the results of our econometric analysis suggest that Tunisia’s economy could grow significantly faster if firms were given incentives to eliminate inefficiencies in the production process and to invest more in innovations that reduce the costs of production. Driven by competition, a five-percentage-point decrease in the profit margins of a sector (also referred to as the “price cost margins”) can increase labor productivity by five percent, on average. This implies that a reduction of the price-cost margin of five percentage points in all sectors of the economy (would boost labor productivity growth by five percent on average and) would translate into additional GDP growth of around 4.5 percent per year and approximately 50,000 new jobs per year. Hence, increasing competitive pressure to reduce firms’ market power (and the price mark-ups they can extract as a result) would give a significant boost to reduce Tunisia’s unemployment. Further, the sectors that would benefit most are the backbone services (such as telecoms, transport services, or professional services), and these are particularly important for the competitiveness of the entire economy (as they are intensely used as inputs in value chains).

In order to realize this potential there is a need to open up the economic field to more actors, both Tunisians and foreigners, in order to expand economic activity and wealth creation. It is worth emphasizing that removing barriers to competition is not intended mainly to allow foreigners to invest in Tunisia. Rather the analysis in this chapter has highlighted that it is Tunisians themselves, first and foremost, who are currently facing severe restrictions to entering large parts of their economy. In addition, Tunisians should also consider removing (most) barriers to entry of foreign investors, and indeed should seek to attract foreign investors, as the additional investments would bring additional jobs and wealth creation. Further, as shown in Chapter One, firms with ownership have job creation rates that are substantially higher than do other firms.

The removal of barriers to market contestability should be gradual, starting with backbone sectors and sectors that hold high potential for jobs creation. The greatest economic gains would arise from increasing competition in sectors that provide services to firms (and to Tunisian citizens) such as telecoms, air and maritime transport, commerce and distribution, professional services, etc., since these services affect the competitiveness of the entire economy. In parallel there is a strong rationale to remove barriers and allow greater investment in sectors with high potential growth prospects in Tunisia, such as the health services, education services, and indeed the telecommunications and ICT services (see Chapter Eight).

The current state-controlled development model, which served Tunisia well in the initial stages of its economic development, has now increasingly become a brake to Tunisia's development. In order to enable Tunisia to move to the next stages of economic development, there is a need to open up the economy and level the playing field to encourage the entry of new investors and enable the most productive and innovative to succeed and expand their businesses, thereby expanding economic activity and jobs creation. In order for this to become possible, the state needs to relax the current strict limitations to market entry and to scale down its direct interventions in the markets, in order to minimize distortions and unfair competition.

It is important to clarify, however, that opening up the economy to greater competition does not require the state to relinquish ownership of public enterprises. There are some manufacturing and service subsectors in which the state at present has public enterprises—such as hotels, restaurants, golf facilities, and the real estate sector—but where there is no clear rationale for the presence of the state. Beyond these obvious cases, however, the recommendation is not that public companies should be privatized. What is critical instead is to ensure that public companies operate efficiently—and this objective can be achieved by adopting a strong corporate governance framework in line with best international practice. It is also critical that public companies do not receive special treatment or privileges from the state. This is required to ensure a level playing field among all market players, so that the most efficient firms (whether public or private) can grow and create jobs.

In concluding, it is worth emphasizing again that the discussion in this chapter is not about deregulation or about reducing the role of the State. A new economic model will continue to require an active and crucial role for the State. This role, however, needs to be different in order to support, rather than impede, the private sector. The ample literature on market failures shows that the state has a critical role to play to enable the operation of markets and foster a competitive private sector. The challenge therefore is to move from a paternalistic state—which seeks to control everything, breeds inefficiency, and has given rise to cronyism and privileges for the elites—to a system where the state is focused on leveling the playing field, enabling private initiative (across the country, not just along the coast), and opening up economic opportunity to all Tunisians.



## Notes

1. This chapter draws on the DPR backgrounds report on “Opening Markets to New Investment Opportunities in Tunisia” (World Bank 2014a) which discusses in detail the operation of Tunisian markets and reviews the restrictiveness of the government regulations and policies that affect product markets, including the effectiveness of the competition and antitrust framework. The background report also includes an analysis of the impact of increased market rivalry on productivity and a snapshot of market restrictions in selected sectors (tourism, agriculture, transport and telecom) that require particular attention from policy makers.
2. Competition policies are defined as the set of policies and laws ensuring that competition in the marketplace is not restricted in a way that reduces economic welfare. In practical terms, competition policy usually involves the enforcement of antitrust legislation (typically rules against anticompetitive business conduct and mergers) and the promotion of measures to enable firm entry and rivalry, through the elimination of restrictive product market regulation and the opening of markets to competition—typically referred to as competition advocacy (Motta 2004).
3. In fact, as discussed in Chapter One, while Tunisia’s real GDP per capita growth since the 1990s was the second strongest in the MENA region, it has remained far below the growth rates observed in other upper middle income countries over the same period—and unlike many of its peers Tunisia did not experience a take off during the past two decades.
4. In order to identify markets where competition is restricted and anticompetitive regulation, the analysis used the Regulatory Indicators questionnaire developed for the OECD Product Market Regulation (PMR) Indicator. The PMR measures the degree to which policies promote or inhibit competition in several areas of the product market. Each of the areas addressed within the PMR questionnaire sheds light on specific restrictions of the Tunisian regulatory framework both economy-wide and in key sectors of the economy. Details are provided in Annex 2.1.
5. Ooredoo (formerly Tunisiana) was awarded the cellphone licence in 2002. It has since enshrined its dominant position in the cellphone market via creation of so called club offers (e.g. “amigos” or “familia” offers in 2013) substantially ensuring very low incentives for members to switch to competing networks, while Orange and Tunisie Telecom compete for the residual demand via sometimes predatory, mostly time-restricted offers (such as “Allo Lelkoll” in 2013) designed to attract a profitable minimum amount of customers in the first place.
6. Orange recently proposed to allow all operators to terminate international communications services to all access customers. Orange has a small access base and would benefit from the access base of their competitors for terminating calls. Second, they can benefit from the wholesale market power of France Telecom for calls to Tunisia and drive prices down. The regulator is concerned about the potential dominance of France Telecom despite the fact that Tunisie Telecom has submarine cables with strong competitors of Orange in the wholesale market (such as Telecom Italia), and fears that an amendment to the existing licenses can be met with opposition and even legal challenges from the other operators. On the other hand, this would effectively increase competition in the market. (World Bank, 2012e; Gelvanovska et al. 2014).
7. The introduction of Mobile Virtual Network Operator (MVNO) and Virtual Network Operator (VNO) licenses could increase competitive pressures in the sector, especially if these services are not be limited only to voice communication, but are expanded also to 3G data and allow operators to provide VoIP solutions.
8. Similarly, removing existing restrictions in key input markets, notably in gas and electricity, would be beneficial for a wide variety of sectors in the economy, as well as consumers. Also, entry in most segments of transport services and access to key transport infrastructure remains limited, resulting in high costs to consumers and firms.
9. UHD (Carrefour), Monoprix (Géant) and Magasin Général. In addition, there were around 232,000 micro enterprises in 2010.
10. Boughzala, M. (2013a), Background note for the DPR: “Le commerce en détail en Tunisie”, Mimeo, April, 2013.
11. Law No. 69/2009, August 12, 2009.
12. An application has to be submitted to the Ministry of Commerce that further transmits the file to the Ministry of Interior, Ministry of Equipment, Habitat and Planning, Ministry of Environment, Ministry of Social Affairs and Ministry of Agriculture. The authorization is issued only if all these Ministries clear the application. The government recently adopted Decree 664/2013 (on the criteria and procedure for granting authorizations for opening large outlets) to clarify the technical and urban criteria for obtaining such an authorization; this decree does not provide a significant improvement from the old practices, however.
13. Rules concerning access and operation of retail outlets (especially large ones) were found to increase the costs of activities in the retail industry in many EU countries (including Eastern Europe). Competition authorities in some countries have considered that retail regulation makes market access of new firms and expansion of existing firms difficult, and induces negative effects and distortions. See European Competition Network (ECN) Subgroup Food (2012), ECN Activities in the Food Sector—Report on competition law enforcement and market monitoring activities by European competition authorities in the food sector, May 2012, page 11. See also Irish Competition Authority (2009), Retail related import and distribution study, pages ix and 35.
14. Typically, self-regulations of professional services have included measures that affect entry into the respective profession, the conduct of members of the profession, including price-controls, and the granting of exclusive rights to carry out certain activities. The EU Commission analyzed the markets in which lawyers, notaries, accountants, architects, engineers and pharmacists operate in the European Union and identified five main categories of national legislation or self-regulation that restrict competition: fixed prices; recommended prices; advertising restrictions; entry restrictions and reserved rights/exclusivity on the provision of services; and regulations governing business structure and multidisciplinary practices. Source: European Commission (2004).
15. As mentioned in Chapter One, FDI in Morocco and Egypt for instance face much fewer restrictions, including in the

agricultural and service sectors. In Morocco, commerce is open to foreigners, and leases of 99 years are allowed which contributes to attracting FDI into agriculture. Morocco allows far greater flexibility to FDI in the service sector, such as through bilateral agreements based on the reciprocity principle for many professional services.

16. Top performing countries are those OECD countries (out of 34 members) with SOE presence limited to essential public utilities, mostly encountered in infrastructure sectors (electricity, gas, water).

17. These SOEs operate transport services and infrastructure; extract, refine, and distribute oil and gas; and generate as well as distribute electricity.

18. The SOE STEG (*Société Tunisienne de l'Electricité et du Gaz*) has the monopoly over gas and electricity supply and distribution. Two companies (STEG, which holds 80 percent market shares and CPC, a private company, which holds 20 percent market shares) are the electricity generators, but STEG has the monopoly over the distribution and supply of electricity. In the gas sector, production is ensured by five companies (British Gas; ENI; PETROFAC; PERENCO; and Winstar), while imports are performed by one SOE (ETAP). The SOEs *Société du Réseau Ferrovière Rapide de Tunis* (SRFRT), *Société des Travaux Ferrovières* (STF) et *Société Nationale des Chemins de Fer Tunisiens* (SNCF) are the most important enterprises in the railways sector.

19. China adopted a dual track and gradual approach to SOE reform focused on lowering barriers to private firm entry and encouraging viable SOEs to join with foreign partners.

20. Tunisair, an SOE created based on an agreement between the Tunisian government and Air France in 1948, controls 63 percent of this closed market. Tunisair is owned at 75 percent by the Government of Tunisia, 20 percent are listed in the public stock market, and 5 percent are owned by Air France.

21. Beyond an Open Skies agreement with the EU, there is potential to encourage more competitive conditions with bilateral air service agreements (BASA) with countries from Eastern Europe, Russia, Sub-Saharan Africa, or North America, where demand for transport services is growing, especially regarding increased frequencies and multiples designations of air carriers. Tunisia has signed multiple bilateral air service agreements with European, Arab and African countries, but its small size and restrictive nature of agreements limited its connectivity.

22. Common types of aid include: deferral of tax payments, subsidies, guarantees, land transfers or leases, free or below the market price, privileged access to infrastructure, free or at a subsidized fee, direct transfers or grants, tax exemptions, capital injections, equity participation and soft loans.

23. The rationale for pursuing competitive neutrality is both political and economic. The main economic rationale is that it enhances allocative efficiency throughout the economy—where economic agents (whether state-owned or private) are put at an undue disadvantage, goods and services are no longer produced by those who can do it most efficiently. The political rationale is linked to governments' role as universal regulators in ensuring that economic actors are "playing fair" (where state-owned corporate assets are concerned and vis-à-vis other market participants), while also ensuring that public service obligations are being met. See OECD (2012).

24. Based on data received from Tunisia's Prime Minister's Office (2012).

25. Price controls are not uncommon in sectors that are typically providers of public interest services, such as health, education, public transportation, but in Tunisia price controls extends well beyond these sectors.

26. An effective competition policy and law framework includes four key elements: (i) applies to all firms, be they private or public; (ii) focuses on combating the most harmful anticompetitive practices (such as cartels); (iii) focuses on deterring anticompetitive behavior and not on price control and regulation; and (iv) is transparent and predictable. A well-designed competition law is part of the competition policy framework. Nevertheless, the mere presence of a competition law is not always sufficient to create a level playing field for investors. What matters most is its effective enforcement and ensuring that markets enable firms to compete and enhance productivity growth.

27. For example, recent international benchmarking based on the OECD Database on product market regulation (2008), evidences that only 7 countries (China, Russia, Israel, Korea, Iceland, Canada and Greece) out of the 32 countries analyzed applied some type of price control on certain staples such as milk and bread.

28. In the case of natural monopolies, the application of the competition law should ensure open and fair access for service providers. Typically, natural monopolies, such as those governing the gas or electricity distribution, give rise to a potential conflict between cost efficiency and competition, with an increased number of competitors leading to some loss of scale efficiencies. In these segments, the entry of new provider requires a great deal of investment and introducing competition is not always the most efficient solution to ensure universal and high quality service. For example, the EU developed the concept of legally separating the provision of the network from the commercial services using the network, in so introducing competition in the sector.

29. See details in the DPR background report on "Opening Markets to New Investment and Employment Opportunities in Tunisia", World Bank (2014a).

30. Interest groups (or interested parties) in every country will lobby with the relevant authorities for the imposition of regulatory measures to their own benefit, but to the detriment of the society as a whole, particularly the consumers.

31. As discussed above, governments provide a variety of subsidies and direct aid to firms in the economy which may result in significant distortions on the dynamics of market competition. Beneficiaries that receive state aid enjoy a comparative advantage over their competitors that is not necessarily associated with their efficiency. This situation may distort competition by creating barriers to entry for competitors, increasing the asymmetry among competitors, facilitating anticompetitive exclusionary practices, and affecting trade flows. The potential harmful effects on competition include: (i) support to inefficient production in specific firms or sectors, which reduces the efficiency of market structures and of the economy as a whole by, for example, rescuing firms in financial distress, supporting companies using outdated technologies, or aiding industries that already have excess capacity; (ii) distortion of dynamic incentives by potentially influencing the investment decisions of beneficiaries' competitors and crowding out investment or by reducing beneficiaries' incentives to become more efficient; and (iii) an increase in

the market power of the dominant firm through the creation of barriers to the entry of competitors. Note however that not all types of State aid are counterproductive. State aid and subsidies can also be provided to address market failures, for instance, aid to support education and foster innovation and the environment-horizontal aid which does not undermine competition could include R&D and innovation, risk capital measures, training, renewable energy/climate change and other measures for protection of the environment that are available for all firms in the markets. Source: Friederiszick, Röller, and Verouden (2007).

32. The website of the Ministry of Finance lists all the legal/regulatory instruments that grant a fiscal or financial advantage. See [http://www.portail.finances.gov.tn/accueil\\_fr.php](http://www.portail.finances.gov.tn/accueil_fr.php).

33. The PCM is defined as difference between price and marginal cost as proportion of the price. It is a proxy for the Lerner index and a measure of market power. We use industry-wide statistics (at 2 or 3 digit levels) and calculate the difference between value added and labor costs as proportion of output, thus approximating marginal costs with average costs. This follows the methodology used by Aghion et al. (2008), for example. In an alternative specification and for the purpose of robustness check, we use the difference between value added and wages as proportion of turnover (sales). Output is defined as the total production of all firms in a sector. It includes sales and changes in inventories. Value added is output less intermediate consumption. Both value added and output are valued at basic prices (as opposed to producer prices).

34. It is important to clarify the relationship between the concepts of price-cost margins (PCMs) at the firms levels compared to the measure of total factor productivity (TFP) at the aggregate-economy level. At the economy-wide level the 'margins' above the cost of input used reflect the productivity (or efficiency) of the economy, which indeed corresponds to the TFP measure presented in Chapter One. At the firm level, however, higher margins could reflect improvements in productivity growth (via higher efficiency and innovation) or they could instead be the result of market power (and hence rents-extraction, at the expense of the rest of the economy). In the analysis of competition at the firm level presented in this Chapter we seek to focus on the rents-extraction. In order to do so, we assume that the cost-advantage gained by innovation and efficiency gains can generate higher margins when looking at contemporaneous values, but these margins would be eroded over time in a competitive market. Hence, in our analysis we relate PCMs from the preceding year (denoted as "[t-1]") with changes in contemporaneous productivity growth.

35. It should be noted that this is a back of the envelope calculation and does not take into account potential secondary effects from labor market rigidities.

36. It should be emphasized that a 5 percent improvement in PCMs can be achieved easily in Tunisia. In the past ten years, annual changes in the PCM of around 5 percentage points were recorded for example in the manufacture of domestic appliances (in 2009), manufacture of machine-tools (2008), casting of metals (2008, 2009) and several textile industries (2007, 2008). The average absolute change in PCM per year lays around 3 percentage point.

37. The relationship between competition and productivity is not necessarily the same for all levels of competition intensity. Recent studies (Aghion et al., 2005, 2008) have shown that when competition is extremely intense (firm's margins on their sales is almost zero), additional competition does not provide incentives for firms with backward technology to innovate more and at times even less. This dampening effect is known as 'Schumpeterian effect'. By allowing for a non-linear relationship between market power and productivity growth, we assess whether any markets in Tunisia present such absence of market power and whether additional competitive pressure could harm productivity growth in such sectors.

38. In a sense, it was the absence of competitive pressure which resulted in the SOEs' managers to prefer to extract rents rather than improve productivity.

39. The positive impact of higher firms' rivalry on productivity holds also in Tunisian sectors in which there are no SOEs. Since changes in the market share of SOEs may distort the productivity growth measure, specific estimations were conducted in sectors less subject to SOE presence. Results are consistent with the importance of the effect of competition on productivity growth. The positive impact of competitive pressure on productivity is clearly visible also among a subset of Tunisian sectors, in which only private sector firms operate and no SOE activity could be identified.

40. In addition, as will be discussed in Chapter Four, there is a need to pursue a very ambitious regulatory and administrative simplification to reduce the room for discretion in the application of the regulations. As will be discussed in Chapter Six, the banking sector is a further area which is characterized by limited competition, notably as a result of the weak governance in the management of State owned banks.

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