Great expectations

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The country's political future and economic recovery are closely intertwined

It's been a difficult two years for Tunisia. But despite a backdrop of regional unrest, the crisis in Europe, and a sharp downturn at home, the indicators show that the country is on the way to economic recovery and is winning back the confidence of foreign investors.

GDP contracted by around 2 per cent in 2011, but the government predicts GDP growth of up to 3.5 per cent this year, based on a 4.8 per cent increase in the first quarter of 2012: although the IMF's year-on-year estimate is a more cautious 2.7 per cent.

Underscoring the government's commitment to increase manufacturing, as well as reflecting growing international confidence, foreign direct investment rose 24 per cent year on year in the first ten months of 2012 to US$957 million, not far below its level in the same period of 2010.

This is in large part due to Tunisia's interim administration pressing ahead with legislation to create a more business-oriented environment. Through the FIPA foreign investment promotion agency, foreign investors can take advantage of a range of fiscal incentives, among them 10-year tax breaks on new operations and special fiscal, workforce, and capital transfer deals in industrial zones, particularly in key development regions in the interior. Along with these incentives, FIPA highlights the country's skilled workforce, dynamic private sector with strong links to France, and a favourable geographical location between Europe and Africa.

The main areas attracting investment are traditional sectors in agro-industry (where investment rose by more than 80 per cent on 2011), leather goods and shoe manufacturing, and rubber processing.

Similarly, tourism receipts, one of Tunisia's key sources of foreign currency revenue, bounced back to reach US$882.29 million between January and August 2012, a 35.3 per cent increase from the same period in 2011.

While returning foreign investment is a positive sign for economic recovery, increased government spending on wages, food and energy subsidies, and new social measures, including revamped youth unemployment programmes widened the fiscal deficit to 3.7 per cent of GDP in 2011 from 1.1 per cent in 2010.

But as the IMF accepts in a report this year, a temporary increase in public expenditure is the only way to stimulate economic growth, at least in the medium term.

The IMF says that public spending means the government will need to take measures to balance this spending elsewhere in the budget. As prices rise, the state has indicated its willingness to tighten monetary policy to contain inflationary pressures.

Reforms are needed in the financial sector to address the high level of nonperforming loans (13 per cent of GDP), as well as to improve access to finance, which is still a major constraint in many regions and particularly for lower income groups that have the potential to start micro-enterprises. At the same time, to help safeguard financial stability, the Central Bank aims to broaden and reinforce recent measures to strengthen banking supervision and improve banks' solvency.

The vision thing

The IMF highlights the need for the interim government to develop a new vision for the Tunisian economy and to further identify priority reforms to meet expectations – particularly among young people and in underdeveloped regions in the interior – for a better economic and social future, with opportunities for all.

In short, Tunisia's medium-term economic growth potential is impressive: harnessing it will require continued macroeconomic stability coupled with root-and-branch structural reforms to encourage private sector investment. Among the priorities are improving governance; reforms to the labour market and education system to address skills mismatches; and strengthening the financial sector.

Meeting these priorities will require continued external financing, including foreign direct investment inflows and borrowing by the government and corporate sectors.

The country's political future and economic recovery are closely linked. Tunisians go to the polls to elect a new Parliament and President in June 2013. Before then, agreement on a new Constitution has to be reached. Aside from bold measures to foster economic growth and win investors' confidence, recovery is dependent on the European economy, which is the country's main trading partner. Instability will only delay economic recovery; at the same time, the ongoing transition to democracy requires that young people's aspirations for a better life are met sooner rather than later. F