

Chapter One

Tunisia's Awakening Economy: A Trilateral Vision

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One has to acknowledge that the circumstances are tougher for MENA than they were when Eastern Europe went through its historic transition. In the early 1990s, the world economy was booming, Europe was keen to embrace the transition economies and provide a policy anchor, and external financing was readily available. That is not the case today and we will need different approaches to this transition.

Nemat Shafik, Deputy Managing Director, IMF, May 10, 2012

And today, as the Arab Spring unfolds... some principles of the [Marshall] plan apply again. As Marshall did in 1947, we must understand that the roots of the revolution and the problems that it sought to address are not just political but profoundly economic as well.

U.S. Secretary of State Hillary Clinton, June 2, 2011

The Swerve, or How Tunisia Became a Model for Democracy and Modernity

The swerve is a good metaphor for the unexpected process of political as well as historical change, where a small event—the self-immolation of a street vendor in a small Tunisian village—can have far-reaching and unintended consequences. As a matter of fact, the spark ignited by Tunisia with the so-called Jasmine Revolution inspired protests from Egypt to Libya and Yemen, and in doing so has irretrievably changed the future course of the countries in the Middle East and North Africa (MENA). It offered—initially—new hope for an inclusive and sustainable development that has not before been seen in the region. But the unfolding of the situation is now affecting the MENA countries differently. Only Tunisia seems well engaged to break with the past and set course in a newer direction. Each country in the region will eventually make the transition towards democracy in its own way and at its own speed.

Tunisia's success matters to the community of democracies and across the Middle East and North Africa, as it sets a powerful and positive example. The recent political developments, especially the ratification of the new constitution and the approval of a new government of technocrats, are a decisive milestone in Tunisia's democratic transition and a prerequisite for it to stay on the right path.

Tunisia seems now on track to succeed in its revolution, which aims at freedom, dignity and job opportunity. The path has not been easy and the journey is not finished yet. But three years after the start of the uprising, thanks to their pugnacity and courage, Tunisians stand closer to realizing the promise of their revolution. They are sending a powerful message to the rest of the region, a message of hope based on a remarkable spirit of compromise and inclusiveness. This political success calls for an "economic spring" and a debate to rethink the region's economic future.

In fact, while the new government has been appointed to prepare the ground for the next elections according to an agreed roadmap, which stresses the need to review partisan appointments in the Tunisian administration, disband the "Revolution Protection Leagues" that are accused of violence, and fight terrorism, it is crucial now to take advantage of the positive momentum and start immediately tackling the economic reforms needed to resume and boost economic growth.

Organizing the next elections before the end of 2014 will put an end to the period of uncertainty that is undermining the country's economic recovery and hindering the confidence of traditional donors and investors. However, some common issues will have to be addressed immediately: How can Tunisia move away from generalized subsidies to those targeting exclusively the poor, in order to free up resources and invest in productive projects and infrastructure? How to reshuffle the tax system to be fairer in order to enhance the standard living of the poorest? How will the private sector be induced to create 1,350,000 jobs in the next decade (650,000 currently unemployed plus 70,000 new job seekers every year)?

Incremental changes to the existing economic model will not deliver this outcome. A qualitative and quantitative increase in the pace of economic growth is needed, and it calls for new policies, inclusion and economic reforms. While there is willingness from the inter-

national community to help, resources are limited. Most of the economic transition in Tunisia will have to be financed through domestic resources. Only Tunisians can navigate the path ahead, but as they do so, they need a vision that will give them incentives to implement tough reforms, and inject a new dynamic to satisfy the rising expectations and hopes of the people. Hope gives direction and so inspires confidence.

Tunisia needs a trilateral vision. (i) A reinvigorated and integrated Maghreb open to the rest of the Mediterranean region and to the Gulf Cooperation Council, (ii) A committed EU “sharing everything but institutions,” adopting for this the “much more for more” policy, and (iii) a fully-fledged U.S.-Tunisia Free Trade Agreement (FTA) open to the rest of North Africa.

Reinvigorate North African Regional Integration

Unleash the Full Potential of the Private Sector...

In order to improve considerably the socio-economic situation across the region, there is a need to promote the expansion of the private sector, notably micro-, small- and medium-sized enterprises (SMEs) and their participation in value chains as a powerful engine of economic growth and the main source of job creation.

North African value chains would be a powerful vehicle for SMEs to diversify and innovate, offering new opportunities for the region to become part of the global factory. Modern international trade has split the production of goods and services among many countries, creating supply chains that reduce overall costs by trading in tasks across borders. By locating activities and tasks in the different North African countries according to their comparative advantages, the total costs of production can be reduced. Successful exporting countries in Asia and Eastern Europe have become active participants in supply chains. An important pre-condition for the participation in regional and global value chains is good infrastructure, transportation, access to trade finance, trade barriers and border policies.

An empowered private sector can serve as an interface with North African governments and international organizations to help devise and prioritize economic reforms and structure policies in support of

private sector development, with a particular focus on border regions and SMEs.

A better business climate helps to promote efficient domestic investment, attract foreign direct investment and increase productivity, thereby raising income and employment opportunities. There is a need for sensitization of people and NGOs about the importance of speeding up the reforms and further liberalize the market. Emphasis should be put on reducing administrative and regulatory barriers for business, building capacities in relevant ministries, and reviewing existing legislation and policies.

This should be complemented by a support for business development services such as training, advice and information services which aim at improving technical and managerial skills and encourage the transfer of know-how and technologies.

...Promoting Border Regions as New Engines for Growth and Regional Integration

The success of the democratic transition in Tunisia requires vigorous economic growth. At this critical time, the private sector can play an essential role in creating economic gains focusing on border regions such as El Kef on the Algerian frontier and Ben Guerdane on the Libyan frontier. Border region co-development strategy could be elaborated as a pilot case and broadened later to the whole country. This strategy of focusing on border regions could pave the way for regional integration.

Significant cross-border trade already takes place in the informal sector, which represents in Tunisia about 40 percent of GDP. Cross-border enterprise zones would seek to formalize and expand economic activity by fostering the growth of small and medium enterprises operating in these border areas.

It is very relevant that people engaging in business activities on either side of the border often have more in common with each other than with their respective capitals. Formalizing, regulating and expanding this type of activity could help anchor economic integration in these border zones.

Efforts should be made to learn from earlier attempts at sub-regional economic integration. In particular, the case of Souk Ahras—Le Kef on the Tunisian-Algerian border area is worth examining. The initiative was undertaken by public companies and ultimately failed. However, a renewed attempt at this type of sub-regional cooperation should instead focus on the private sector. The example of the Tunisian company Poulina's operations in Ben Guerdane and its cross-border operations in Libya may be instructive and worth replicating.

Similarly, the creation of an economic corridor between Algeria and Morocco has also been under consideration. Two years ago, discussions of an economic corridor between Algeria and Morocco was modeled on a similar plan developed in China. In the case of Algeria and Morocco, frontier passage points would be established to allow the flow of goods between the countries. (Currently the Algerian-Moroccan border is closed.) The movement of goods would be monitored to determine whether the cross-border trade has a negative or positive impact on each country's economy.

Existing literature on regional integration focuses predominantly on supranational levels of integration such as the European Union and North American Free Trade Agreement (NAFTA) to the exclusion of sub-national regions at the borders of nation-states.

Theoretically, integration, i.e. the opening of the border for trade and factor mobility, may significantly change the economic situation of border regions. The reduction of border impediments decreases access costs with respect to foreign markets especially in border regions.

However, this is not straightforward. Trade in the EU has been essentially free of tariffs since the late 1960s. But significant barriers to cross-border trade remain due to differences in technical standards or bureaucratic impediments. The Single European Act aimed at a completion of the internal market in 1992 via a reduction of non-tariff barriers to trade.

The literature emphasizes also the differentiation of regional development paths in East Central Europe, contrasting a "high road" and a "low road" to development. This is explained by the "endogenous influences," i.e., the communication barriers and a "low trust environ-

ment” that are rooted in the particular development history of the European regions and are a hindrance to regional integration. However, this is absolutely not the case for El Kef and the other border-regions in North Africa. The inhabitants of El Kef, for instance, feel very close to their neighbors in Algeria, and are often related. There was always a high trust environment that could be conducive to joint venturing in the new settings. The same applies for the Tunisian-Libyan border region. It was very clear following the Libyan revolution where the neighboring region offered spontaneously hospitality to more than 300,000 Libyan refugees. The integration of power networks and the joint oilfield exploitation could be an engine for growth and development for the south of Tunisia and a win-win strategy for both countries.

Consolidate the Partnership with the EU

The EU to Act as a Responsible Neighbor...

Our response ... is built on the need to acknowledge past mistakes and listen without imposing. We are doing exactly that and it requires perseverance and sustained commitment. Success should translate into what I have called “deep democracy.”

Baroness Catherine Ashton, the EU’s High Representative for Foreign Affairs and Security Policy, in 2011

The European Union first responded to the Arab Spring by issuing a joint communication on 8 March 2011 titled *A Partnership for Democracy and Shared Prosperity with the Southern Mediterranean*. In this document, the EU expressed its intention “to support wholeheartedly the wish of the people in our neighborhood to enjoy the same freedoms that we take as our right.” It further outlined a new “incentive-based approach based on more differentiation (‘more for more’)” for its partners in the region, promising that “those that go further and faster with reforms will be able to count on greater support from the EU.

In May 2011, the European Commission issued the results of its review of its European Neighborhood Policy, which drives its relations with its southern and eastern neighbors, including Tunisia. The review entails a new partnership with the EU based on greater economic integration, trade and increased funding for the Southern Neighborhood. As part of this offer, the EU allocated an extra €1.24

billion in funding for the region, on top of €11.5 billion already allocated for the period 2007–13. It also announced that the European Investment Bank had been authorized to increase its lending by €1 billion for Mediterranean countries undertaking political reform, as well as the creation of several funding tools, including a European Endowment for Democracy, a Civil Society Facility, and a €26 million ‘umbrella’ programme named SPRING (Support for Partnership, Reform and Inclusive Growth), to supplement reform efforts in existing country programmes in the region.

A third Communication¹ was published by the EU in 2012: “*Supporting Closer Cooperation and Regional Integration in the Maghreb*.” This new flexible institutional framework is supposed to allow progress at different speeds (based on variable geometry) and enable the Mediterranean partners to carry out the remaining reforms.

However, in front of the economic challenges facing Tunisia and the region, there is growing concern that the EU lacks ambition and the means to implement its vision and incentivize its reforming southern partners. And even more so when we compare with the amount the EU is offering to support Ukraine, i.e., an overall support of at least €11 billion over the next couple of years, from the EU budget and EU-based international financial institutions

However, the EU proposals are not enough to address the important breakthrough made by Tunisia and clearly needs a bold vision from the EU member states. The EU needs to institute a new and inclusive regional approach that would help keep and promote peace and foster stability and security throughout the continent, ultimately promoting the emergence of democracy and better global governance.

...Tunisia's Candidacy for European Economic Area Membership

Tunisia was the first country to sign an Association Agreement with Europe and the first also to put in place a free trade zone for industrial products back in 2008. The level of trade and EU investment in Tunisia and the level of intra-regional trade in North Africa remained below expectations, despite several tentative attempts to reinvigorate

¹“Supporting Closer Cooperation and Regional Integration in the Maghreb” (17.12.12), JOIN(2012) 36 final.

the Barcelona process with the European Neighborhood Policy and the Union for the Mediterranean.

The Arab Spring, initiated by Tunisia at the end of 2010, posed several challenges to Europe and marks a new phase in the political and economic relationship between the EU and Tunisia. It is not clear today whether there is a clear European strategy for cooperation and work with the new Tunisia in the short and longer term.

The Deep and Comprehensive Free Trade Agreement (DCFTA) is the long-term incentive on offer by the EU to those countries that are moving towards “deep democracy,” an upgrade compared to the Free Trade Areas that were the ultimate aim of the Association Agreements set in motion with the Euro-Mediterranean Partnership.

In the short term, Tunisia was granted “advanced status.” It was a good start, but clearly not enough, especially now after the adoption of the new constitution. The advanced status was supposed to provide a framework for a deepening of the free trade area in order to unlock growth potential and consequently to raise living standards and to create jobs for a rapidly growing population. However, there are doubts that it might not be enough as an incentive.

The EU support is based on an assessment of the country’s progress in building democracy and applies the “more for more” principle, which means that the more a country progresses in its democratic reforms and institutional building, the more support it can expect from the EU. However, there is not much to incentivize a country to undertake painful reforms. To be truly effective, “more for more” should be “much more money, for much more reform” in order to have an impact. It was the case with Central and Eastern European countries after the fall of the Berlin Wall.

EU membership prospects and huge financial aid enabled Central and Eastern European governments to have a clear vision and to implement the necessary reforms to resume growth and reinvigorate their economies. Only this prospect sustained the reformers in their efforts to overcome nationalist and other resistance and fears of change and modernization.

One of the weaknesses of the translation of EU successful experience from accession countries into the Neighborhood partners rests

on the absence of the final “carrot.” While developing countries are more dependent on EU aid and accession countries are prized for their efforts with final membership, the EU has much less to offer to the Mediterranean countries.

Tunisia should be “upgraded” and granted explicitly the “everything but institution”² status, and should become a member of the European Economic Area (EEA) after a transition period. The Agreement on the European Economic Area, which entered into force on January 1, 1994, brings together the EU Member States and the three EEA EFTA States—Iceland, Liechtenstein and Norway—in a single market, referred to as the “Internal Market.” They share one single market, which is governed by the *acquis communautaire*. The single market entails all four freedoms: the free movement of persons, goods, services and capital. If a country has reached this level, it has come as close to the EU as it is possible to be without being a member.

This might take a long time for Tunisia. But it would help to carry out the necessary reforms and take the right measures because it would have an objective to aim at. And it would clearly bring mutual benefits, and consequently mutual incentives, to both the Union and its neighbors.

The main aim is to respond to the pressing socio-economic challenges that Tunisia and other countries in the Mediterranean region are facing and to support them in their transition to democracy.

The European Union should have a real strategy vis-à-vis the Mediterranean region in response to the Arab Spring. It is time for EU Member States to be bold, ambitious and coherent. EU must “give every incentive to countries in the region to make decisions that bring freedom and prosperity” and to “marshal its resources to act as a magnet for positive change in the region.”

There is now growing hope that the forthcoming Italian Presidency of the EU will put the Mediterranean region at the center of its six-month program. This was highlighted by the Italian Premier Matteo Renzi during his visit to Tunis in March 2014. He also stated that

²“Everything but the institutions” was one of the slogans advanced by Romano Prodi who was President of the European Commission until November 2004.

“the Mediterranean will not be a border but the center of Europe.” We thus hope that he will base his approach on the nature of existing challenges rather than on the instruments available.

The quality of the relations between Arab Spring countries and the EU should largely depend on the performance and the political will on either side on the basis of “shared principles and values.” Therefore, if the EU’s aim is genuinely to extend to its neighboring region a set of principles, values and standards that define its very essence, then it needs to upgrade substantially the nature of its partnership with the new Tunisia, enhance its interdependence with a changing Mediterranean region and identify the common interests and concerns that correspond to the demands of the people in the Mare Nostrum.

Further enhancement of the EU-Tunisia relationship will depend on Tunisia’s commitment to actively pursuing the transition to democracy and clearly outlining and implementing reform to create jobs and achieve inclusive growth. The new European Commission, backed by EU Member States, will have to pursue its engagement to develop dialogue, explain better its incentive-based offer (everything but institutions) and explore options to foster regional integration in North Africa and improved access to the EU internal market.

U.S.-North Africa Trade and Development Agreement

Our message is simple: if you take the risks that reform entails, you will have the full support of the United States.

President Obama, *A Moment of Opportunity*, May 19, 2011

The Middle East and North Africa today is going through complex historical transformation, and demands greater diplomatic and economic American engagement.

The Arab Spring, Vali Nasr writes, was a ray of hope in a troubled region. But a brave call for freedom cannot alone change the reality of economic stagnation, social misery, and political frustration. Not without outside support.

The international community would have to come up with a new Marshall Plan to bring about change of that magnitude, and that

requires American leadership, to rally donors, mobilize funds and convince the region's capitals to undertake the necessary economic reforms.

President Obama acknowledged it in his speech on the Arab Spring:

Our support for these principles [human rights and democratic, peaceful demands for political freedom and economic opportunity, and legitimate aspirations of people] is a top priority and central to the pursuit of other interests in the region. The U.S. will marshal all our diplomatic, economic and strategic tools to support these principles.

The new Tunisia should be viewed by the U.S. as its best ally in the region to spread these principles, fight against terrorism and enhance trade exchanges. Tunisia should be seen as a free trade partner, as well as a model for democracy and modernity in the region. Ties between the U.S. and Tunisia could only increase after the very sad events that saw the storming of the U.S. embassy in Tunisia (and the torching of the American School) on September 14, 2012, as the two countries begin a Strategic Dialogue (announced by Secretary Kerry during his visit to Tunisia in February 2014) to identify issues and define modalities for greater collaboration.

What makes the Strategic Dialogue so important, especially at this time, is that it reflects the recognition of Tunisia's importance as a pillar of shared interests and values in a very challenging region.

As a short-term economic strategy, there is a need to set up a new form of U.S. trade preferences, exclusively for post-revolution countries, in addition to the already existing Generalized Systems of Preferences (GSP). It would expand North African exports to the U.S., increase foreign direct investment, and create new employment opportunities in North Africa.

However, a strategic partnership should go eventually beyond simply creating another set of trade preferences akin to the African Growth and Opportunity Act. That means setting up a U.S.-Tunisia Free Trade Agreement entailing trade liberalization on both sides, accompanied by a commitment in terms of financial assistance dedicated to building the physical and institutional infrastructure and cre-

ating the human capital to make the underlying trade agreement work.

It is one of the most effective ways the United States can offer support to Tunisia in this critical phase of transition to solidify democratic gains by expanding trade and commercial ties. Spurring faster economic growth through increased trade would bring the necessary resources for sustainable democratic development and prosperity in Tunisia, which counted the United States among its top five trading partners in 2010.

In 2012, U.S. Congressmen David Dreier, Gregory Meeks and Erik Paulsen introduced a bipartisan resolution (H. RES. 719, June 29, 2012) calling for a free trade agreement with Tunisia, and the Office of the U.S. Trade Representative relaunched the Trade and Investment Framework Agreement (TIFA) talks with Tunisia.

In the meantime, Tunisia must speed up reforms such as investment regulations, border controls, and other regulatory changes that could help facilitate trade between the U.S. and Tunisia. By taking some of these steps earlier on, Tunisia might get some of these trade benefits sooner than if they were wrapped into one large negotiation for a free trade agreement.

Further, the U.S.-Tunisia Strategic Dialogue provides both parties with opportunities for greater cooperation and collaboration on issues ranging from economic growth and jobs promotion to promoting the establishment of a Tunisia-U.S. Free Trade Agreement and a Millennium Challenge Corporation Compact. The first meeting, coming at a time of many transitions and challenges in the region, indicates the pivotal role that Tunisia does and can play as a leader in the region for democracy and development, as well as recognition of the importance of the adoption of the new constitution.

The Strategic Dialogue should therefore:

- Enhance U.S. support for the ongoing political, social, legal, judicial, and economic reforms.
- Expand military-to-military exercises and training with Tunisia and increase opportunities for greater intelligence sharing.

- Assist and promote Tunisia's successful model of consensus building and religious tolerance to encourage moderation and peaceful dialogue in the Arab world.
- Commit to structure a trilateral U.S. relationship with Tunisia, as the anchor, and the region to boost political and economic security through greater regional integration.
- Support the need for additional economic reforms that will advance Tunisia's economic freedom and be able to fully reap the benefit of a U.S.–Tunisia FTA. This FTA would establish the basic underpinnings of market economies capable of pulling those in the informal sector into the formal sector and linking the countries of the region through linkages between local markets, with regional markets, and, eventually, to global markets. The goals of establishing those underpinnings would be twofold. The first is to provide assurance to potential investors. The second is to build a strong set of economic institutions that reinforce political pluralism.

It is important to have a successful model in North Africa for the other countries struggling with democratic reform. Tunisia could be a critical ally for the U.S. to help set up the comprehensive trade and investment partnership initiative with the Middle East and North Africa announced by President Obama on May 19, 2011. The commitment is part of a new approach to promoting democratic reform, economic development, and peace and security across this region, in the midst of significant changes.

President Obama said it will be the policy of the U.S. to promote political reform and support transitions to democracy across the MENA region. Because successful democratic transitions depend on an expansion of growth and broad-based prosperity, “the goal must be a model in which protectionism gives way to openness, the reins of commerce pass from the few to the many, and the economy generates jobs for the young. ... America’s support for democracy will therefore be based on ensuring financial stability, promoting reform, and integrating competitive markets with each other and the global economy.” This will need substantial financial means as well as innovative ideas such as the LEND (Leaders Engaged in New Democracies) Network which brings together key leaders from the world’s newest democra-

cies and the Network's advisors, through peer-to-peer exchanges, to facilitate constant exchange of knowledge and experience, with the vision that a global virtual forum for exchanging information and expertise on democratization shall support leaders as they work to build strong, accountable institutions and establish the rule of law.

Conclusion

Tunisia is a modern, pluralistic, civilized place. It is a moderate country that recognizes the equality between men and women and respects its minorities, and is recognized as such. The first Arab nominated for recognition as Righteous Among the Nations by Yad Vashem, Israel's official Holocaust memorial, is a Tunisian who risked his life to save Tunisian Jews from Nazi persecution in Mahdia (Tunisia), during World War II.

Tunisia's constitution is an important milestone to consolidate these characteristics and the foundation of a thriving democracy that strengthens the voices of those who are advocating for democracy, dignity and freedom in other MENA countries.

The new constitution goes even further than many in Western countries concerning the equality between female and male citizens in rights and duties as it enshrines the commitment of the State to ensure gender parity in all elected assemblies.

Tunisia remains a source of inspiration for people across the MENA region. It stands as an example of what dialogue and compromise can achieve. And it reminds us that despite all the challenges and the uncertainties of change, a better future is still very much within reach.

However, Tunisia's lagging economy and threatened security must be addressed or they will risk derailing the democratic transition, putting an end to the Arab Awakening. The EU and the U.S. should therefore enable joint policy approaches and new instruments to support the country (at least) proportionally to its already substantial achievements.

Furthermore, the EU-U.S. trade deal, known as the Transatlantic Trade and Investment Partnership, or TTIP, will bring additional

opportunities for Tunisia and thus, this is an additional incentive for a transatlantic cooperation that would enable Tunisia to fully benefit from the TTIP. Increased trade between the two economic giants will raise demand for raw materials, components and other inputs produced by Tunisia and the other Mediterranean countries.

Therefore, the debate on the strategic vision to be adopted by Tunisia should be launched immediately and engage the different sub-regions (that have been marginalized for too long) as well as the youth whose economic futures are at stake—both their job prospects and the debt they will have to repay if the transition fails.