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COST OF DOING BUSINESS IN TUNISIA: An application of the Growth Diagnostic Model

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To my Parents and Grandparents

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ABSTRACT

Observing the entrepreneurial activity in Tunisia, one cannot but notice the great number of constraints and regulatory barriers hindering business productivity. The aim of this research is therefore to pinpoint the most impactful institution-imposed obstacles that disincentivize enterprise growth by increasing its cost of doing business in the country. Differently from most of the approaches used to evaluate a country's political economy, here the analysis will be conducted using the Growth Diagnostic model from Hausmann, Rodrik and Velasco, for which the most-constraining barrier is deconstructed to find appropriate solutions, thus leading to a sustainable path for economic development.

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INTRODUCTION

Whoever knows a little of Tunisia would have noticed its peculiarity in relation to its identity: while belonging to the Middle East and North Africa (MENA) region, there is a great feeling of being a "Mediterranean Country"[1]. This openness, particularly to Europe, is reflected by a long history of political and economic relations, making Tunis the preferred destination to start a business. Due to its proximity and its cultural similarities, Italian and French entrepreneurs especially have developed a strong business community in the country that has been dominating until 2011. In this period, the most relevant example is the Italian energy enterprise ENI planting its roots in Tunisian soil. However, the turning of events stirred from the Arab spring uprising changed the environment that has always been so favourable to foreign entrepreneurs.

Starting from this framework, this analysis will dig deeper into the contribution of institutional factors in the determination of the cost of doing business in Tunisia, both for foreign and local enterprises in the post-revolutionary period until today. Although the political situation is a crucial element in building a favourable business environment, this is beyond the scope of this research. The focus, instead, will be on the economic and regulatory variables generating entry barriers and performance constraints for entrepreneurial activities. In other words, these regulatory restrictions constituting the cost of doing business are intended as all obstacles imposed by the Tunisian institutions disincentivizing the birth and/or the development of a profitable business, thus hindering the flourishing of innovation and productivity. In fact, the *fil-rouge* that lays under this analysis is the concept of incentive: what are the institutional constraints hampering the incentives for businesses to efficiently grow and contribute to the economic development of the country?

The research will develop as follows. A brief overview of the general economic performance of the country in Chapter 1 will present the most relevant macroeconomic variables, such as GDP growth, inflation rates, unemployment, together with some socio-economic indicators, meaning poverty rates, GDP pro capita and education quality. Chapter 2 will instead be devoted to an empirical analysis of all major constraints hindering business

[1] When I lived in Tunisia during my High School cycle, a Tunisian once confided in me a shared feeling that better describes themselves. He said "We, the Tunisians, are not African because Africans live south of the Sahara Desert; we are not Arab, although we are Muslim and speak the Arab language. We are Mediterranean, the Carthaginians, descending from the ancient population of the Phoenician".

productivity and growth. These are regulatory obstacles and constraints on business activities, employment protection legislation, cultural barriers, and competition market distortions. Finally, Chapter 3 will present the application of the Hausmann-Rodrik-Velasco model, i.e. the Growth Diagnostic approach, for the search of the “most-binding constraint”, and it will provide possible recommendations with the aim of lifting burdensome barriers on performance imposed by the institutions’ influence on the economy.

Chapter 1: ECONOMIC ASSESSMENT

Section 1. MACROECONOMIC ASSESSMENT

1.1.1 GDP growth

According to the analysis conducted by the World Bank, in the period between 2011 and 2018 Tunisia has registered a declining trend accounting for -1.7% Gross Domestic Product (GDP) growth on average. During the difficult years of the Covid19 pandemic, the average growth rate fell to -0.6%. The crisis of 2020 saw a drastic drop in all sectors of the economy, reaching nearly a -10% GDP growth. Nevertheless, the economy started to recover already in 2021 with a real GDP growth of +4.4%. After a speedy recovery, in the following year the trend slowed down, recording a +2.5% growth (World Bank, 2023).

Digging deeper into the contributions of the main sectors of the economy, the performances vary. Firstly, the agricultural sector has been crucial for the Tunisian economy since it still holds a relevant share of GDP[2]. Secondly, despite a sharp reduction in GDP contribution during the pre-Covid decade, the manufacturing industry was the main driver of the 2022 recovery (+14%), followed by services (+2.4%), including tourism and transport, and a modest contribution of agriculture (+0.2%). On the other hand, the non-manufacturing sector registered a negative real GDP growth of -1.1% in 2018, and the energy and mining activities lagged behind dragging GDP growth down (-0.9% GDP growth) (World Bank, 2023).

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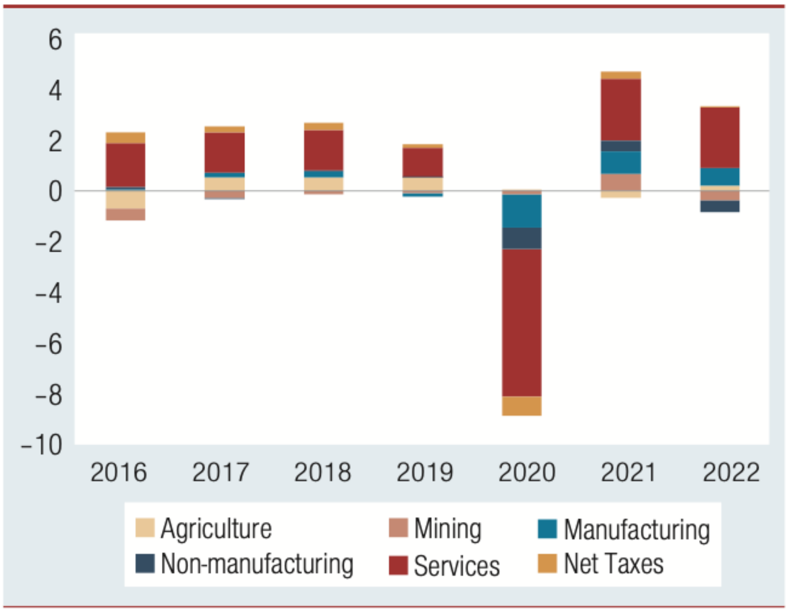
[2] During the period 2011-2018, it was the sector that generated more real GDP growth than the pre-revolution period (2000-2011), reaching a 10% share of GDP in 2018. In 2022, it decreased to 9.8% and in comparison the percentage is lower than its similar countries, but still high with respect to the European countries: in 2022 Algeria 11.6% , Egypt 10.9%, Italy 1.8%, Spain 2.3% (World Bank, n.d.-a).

Figure 1: GDP Growth and sector contribution



Source: National Institute of Statistics, World Bank

Without considering the impact of trade balance for the moment, GDP is composed by consumption, investment, and public expenditure. Looking now at the investment contribution, after 2011 the economy registered a lower volume of private and business investments. In fact, while in the period 2000-2010 private investments accounted for 17.4% of GDP, in 2011-2019 it dropped covering only 14.9% of GDP (World Bank, 2022). Furthermore, together with a decrease in investment, industries are also devoting less attention to innovation. In fact, compared to 2013, only 31% of firms invested in fixed assets, 4% invested in new processes and 7% in research and development in 2019. Moreover, not only this affected the efficiency of the firm, but also the capacity of the workforce, since only 19% of firms offered formal training. This trend is true especially for small and medium enterprises. Concentrating now briefly on the government expenditure, public spending has been increasing over the past decade, covering from 28% of GDP in 2010 to 37% in 2020 (World Bank, 2022). What stands behind this welfare state approach are multiple subsidies and social benefits granted by the state to support the lower income households and reduce poverty. The higher state expenditures are consumer subsidies, i.e. subsidies for food, energy and transport to protect the household's purchasing power; transfer to state-owned enterprises; social transfers, like the PNAFN social transfer program; and public wage bill (World Bank, 2022). As a result, budget deficit stood at 6.2% of GDP in 2021, but increased to 6.8% in 2022 due to the increase in both energy and food subsidies (World Bank, 2023). The functioning and impact on budget deficit of the significant energy subsidies is presented in greater detail in ANNEX 1.

In light of the shown data, it is possible to note the following trend: the GDP composition is decreasingly driven by investment, while both consumption and public expenditures are increasing. Therefore, Tunisia can be referred as a "consumption-based country" (World Bank, 2022).

1.1.2 Inflation

In analysing the macroeconomic environment of a country, one cannot ignore the relevance of the inflation trends. Both the inflation and the interest rate fluctuations are relevant in defining the macroeconomic stability for enterprises to rely upon. This subsection will illustrate the value of the Tunisian currency over the last year.

The inflation rate reached a peak of 10.4% in February 2023. In particular, it rose to 16.1% for food, which is extremely high despite the control prices put in place by the government. Concerning other goods, it stabilized at 14.9% for electricity, gas, and other fuels, and at 12.1% for transport. Although this increase is significant, Tunisian levels align with the other countries in the region (World Bank, 2023). In September 2023 inflation dropped slightly, reaching 9%. Splitting it into sectors, 13.9% was the inflation rate recorded for food, and 6.3% for services. Moreover, goods having set prices, such as bread, kept the same rate at 6.2%, while inflation had a steeper increase for goods whose prices are not constrained. The latest update records the inflation rate at 7.8%, therefore experiencing a further decrease compared to September 2023 (INS, 2024). The key interest rate stays constant at 8% (Central Bank of Tunisia, 2023).

It must be noted however that the real interest rate is negative. This implies that the inflation rate was higher than the nominal interest rate: 10% inflation against an 8% nominal interest rate set by the Central Bank to avoid the worsening of the situation. The main objectives that the Central Bank aimed to achieve was the strengthening of the national currency, preserve the foreign exchange rates and try to reduce import demand (World Bank, 2023).

In sum, financial stability at the macro level is challenged by the increasing inflation rates that reach the double digits. This has implications therefore on the interest rate set by the Central Bank, but despite its recent monetary policy, the real interest rate remains negative.

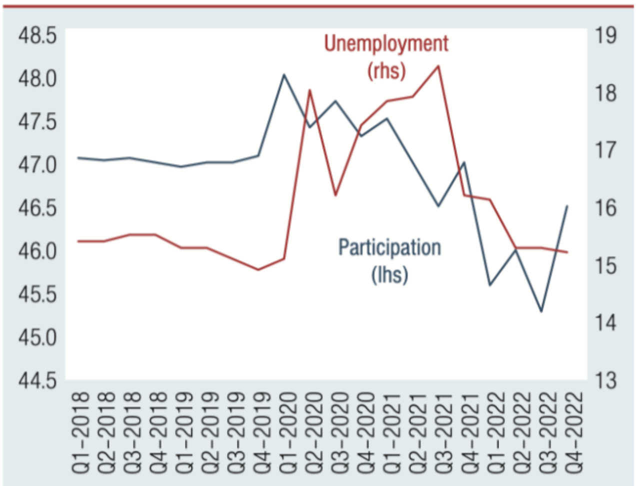
Section 2. LABOUR MARKET ASSESSMENT

One of the most crucial variables to analyse for the macroeconomic assessment is the labour market. In fact, Tunisia has a very peculiar situation in which unemployment is one of the main causes for social unrest and tension. Looking at unemployment, we can determine this main trend: behind a high and consistent unemployment rate, there is a weak job creation in the private sector, that is in opposition to the proliferation of public employment.

1.2.1 Unemployment rate

Considering the trend over the past years, unemployment stood at 14.9% in 2019, then between 18-19% in the third quarter of 2021 due to the effects of Covid19. In the last quarter of 2022, unemployment rates returned to pre-crisis levels, however, not because of an increase in job creation (World Bank, 2023). In fact, according to the World Bank, the decline was driven more by a drop in participation rather than by an increase in employment. In other words, because the amount of people looking for a job diminished, the unemployed rate declined since the unvaried number of employed are divided by a decreasing labour force. This can be empirically shown using the participation rates, that stood at 47.1% in 2019 and dropping to 46.5% in 2022 (World Bank, 2023). Furthermore, it is important to stress that the unemployment rate varies significantly between the rural internal areas of the country and the coastal regions, where industrial and trade activities are concentrated.

Figure 2: Trend of unemployment and participation rates



Source: National Institute of Statistics, World Bank

1.2.2 Public and Private Job creation

Behind these high and consistent unemployment rates, there is a poor job creation that cannot keep up with the increasing flow of university students searching for employment. In fact, despite the general GDP growth, job creation dropped to 1.2% between 2011-2018, compared to the 1.7% of the period 2000-2011 (World Bank, 2022). This negative trend is explained by multiple factors. Firstly, while medium and large firms hold 55% of total employment, small businesses poorly contribute, by creating very little employment. Its impact is significant because, differently from other countries, the number of medium-large firms is low[3]. Therefore, the economic landscape is mainly composed by these small family-owned businesses that however struggle to generate jobs able to absorb the new labour force. The main job creating sectors are manufacturing and services, providing for 19% and 52% of the labour force respectively (Belgacem & Vacher, 2023)[4].

In assessing employment in Tunisia, one cannot ignore the extremely relevant role played by the public sector in the labour market. As a reaction to the growing unemployment and the obstacles to the private sector's productivity, there has been an increase in the public sector recruitment, reaching one of the highest levels of public sector wage bills in the world, going from 14.6% of GDP in 2019 to 17.5% in 2022 and accounting for 49% of government expenditure (IMF, 2021). The increase of the public expenditure is not only driven by a rise in the number of public employees, but also from the high increase in wages, that are estimated to be double the private sector's remunerations. In addition to this attractive feature, the civil service also guarantees better working conditions and ensures job security more than the private sector. For this reason, the public sector is considered to be the "employer of last resort" (OECD, 2022a; World Bank, 2022), thus increasing the pressure on the civil service wage bill. Despite being able to absorb part of the unemployed and granting additional benefits for workers, it has major spillover effects both on macroeconomic stability, as for the budget deficit is concerned, and on the distortions generated in the corresponding market.

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[3] 97% of firms are self-employed and micro enterprises (1-5 employees), 0.7% are firms with 20 to 99 employees, and 0.2% are firms with more than 100 employees (World Bank, 2022)

[4] Additionally, in line with data provided by the World Bank, the GEM report demonstrated that nascent, smaller firms contribute less to job creation than bigger, more established firms.

The trend of labour demand is based on an essential difference between the private and the public sector. While the former is contributing mainly through the creation of low-skilled intensive activities, such as textile, tourism and construction, the latter holds most of the high-skilled intensive activities. This distinction can therefore explain the reason why unemployment is very high for graduate students: nearly 60% for women and just above 40% for men. In fact, because graduates are high-skilled, they cannot find a position in the private sector matching with their capacities. Consequently, most of them try to rely on the public sector, that ensures a higher salary in addition to all other benefits. In support of this claim, the Tunisian Labour Market Panel Survey estimates that even with a job offer in the private sector, 78% of new university graduates would prefer to wait for a position to open in the public sector (Assaad et al., 2016). Moreover, also for most of unemployed that do not have a tertiary degree (60% of the unemployed) the private sector is not as attractive, due to low wages and poor working conditions. Therefore, for this category of people, the better solution relies on the labour market informality. To support the argument that informality in Tunisia remains the major kind of employment, especially for the youth, the IMF's findings show that informality tends to be positively related to the education level: non-graduates tend to have the largest share of informal positions (Belgacem & Vacher, 2023). Also, participation rates highlight the alarming performance of private job creation (see above). Discouragement in finding an adequate position and some cultural influence leads to a participation rate that is below 25% in general, but higher for women than for men. Finally, it is curious to note how among the remaining category of workers able to fit in the private sector, 47% are involved in an offshore sector.

All these elements combined suggest that at the root cause of unemployment there is a structural fallacy that leads to skill mismatch constituting an important labour market distortion. In other words, the sectors creating employment are not the ones where there is the majority of unemployed. A deeper analysis on the causes leading to the imbalance between labour demand and supply will be presented in the ANNEX 2.

Section 3. SOCIAL PERFORMANCE

1.3.1 Poverty and vulnerability

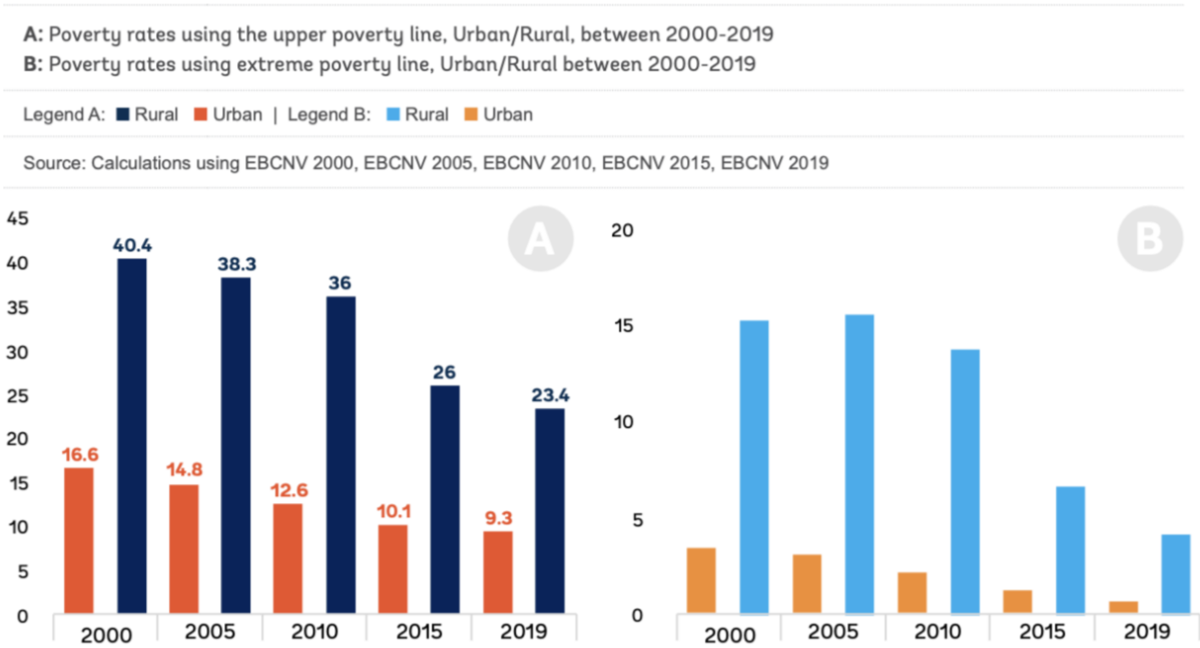
Poverty in Tunisia is still an important issue describing its social and economic development. Despite the decreasing trend, there is still a very high level of inequality among the coastal and the inner regions of the country.

Poverty rate in the last decade has dropped from 20.5% in 2010 to 13.8% in 2019. More specifically, the biggest improvement has been registered between 2010-2015, thanks to the decrease in rural poverty and the expansion of social transfers. Furthermore, the levels of extreme poverty have reduced enormously, reaching 1.7% in 2019 from a starting point of 6% in 2010. In addition, also extreme poverty has declined the most between the period 2010-2015 (World Bank, 2022). However, after a downward trend, poverty levels rose again from 13.8% in 2019 to 16.6% in 2021[5]. Nevertheless, looking at these values and comparing them to other similar countries, it is possible to state that poverty levels in Tunisia are one of the lowest in the region. Contrarily to the improvement on poverty, the percentage of vulnerability[6] has not dropped significantly over the 2000-2019 period, going from 46.2% to 41.9% in 2019 (World Bank, 2022).

[5] According to the 2021 National Survey on the Budget, Consumption and Standard of Living of Households (EBCNV), the main cause of the hampering of poverty reduction were the effects of Covid19 (World Bank, 2023).

[6] According to the Atamanov and Lopez-Acevedo's methodology, vulnerability is the "category of poverty in which people are not poor but still vulnerable to poverty" (Atamanov et al., 2020)

Figure 3: Poverty rates



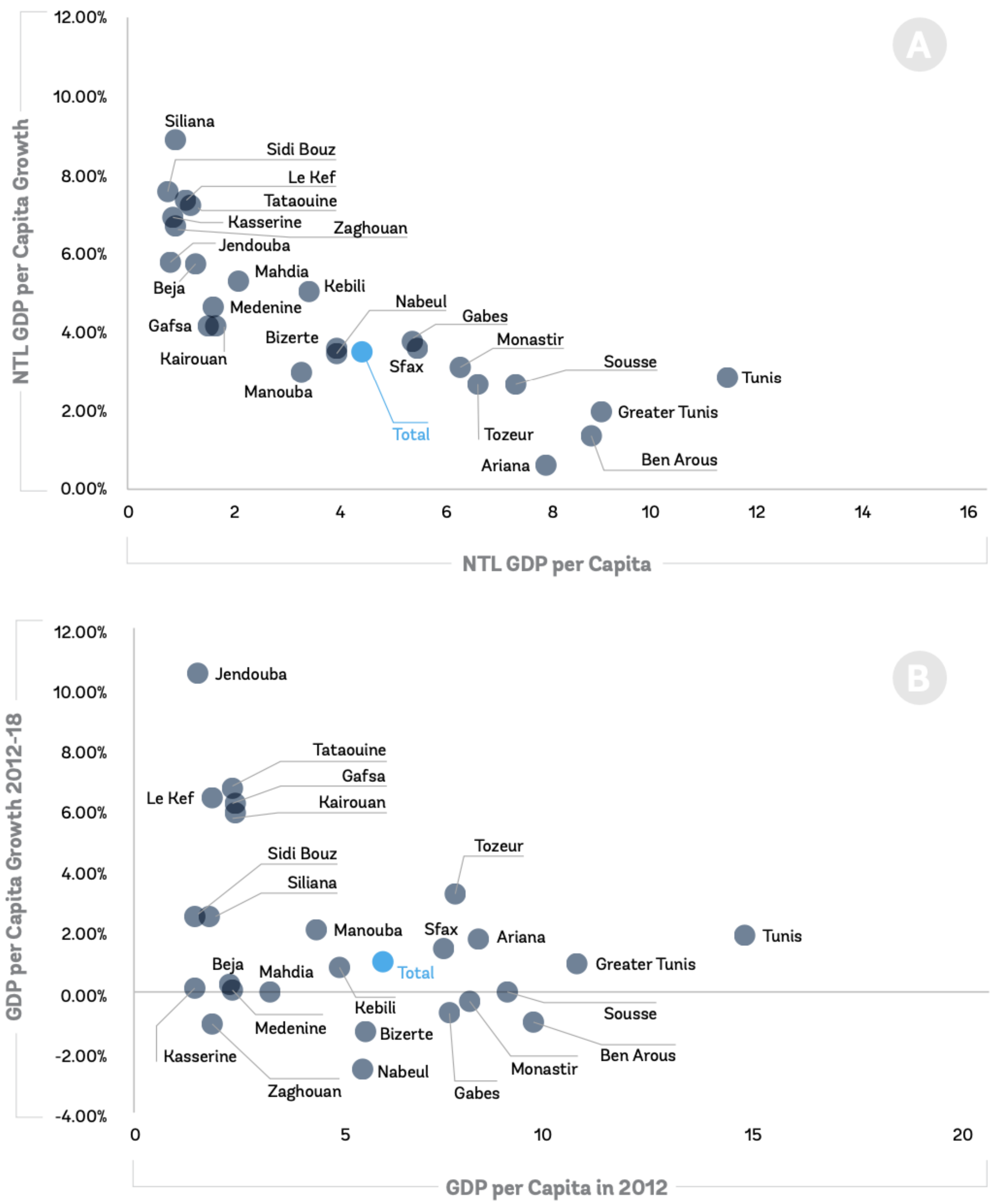
Source: National Institute of Statistics, World Bank

Despite a relative low level of poverty, there is a very deep inequality between the urban and the rural regions of the country. In Tunisia, the leading regions are concentrated on the coastline, where the major cities are Tunis, Monastir, Sfax, Gabes, and Sousse. While the lagging areas are the more south-west regions, far from the dynamic city lifestyle and in a more desert-like environment. The Gini index will be used to assess the level of inequality. In 2000 the Gini index was 0.4, decreasing to 0.328 in 2015 (World Bank, 2022). Hence, this means that the rural areas have been slightly converging towards the urban areas, but the divide remains wide with the capital, the richest region, due to evident disparity in living standards and basic services. Firstly, the health system is affected by weak supply chains, fragmented information system and inefficient infrastructure. Secondly, water is becoming in the last years increasingly scarce and unevenly distributed. Thirdly, the decentralization reforms that have been put in place to overcome regional inequality are still lacking (World Bank, 2022). Consequently, these vulnerable regions have limited access to services and opportunities, thus leading to dissatisfaction, internal migration, and social turmoil. The gap between urban and rural regions can also be observed through the lens of GDP per capita. While in the period between 2000-2011 these latter regions were showing a robust growth and slowly converging towards the leading ones, this trend has been attenuated in the following decade (Figure 4).

Therefore, it can be observed that despite a declining trend in poverty rates, vulnerability persists. Furthermore, wealth distribution across the region is highly inequal, as both the Gini index and GDP per capita have shown.

Figure 4: Growth convergence at the governorate level

A: 2000 – 2010   B: 2012 – 2018



Source: World Bank staff estimates based on INS and DMSP/VIIIRS night-time light data (World Bank, 2022)
Note: Greater Tunis, Ariana and Ben Arous are some of the capital's suburbs

1.3.2 Education

Finally, education variables of the Tunisian population will be presented. Briefly observing the education performance will be instrumental to better interpret the peculiar features of the labour force and their implications on the entrepreneurial activity.

In Tunisia, the education levels have been improving over the last years. This is evident especially in the increase in the enrolment rates in both secondary and tertiary education, reaching 92% and 32% respectively in 2018 (from 45% and 8% in the 90s) (OECD, 2022a). Although this generalization leads to think that education in the country is somewhat efficient, digging deeper it is possible to notice that enrolment rates vary significantly across regions and across family-income (OECD, 2022a). The latter specifically show that lower income families struggle to ensure a proper education especially for early childhood enrolment compared to higher income households.

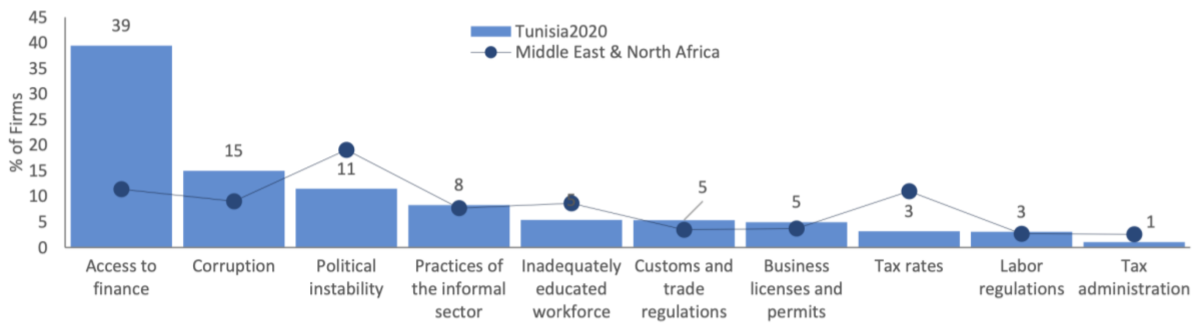
However, observing only enrolment levels is not explanatory of the quality of the educational system, which is better described by the average student performances. In fact, despite a positive trend in enrolment rates, the quality of education is low: according to the Organization for Economic Cooperation and Development (OECD) Program of International Student Assessment (PISA), Tunisia is at the very bottom of the ranking. This poor performance is also confirmed by the high rates of failure on the secondary education's exam (around 70%) (OECD, 2022a). There are multiple factors that are behind this weak education service: misallocation of teachers across regions, low quality teaching, poor infrastructure, and outdated curricula and lack of soft skills focus.

This low quality of basic education is crucial to be highlighted since it is strictly connected with the structural problems affecting the labour market (see Annex 2). In fact, this is a possible explanation for the gap between high-skilled graduates absorbed in the civil service and the low skilled unemployed that are not qualified enough to find a position in the formal sector, due to lack of communication and soft skills that basic education lacks to provide.

Chapter 2: COST OF DOING BUSINESS

This chapter will be devoted to the analysis of regulatory constraints and institution-induced market distortions affecting entrepreneurial activities in Tunisia. More specifically, section 1 will take into consideration all regulatory constraints hindering entrepreneurial activities, such as financial accessibility, the weight of administrative procedures and taxes, and costs for trading activities, and labour market regulations. The last subsection will instead focus on a cultural barrier for starting an enterprise: fear of failure. Section 2 will consider relevant market distortions, together with governance performance's influence on business incentive.

Figure 5: Top ten business environment constraints



Source: World Bank's Enterprise Surveys (World Bank, 2020b)

Looking at Figure 5, one can argue that the obstacles businesses are facing the most are all barriers coming from institutional regulation, such as customs and trade regulation, tax rates, labour regulations and so on[7]. Most importantly, both access to finance and corruption seem to be the most relevant constraints, also compared to the MENA average. Except for political stability, all these will be analysed in further detail in this chapter to precisely grasp their impact on the cost of doing business.

[7] One must remember that data underlining the graph is collected from a survey of multiple entrepreneurs in Tunisia.

Section 1. ENTREPRENEURIAL CONSTRAINTS

2.1.1 Financial accessibility

In Tunisia, access to finance is one of the main constraints for firm growth, also compared to the other countries in the MENA region. In fact, the World Bank enterprise survey shows that firms in Tunisia perceive limited financial access to be the main obstacle to face for all sizes, compared also to corruption and political stability (World Bank, 2020b). Hence, it is a crucial issue that must be taken into consideration when assessing business incentives for fostering economic development.

In the analysis of market performance, the World Bank assesses the cost of doing business in Tunisia. Among all the dimensions of the regulatory framework surrounding a business, the most problematic seems to be the so called "Getting Credit" indicator, which measures the credit report performance and the legal rights protection of lenders and borrowers through collateral and bankruptcy laws. Therefore, the main questions that this indicator addresses are: "Do lenders have credit information about entrepreneurs seeking credit?" and "Is the law favourable to borrowers and lenders using movable assets as collateral?" (World Bank, 2016). To this end, the role of a collateral registry and credit reporting services are of crucial importance.

First, the most significant weakness of the banking performance is the lack of a collateral registry. Since the main aim of this banking instrument is to ensure the lender of an existent and verifiable collateral of the borrowers, the lenders rely on this mean to decide to grant a loan or not based on the movable asset's information registered as collateral. Instead, with the lack of a collateral registry, lenders have no insurance of the existence of a collateral, hence, they become more reluctant in granting loans. This line of thought is based on evidence provided by Soledad et al, for which "while a sound legal framework is essential to allow movable assets to be used as collateral, without a well-functioning registry for movable assets, even the best secured transactions laws could be ineffective or even useless" (Love et al., 2013). Moreover, according to their evidence-based research, inserting a movable asset collateral registry increases firms' access to finance. Finally, it must be noted that this increase is higher for smaller firms. In the Tunisian context, indicators measuring the existence and the functioning of a collateral registry are not promising. The analysis of "Doing Business" by the World Bank reports that there is no operating collateral registry, which is unified geographically and by asset-type, nor for incorporated and non-incorporated entities. Furthermore, there is no noticed-based collateral registry in which all functional equivalents can be registered and there is no possibility for interested third parties to record amendments and cancellations online. As a result, Tunisia ranks 104th out of 190 countries and compared to similar peers, it shares the same score as France, but it distances itself from Egypt, which is the best performing country in the MENA region (World Bank, 2020a).

A lack of an efficient collateral registry has a twofold effect: first, the smaller businesses are the ones that are affected the most, since the lenders are more spurred to favour bigger companies of which movable assets as collateral are known; second, the economy is restrained by this barrier that limits the innovative contribution of smaller entrepreneurial initiatives. In fact, only 33% of small firms (with 5 to 19 employees) have a bank loan, compared to a 54% of medium firms (with 20 to 99 employees) and 47% of large firms (more than 100 employees) (World Bank, 2020b). This data empirically confirms the theoretical deduction made above, according to which it is more difficult for smaller firms to access credit.

In addition to limited collateral registry, other institutional constraints contribute to disincentivize business growth. Firstly, an administrative approval required for the purchase of a 50% stake in a listed company is an example of a series of foreign investment restrictions, which generate a relevant barrier to entry for investments (OECD, 2015). Secondly, the instalment of a permanent interest rate cap for lending is of major concern, since it drives out risk-based lending possibilities, especially for small, new innovative business projects (OECD, 2015). What is more, smaller firms are disincentivized from more provision of credit also by a lending rate limit of 2% (World Bank, 2020c). Because of these lending interest rate constraints that affect risk prone investments, banks tend to increase the required collateral for a loan. While it may not be an issue for bigger, more established firms, it may further limit access to finance to smaller, new firms. Fourthly, gaps between the regulatory and legal frameworks regarding microfinance are extremely relevant. Above all, the OECD points out that Tunisian Microfinance Institutions (IMIs) rely on banks that do not refinance themselves with the Central Bank. Consequently, the financial intermediaries are driven into excessive risks that hinder their capacity in supporting sectors of the economy (OECD, 2022a). Finally, a lack of adequate information for risk management together with the inefficiency of the public sector's direct interventions in the financial sector participate in generating incentive barriers for potential entrepreneurial activities (World Bank, 2022).

Limited access to finance contributes to a heavy barrier to entry, that disincentivizes firms to start a business in Tunisia, or instead incentivizes them to abandon the entrepreneurial activities. In this regard, among all the reasons that force entrepreneurs to leave the business environment, issues related to access to finance drive 14.2% of firms to exit (Hassen et al., 2023). Therefore, financial accessibility isn't only related to the establishment of an entrepreneurial activity, but also for its durability in time, which is crucial to build greater incentives in the country.

The inefficiency of the financial intermediation can be assessed also looking at the financial sources on which firms rely on the most. According to the Enterprise Survey, 47% of financial assets are supplied internally, meaning by family or friends, against a 20% supported by banks (World Bank, 2020b). Therefore, the higher the inefficiency of the financial institutions, the more internal resources are necessary. However, it must be highlighted that this tendency cannot be sustainable in the long term. Thus, these constraints must be addressed to stimulate a friendlier business environment.

In sum, it can be concluded that the accessibility to finance for smaller firms in particular is extremely scarce. In fact, not only there are multiple flaws in the banking activity due to absence of a collateral registry, but also due to regulatory barriers limiting lending, therefore forcing enterprises to rely on internal financing or to exit the market altogether.

2.1.2 Burdensome Authorizations and Taxes

In considering the cost of doing business in Tunisia, the most salient weak point continuously stressed by entrepreneurs is the excessive amount of authorizations and permits needed to pursue their business. Despite the will of the state to protect public interest, most of these regulations are unnecessary and, instead, create a heavy barrier to entry disincentivizing entrepreneurial activities. Moreover, it is showed that more politically connected firms are more likely to be favoured in this regard compared to smaller, non-connected businesses[8].

Dealing with authorization requirements, entrepreneurs must start procedures that in the case of the Tunisian administration, are described as "lengthy" and "opaque" (World Bank, 2020c, 2022). To support this claim, the Doing Business report of the World Bank suggests that for construction permits the number of procedures and costs are above OECD average, 14 days

[8] This phenomenon is connected to the reputation left by Ben Ali before the revolution. In fact, the businesses owned by his family were favoured and privileged in getting permits and authorization more easily than other firms that didn't have any connection to the political regime. As a result, their firms dominated the economy and frequently were able to avoid tax duties (OECD, 2022a).

and the cost of 3.4% of building value against 12.7 days and costs of 1.5%, respectively. In fact, 68 days are needed to receive a building permit by the Municipality, and the costliest procedure is a mandatory private company soil test for TND 6.000 (roughly 1.800€) for 10 days. The same can be said for registering property, where time (35 days) and costs (6.1% of property value) necessary are well above OECD standards (23 days and 4.2% of property value). Furthermore, the quality of the land administration is scored very low, since the cadastral plans are still on paper, and geographical privately held land plots mapping are non-existent (World Bank, 2020a). All these features put together create a complex and burdensome business environment that could prevent potential fruitful investments.

In this regard, the restrictions that are the most present are the *cahiers des charges*, business licenses, and *conditions d'exercice*. These authorization requirements are mainly "ex-ante barriers" (OECD, 2023), meaning that they must be complied with before starting the activity. For example, in 2023 26 authorizations and 8 administrative procedures were found in the tourism sector[9], which is extremely relevant for a country like Tunisia. The impact of these superfluous barriers is significant, since the OECD estimates that their abolition would generate a rise of the GDP by TND 672.8 million (OECD, 2023).

In light of the evident unappealing business environment, many reforms were put in place by the Tunisian government to alleviate some of the authorization requirements. Yet, they seem to have failed in achieving their goal. Firstly, the 2016 Investment Law reform justifies some authorizations and procedures as defending the public interest, but fails in distinguishing the most relevant with the excessive, burdensome ones affecting mostly entrepreneurs (World Bank, 2022). Secondly, the 2018 regulatory reform[10] was able to abolish only 27 of the 127 authorizations requested, and still not even 10 were definitely abolished (World Bank, 2020c).

Furthermore, also the deeply fragmented, obsolete, and unclear regulatory framework in which these permits and licenses are stated affects the flourishing of the business environment. Firstly, the fragmentation of the content in different pieces of legislation is confusing and unclear for the businesses that are subject to them. Secondly, obsolete laws that are not officially removed become inconsistent with practices and new regulations, thus increasing uncertainty. Thirdly, an inconsistent publication of new pieces of legislation suggests an important lack in transparency. Finally, uniform enforcement makes these

[9] For example, the cultural activities like private galleries, museums need specific permits for equipment, professional standards, and minimum capital threshold (OECD, 2023).

[10] Decree 417 of 2018

regulations seem arbitrary (OECD, 2023). For all these reasons, investors may not be incentivized enough to invest in an economy where there is uncertainty and lack of transparency.

Another important barrier to entry for businesses is the imposition of a heavy tax regime. In Tunisia, despite the numerous tax incentives for businesses and financial reforms (UHY, 2021), there are still some weaknesses that do not favour a friendlier business environment. In 2020, tax revenues had risen to 32% of GDP and the VAT reached 7% (OECD, 2022a).

Analysing the taxes applicable to businesses, the World Bank highlights that the total tax and contribution rate are 60.7% of profit, while social security contributions reach 18.69%. In addition, the corporate income tax is at 13.1%, profit taxes at 13.6% of profit, and labour tax and contributions at 25.3% (World Bank, 2020a). As a result, these numbers show that the labour and contribution tax are double the MENA and OECD average, suggesting a very high rate compared to similar and higher income countries. This is a crucial element for entrepreneurs, since it increases the cost of doing business, hence it may reduce the possibility for investment, innovation, and growth.

In addition to a high tax wedge between personal income tax and social security contributions, the use of the flat tax regime is another weakness of the current Tunisian tax regime related to the widening of the informal sector, discussed in Section 2.3. The flat tax regime imposes a lower tax rate for businesses having a turnover lower than a specified threshold, and it was aimed at simplifying regulations and tax compliance costs to incentivize the formal sector. However, the difference between the flat tax rate and the standard tax rate is so wide that firms are motivated to under declare their turnover to fit in the category of the flat tax, to be then able to pay less. As a result, on one hand the flat tax led to 60% of existing firms to register in the formal sector, but on the other only 35% declared their full turnover (Vacher et al., 2022). Consequently, the effects of the flat tax have been controversial and not satisfactory in terms of revenue since firms are more and more tempted to take advantage of the lower tax rate.

In light of this analysis, it is possible to empirically sustain the argument according to which actions are obstructed or disincentivised altogether by burdensome administrative procedures and additional costs that may not be fully necessary for the purpose of protecting public interest.

2.1.3 Trading Across Borders

Related to the heavy presence of the state through taxations, authorizations, and permits, entrepreneurs experience also tariff and non-tariff barriers to trade. In fact, this regulatory framework is crucial in creating incentives for fostering trade and consequently growth. Although Tunisia has been increasingly improving its attractiveness in the offshore sector, there are still many barriers that reduce firms' efficiency and proper allocation of resources, especially for domestic firms.

Spread across all sectors, there are numerous procedures and regulatory requirements that increase time and costs of trade. First of all, poor quality of infrastructure and low logistic capabilities are major factors that increase time and additional costs for firms, hence impacting on their efficiency and productivity. In particular, the most concerning infrastructure weakness is the efficiency of port facilities, mainly of the port of Rades, where congestions and long waiting times make trade practices more difficult (EBRD, 2020; OECD, 2022a; World Bank, 2020a, 2022). Secondly, many authorizations are required, such as a merchant card authorization to start a commercial activity for foreign controlled companies, and pre-authorization by the Ministry of Trade of the import of certain goods (OECD, 2023). Although the aim behind these requirements is promoting quality and safety for the goods exchanged, they also tend to generate barriers to the proper functioning of business activities. Thirdly, another important aspect is non-automatic import licencing followed by cumbersome administrative procedures, such as Foreign Product Quality certificates (OECD, 2022a). Moreover, heavy taxes imposed upon trade are import quotas, excise tax, and tariffs for intermediate inputs and capital goods (OECD, 2022a). Compared to other countries, these sums are extremely high. Consequently, they reduce the incentive for efficient resource allocation, innovative improvements and they limit the availability of quality inputs that make Tunisian firms competitive at international level.

As a result, these additional trade regulations increase dramatically costs and time spent by firms for trade, disincentivizing business growth in the country. According to the simulation made by the World Bank, costs on border compliance and documentary compliance for both imports and exports are very high, also compared to other similar countries (World Bank, 2020a)[11]. Additionally, it was estimated that the average days to clear imports through customs

[11] Assuming a shipment of 15 metric tons of auto part of $50,000 of value, import border compliance reach an expenditure of $596 (against a $98.1 for OECD countries), costs for exports border compliance sum up to $375

are 16, while the average for MENA is 11, and 13 for lower middle-income countries (World Bank, 2020b). Therefore, these lengthy and costly procedures for trade are not to be overlooked when calculating the cost of doing business, since they have a big role in shaping the attractiveness of the Tunisian economy.

Finally, the impact of these barriers to trade must be analysed in the relationship between onshore and offshore firms in terms of global value chain integration. To further increase integration, the Tunisian government has pushed trade liberalization with free trade agreements and tariff reductions, therefore creating a very favourable regulatory regime exclusively for offshore enterprises, while keeping the onshore firms to produce exclusively for the domestic market. More specifically, this set of policies intended to facilitate trade include for example the reduction of corporate taxes, liberalisation of foreign equity rules and so on[12]. However, the effect was a creation of an offshore-onshore dual economy that has been causing significant distortions in the market: imposing barriers to trade for the domestic firms has negatively impacted their productivity and competitiveness, together with limited global value chain linkages in the local market (EBRD, 2020).

Inefficiencies in infrastructure, long and costly administrative procedures are all major constraints affecting the performance of businesses dealing with trade. More importantly, affecting majorly the onshore businesses, trade barriers directly hinder the exporting potential of these enterprises, hence affecting trade balance and integration in the global value chain.

2.1.4 Employment Protection Legislation and Labour Market regulations

One of the most important incentives for businesses to invest and grow is related to the regulation standing behind employment. The more protective the law is over workers, the more the employer has difficulty in adjusting its labour force, especially in periods of shocks. In the

(against $136.8 for OECD countries). As for time needs, the lengthiest procedure refers to the import border compliance, that reaches 80 hours to complete (World Bank, 2020a). In general, the trends suggest that costs and time are higher for import practices than for exports.

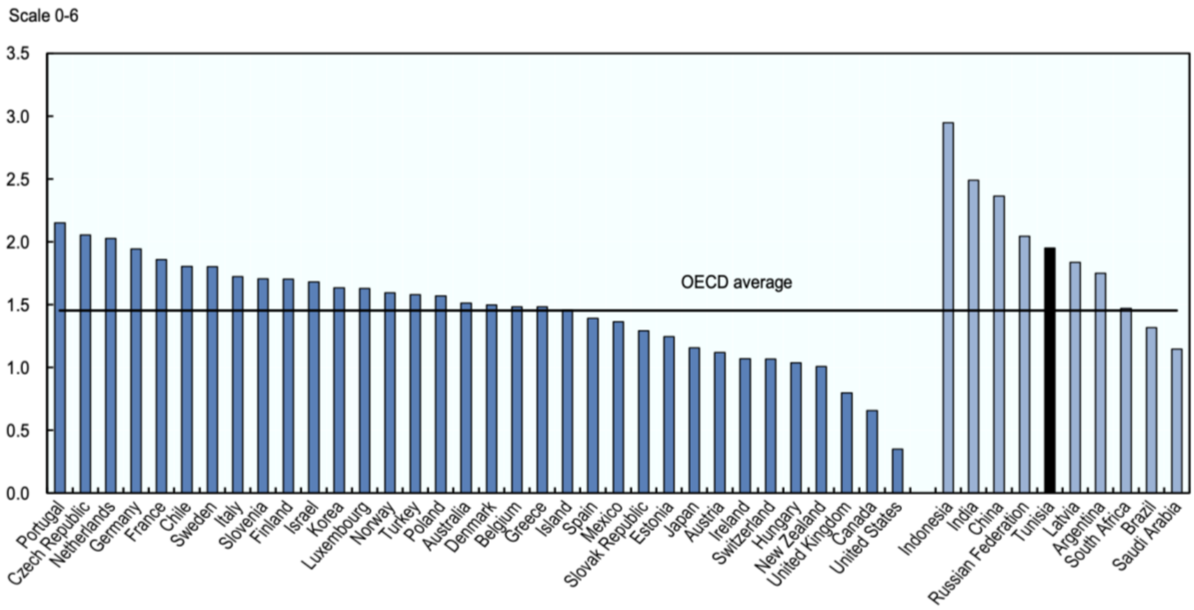
[12] Benefits granted to the offshore firms compared to the domestic firms are both on tariff and non-tariff measures. Firstly, to reduce waiting time in the ports, custom clearance is granted inside the firm itself. Secondly, imported inputs are free of tax charge and authority check and control. Finally, the possibility to grant a foreign exchange account avoids going through burdensome currency exchange procedures (World Bank, 2023).

Tunisian case, Employment Protection Legislation (EPL) and labour market regulations affect business employment in four ways: high costs of dismissal, centralised wage bargaining system, wide gap between open and fixed term contracts, and finally legal uncertainty over fragmented and obsolete EPL.

One of the main characteristics of the Tunisian EPL is the cumbersome bureaucratic and administrative procedures related to workers' dismissal. Barriers for employers are mainly two. First, the bureaucratic procedure of layoffs requires a tripartite mechanism with the involvement of more than one public authority, thus lengthening and complicating procedures (Koranchelian & Fanizza, 2005). Secondly, in case of redundancies, these are granted following both notification and approval of a third party for not only a party of 9, but also one single redundant worker to be fired. Moreover, it is mandatory for firms to retrain workers even when their intentions are to make that specific position redundant, hence increasing time and costs for the business (World Bank, 2020a). As a consequence, in order to avoid going through the lengthy procedures, firms tend not to dismiss at all (for example the period between 1998-2001 only 1% of layoffs were completed (Koranchelian & Fanizza, 2005)). Therefore, trends reflect both a decrease in job destruction and job creation by reducing the number of short time jobs and by fewer empty vacancies to fill. It must be noted however that, although the alleviation of dismissal procedures by one score point leads to an improvement of employment by 4.5% (Belgacem & Vacher, 2023), addressing EPL alone is not the answer to solve unemployment in the country.

In relation to the burdensome EPL regulations, there is a wide difference in employment protection between open end and fixed term contracts. In particular, workers with a permanent term contract enjoy greater protection than those signing a fixed term contract (Belgacem & Vacher, 2023). Consequently, from the worker's perspective, the translation from a fixed to permanent position is rare and difficult, since there is no incentive to do so. However, from the business perspective, fixed term contracts hinder its productivity and efficiency by increasing time spent with dealing with administrative procedures and the maintaining of a stable employment.

Figure 6: Employment protection legislation on regular employment (individual dismissal)



Source: OECD employment Protection Database, 2013 update OECD website, (OECD, 2015)

Additionally, a friendly business environment cannot include uncertainty within the legal framework. In Tunisia the EPL is scattered in many different pieces of legislation: norms dealing with the private sector are in 56 collective agreements, 54 sectorial agreements and 2 global agreements; provisions specific to SOEs employees are in the institutions' statutes; and the benefits granted to government employees are listed in another different set of regulations (Belgacem & Vacher, 2023). Furthermore, the fact that this packet of legislation has not been revised since the 1990s may create uncertainty, since they do not entirely reflect current practices and ensure proper protection while favouring enough flexibility for business growth and competitiveness.

Since EPL is not the sole variable explaining a weak business environment in terms of employment legislation, wage bargaining systems need to be considered, as they create additional entry barriers for the development of the private sector (Belgacem & Vacher, 2023). Even if over the last decade labour market regulations have not changed significantly, results from Fraser Institute's surveys show that employers have perceived a more centralized bargaining system. Yet, in theory the Tunisian system is neither fully centralized, nor fully decentralized, in other words an "intermediate level of bargaining" (Belgacem & Vacher, 2023). Nevertheless, as empirical evidence is provided by the OECD, a more centralized bargaining system can be considered as a disincentive for firms, since it grants them a lower flexibility, and consequently can be associated with lower productivity growth (OECD, 2019).

Therefore, it is possible to state that through the quality of labour legislation, such as dismissal regulation and wage bargaining systems, enterprises can be under higher costs, leading to a misallocation of resources that could be otherwise implemented for innovation or productivity building.

2.1.5 Entrepreneurial culture

Barriers to entry are not only a result of institutional regulation, but also from the social attitudes and entrepreneurial culture embedded in the country. In this regard, the Global Entrepreneurship Model (GEM) puts forward a deep analysis on the surveyed perception of running a business in their country. Some of the results are crucial to take into consideration as a verification of an empirical economic assessment. In this section, the focus will be on three aspects in particular: the perception of the ease of starting a business, entrepreneurial intentions, and the impact of fear of failure.

The World Bank indicator measuring the costs and time necessary to start a business in Tunisia shows a very good performance and efficiency of the competent authorities and institutions. In fact, costs are very minimal, the numbers of procedures are limited and there is no requirement of an ex-ante deposit before registration[13] (World Bank, 2020a). However, despite this positive and encouraging result, only above 40% of people surveyed recognizes the ease and flexibility of the procedures for starting a new business in their country, so much so that the GEM report ranks Tunisia as 30 out of 49 participant countries in the study (Hassen et al., 2023). This divergence is a consequence of the subjective and objective point of view, from which emerges a point of reflection: in Tunisia, potential entrepreneurs may perceive more difficulties in starting a business than it actually is. Therefore, the institutional efforts in attracting business have limited effect if, due to lack of trust or misinformation, there is no incentive for entrepreneurs to develop a new business activity.

Nevertheless, for Tunisians entrepreneurship is still considered as a good career choice providing for high societal status guarantees. In fact, 50.67% have the ambition of starting a business within 3 years, thus reflecting high social attitudes and good perception on the possessed capabilities required. Considering that in the Arabic culture the "non-acceptance

[13] In this regard, the World Bank gives a score or 94.6 out of 100 and places Tunisia as 19th ranked out of 190 economies studied (World Bank, 2020a).

from family members" is one of the biggest barriers for entrepreneurial activity (Hassen et al., 2023; Youssef et al., 2011), the outcome of business intentions is positive in comparison. Yet, the actual reason Tunisians start a business seems to suggest otherwise. The GEM report's data support the "push theory", or in other words "necessity entrepreneurship", according to which "individuals are pushed into entrepreneurship by social factors, such as job scarcity". In fact, 90% of Total Entrepreneurial Activities (TEA) started "to earn living because jobs are scarce" (Hassen et al., 2023). This outcome stresses the weight that unemployment has in the country, on one side being an incentive driving business creation, but on the other underlining the labour market distortions and extremely weak job creation in the private sector. The perpetuation of this trend however cannot be sustainable in the long run, thus the perceptions on entrepreneurial activity become a consequence of addressing the root cause of poor labour demand.

Furthermore, the implications of labour market distortions on entrepreneurial culture create another fundamental barrier to consider: the fear of failure. Observations from the International Labour Organization suggest that even if the rate of business creation is high, the rate of failure is equally relevant (ILO, 2012). Consequently, fear of failure becomes the decisive factor in starting or not a business, becoming one of the biggest barriers (GEM, 2023). In fact, there is evidence suggesting that in the MENA region, fear of failure is bigger than in other developed regions, such as the US or Europe. Hence, the Arabic culture highly supports working for large and established enterprises for stability and job security rather than creating something from scratch for fear of failing sooner or later (Hassen et al., 2023; Youssef et al., 2011). In Tunisia specifically, over the last decade the percentage of people surveyed held back because of fear of failure has increased (from 15% in 2012 to 42,6% in 2022 (GEM, 2023)). In addition, this risk aversion is demonstrated by the overwhelming preference of a public sector position in relation to private sector's employment, hence supporting the idea that stability and security is better accepted. Therefore, the cost of doing business in a country must evaluate that the friendly business environment easing the start of a business does not have the desired effects if overcome by fear of failure.

In sum, fear of failure is a major contribution in shaping the decision to start an enterprise. Together with other the constraints studied previously, fear of failure can be considered in Tunisia as a relevant barrier to entry.

Section 2. MARKET DISTORTIONS

In Tunisia, the economy is shaped by some regulatory interferences that generate some imbalances in the market, generating distortions that may affect business incentives to participate and develop. Specifically, this analysis will consider three main regulatory frameworks that hinder firm productivity and innovation by producing relevant market distortions. First, the effectiveness of competition law will be assessed. Second, the impact of the state-owned enterprises' domination in the market must be observed. Finally, the increasing share of informality must also be considered, since it may pose a serious threat to the formal sector.

2.2.1 Competition

Competition environment is fundamental for business development since it generates incentives for firm innovation and ensures a fair and certain legal framework on which entrepreneurs can rely on. In Tunisia, competition regulation hinders business incentive via three paths/roads. On the one hand, it is one of the heaviest price regulators compared to similar countries. On the other, for what concerns competition law, firstly institutions' efficiency leave room for improvement, and secondly its enforcement is lagging compared to its potential.

Institutions dealing with competition law enforcement are of crucial importance, since they are able to promote competitive prices and reduce barriers impeding such equilibrium. The Tunisian system involves a cooperation of major institutions, such as the Competition Council, the Department for Competition and Economic Investigations (DGCEE) within the Ministry of Trade, and the Administrative Court[14] (OECD, 2022b). In this system, however, there are some problematic structural issues that hinder an efficient enforcement of competition law (OECD, 2022b). Although the Competition Council in theory is supposed to be independent, there are many areas where this essential characteristic is lost since it's overcome by a heavy influence of the Ministry of Trade. In fact, the Council's budget and its presidency's

[14] The Competition Council is an independent body composed of 15 members and performs a judicial and advisory function. The former role is composed by an investigative body and a decision-making body. The ministry department on the other hand has a more regulatory function, so it deals with the development and enforcement of competition law (OECD, 2022b). Because these two bodies act in the same regulatory framework with similar roles, overlapping and prevalence of one of the authorities must be avoided.

remuneration is tied to the Ministry, thus reducing the margin of manoeuvre of the institution. Additionally, some of the competences of the Council and the DGCEE overlap, such as investigation, leading to further coordination costs and questioning of the council's autonomy, since it may be object of manipulation from the Ministry. Furthermore, the powers of the Council are further reduced by not having the ability to conclude settlements. This capacity is however crucial to possess, since on one side it decreases the dependence from another institution, reducing unnecessary time and costs while doing so, and on the other it allows for a more efficient allocation of resources, meaning that investigators can focus on more than one investigation at the same time. Finally, it must be highlighted that not all decisions released by these competition institutions are always accessible, both in terms of language and publication. All these factors together create an environment of confusion and uncertainty that is not attractive for investors and entrepreneurs, who may not feel fully protected by well-functioning authorities enforcing competition law.

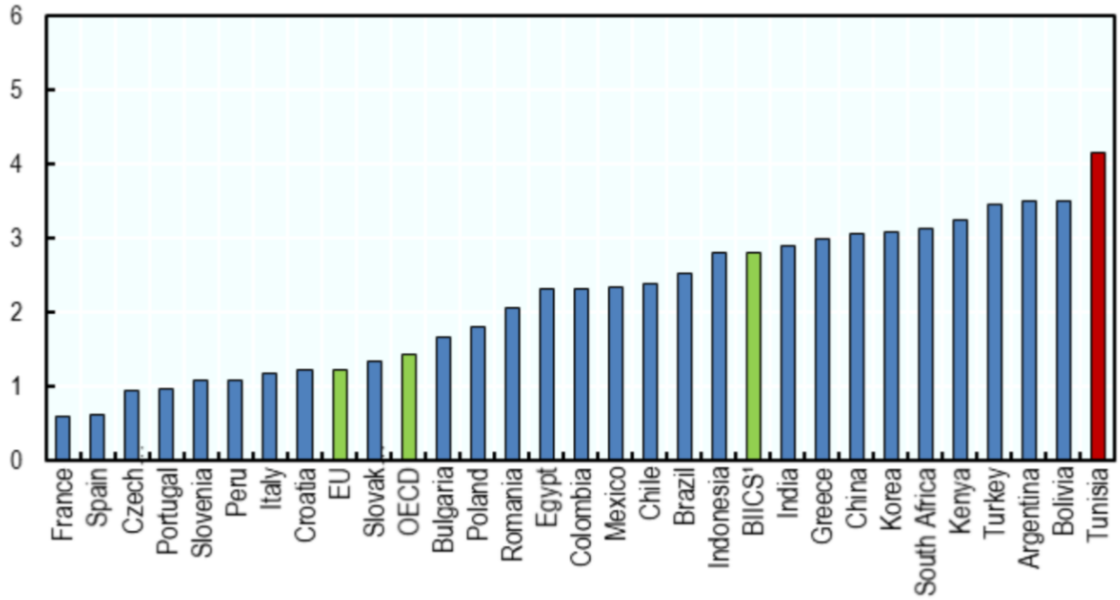
Not only the institutional set up may present some challenges, but also the enforcement of the law itself is demonstrating some weaknesses that impedes the permanence of a flourishing competitive market (OECD, 2022b). Firstly, in the case of a cartel, there is not enough deterrence due to low fines, lack of competition authority control and rejection of the use of leniency programs. Hence, cartel members do not feel the urge to disclose a breach of competition provisions, since the consequent punishment is not proportionate enough to incentivize the business not to pursue that unlawful act, hindering therefore the competitive setting of the market. Secondly, legal uncertainty is present, due to the lack of definition for some important concepts such as "joint venture", and due to some inconsistent and outdated competition provisions (Belgacem & Vacher, 2023). For example, some competition provisions create administrative and regulatory barriers for firms. On the one hand, for those willing to notify a proposed merger, the conditions imposed (turnover based test and market share test) require high costs for the companies, and the interpretation of the notification requirement is very uncertain. On the other, not distinguished procedures between more and less complex cases lead to simple cases taking double the amount of time that is actually needed. Finally, the promotion of competition by this regulatory framework lacks important elements that attract entrepreneurial activity in the country, such as market studies and public guidelines. In fact, these instruments are of fundamental importance for companies, since they allow to properly allocate resources, create legitimate expectations, and reduce legal uncertainty related to transparency of administrative procedures and legal interpretation by the competent authorities.

The final consideration of competition assessment in Tunisia looks at the implications of price regulation on business incentives. Price control is one of the most controversial regulations concerning product market regulation. Established for the first time in the 1970s[15], the aim was, and still is, to protect the most vulnerable part of the population by guaranteeing the basic commodities (OECD, 2023). To this end, the government still has full control over the setting of these goods' prices and for some specific sectors it also grants subsidies. For example, goods that fall in this category are bread, pasta, oil, sugar, and many others subject to a controlled distribution margin. To grasp the magnitude of these price regulations, the OECD indicator of price control underlines that the Tunisian average is well above both the European and most of the developing countries (OECD, 2022b). Since they are defined as an exemption from competition law, there could be negative implications for the competition balance in the market. The most evident refers to lower prices for suppliers than in a competitive market. Consequently, lower prices do not create enough incentive for firms to improve their efficiency, especially those businesses that are already poor performing (Belgacem & Vacher, 2023). In this key, firms avoid using all their capacities, resulting in shortages and lower quality product (Belgacem & Vacher, 2023). Paradoxically, some studies argue that inefficiency and lack of productivity is encouraged by this system of subsidies, especially for the large public enterprises holding a monopolistic position in the market (OECD, 2015). Furthermore, some sectors are affected by non-profitable private investments because of lower prices. Consequently, the market distortion arises precisely from a lack of incentive to produce and innovate due to the direct and indirect consequences of price controls.

Therefore, the lack of proper competition law enforcement together with poor performing competition institutions all together disincentivize entrepreneurs, since they are not able to ensure a safe and protected environment on which businesses can rely on. Additionally, price controls further enhance product market barriers that a-priori prevent any form of competitiveness, hence innovation and productivity.

[15] During this decade, the country's political economy was oriented towards a welfare approach, whereby the state was present and heavily interfering with market equilibriums. Despite the turn to neoliberalism and Washington Consensus in the 80s that led to a degree of liberalization of the economy, price controls remain a remnant from that previous economic vision.

Figure 7: Price Control – OECD Product Market Regulation Indicator

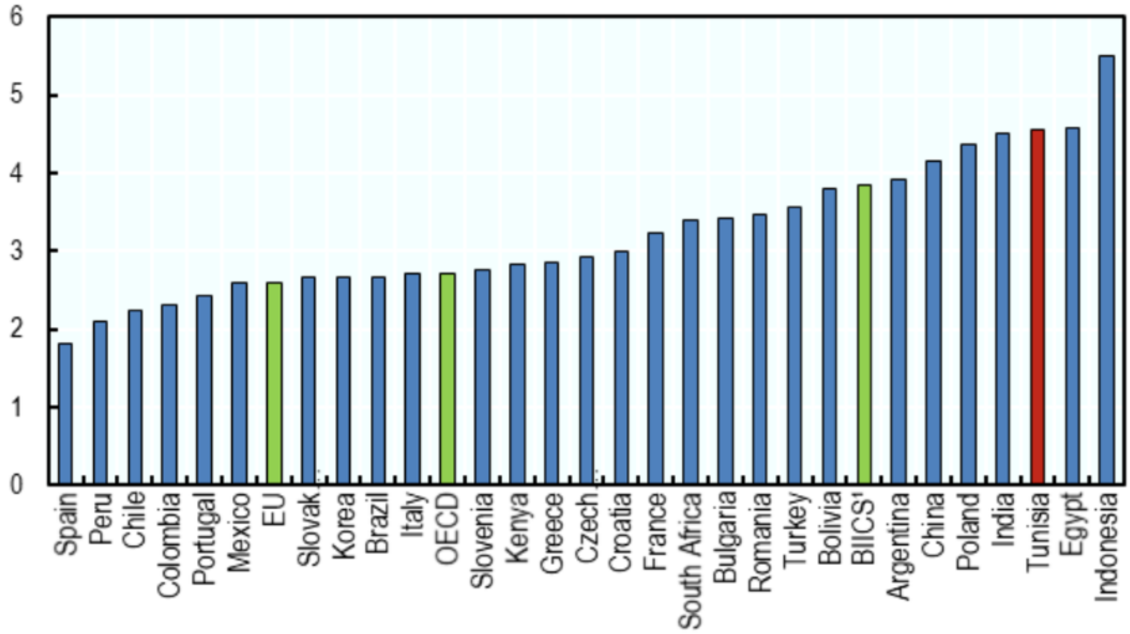


Source: OECD-World Bank Product Market Regulation database (OECD, 2022b)
Notes: While other countries have data from 2013, Tunisia's data is from 2016.

2.2.2 State-Owned Enterprises

An additional contributor to a limited market competition is the dominant presence of the very abundant State-Owned Enterprises (SOEs). In Tunisia it is possible to count more than 100 SOEs, 55 of which are commercial, and generating over 50% of the total turnover (OECD, 2022b). The main sectors in which they are mostly concentrated are transport, industry, financial services, and infrastructure (World Bank, 2022). Compared to similar countries, the power of the state-owned enterprises is the outcome of the evolution of the dictatorship of the Ben Ali family, which possessed the majority of the firms, making them dominant above all other non-politically connected firms. As a consequence of this crony capitalist approach, these enterprises have been seized by the democratically established government after the revolution to become state-owned, however still maintaining a monopolistic position in the market and strengthening the state's influence in the economy (OECD, 2022b).

Figure 8: State presence in businesses - Public share ownership



Source: OECD-World Bank Product Market Regulation database (OECD, 2022b)
Notes: While other countries have data from 2013, Tunisia's data is from 2016.

Monopolistic enterprises dominating the market hinder its competitiveness, reversing problematic conditions for the other players in the game. Firstly, no or small competition reduces the incentive for the dominant enterprise to innovate and increase its productivity (IMF, 2021). Hence, the quality of the product stays low, not all the firm capacity is implemented, and the Tunisian SOEs' financial fragility affects the performance of the whole sector. As an example, the *Société Tunisienne de l'Électricité et du Gaz* (STEG) dominates the electricity and gas distribution[16], however its weak performance due to financial distress and poor governance[17] affects the efficiency of the energy sector, by reducing the possibility for

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[16] STEG has a hold of above 90% of energy production capacities and provides more than 80% of electricity to the whole country (OECD, 2015).

[17] The OECD argues that these companies' directors are highly connected to the political environment. Consequently, they do not seem to have any form of independence, hence opening the door to collusion, corruption and lagging efficiency performance. Furthermore, due to their political ties, proposed reforms to increase the SOEs productivity are often blocked, thus hampering even more their already weak performance (OECD, 2022a). Additionally, the World Bank adds to this description by pointing out that SOE's governance is centralized, decisions-making is top-down, controls and audit systems as well as resource management are opaque, and the legislative framework regulating SOEs is obsolete and incomplete (World Bank, 2022).

innovative investments in renewable energy or for a reliable energy supply with good quality infrastructure. Furthermore, a market domination has spillover effects also in the labour market: they offer very high remuneration to public employees and many additional benefits than what the private sector is able to provide (OECD, 2015). This inequality between the private and the public sector is the main key that generates labour market distortion and unemployment (see section 2). Therefore, in this perspective the monopolistic position both disincentivizes the SOE themselves to increase their productivity, but also creates very high entry barrier for smaller private businesses in the same sector.

The most problematic issue related to the SOEs is their financial fragility. In fact, the 30 largest SOEs have accumulated a debt of 40% of GDP in 2019, the three largest ones (STEG, *Société Tunisienne des Industries de Raffinage* (STIR), and *Office Nationale des Céréales*) had a negative capital of 5% of GDP, and they hold arrears and cross-arrears with the government and private firms. In addition, 15% of the debt was covered by government guarantees (OECD, 2022a). The debt accumulated originates both from the fixed prices below costs imposed by the government and from government subsidies trying to cover the price difference. A detailed overview can be found in ANNEX 1. However, not only this subsidy system affects the financial stability of the country at macro level, but also at microlevel, where price distortions affect competitiveness and generate entry barriers for private firms. Moreover, the IMF shows that SOEs' arrears and cross arrears with the government may also impact the private sector. In fact, among other arrears, SOEs are indebted to private entities for around 3% of GDP (IMF, 2021). Therefore, exactly because the SOEs play a major role in the Tunisian economy, their financial, governmental and productivity issues greatly affect the performance of the market, making it more difficult for Small-Medium Enterprises (SMEs) to enter in the market, hence annulling any form of competition in the sector.

In conclusion, it is possible to argue that the SOEs domination heavily impacts the possibility for smaller enterprises to participate in the market, even more when the state holds a monopolistic position for high productivity economic sectors.

2.2.3 Informality

While on one side there is the duality between the private and public sector, on the other the economy is subject to another duality between formality and informality. In fact, in Tunisia the levels of informality are so high that it forms a parallel economic activity beyond the radar of authorities and regulations. According to many studies, a rise in informality is associated with rigid and unfriendly business regulations creating policy distortions in the economy (OECD, 2022a; Vacher et al., 2022). After briefly looking at the main drivers of informality, the main aim of this section is to assess the impact of informality on the cost of doing business in the country.

The magnitude of informality in Tunisia is manifested by very high numbers compared to the high income and lower middle-income countries. Concerning unemployment, in 2019, 45% of employment was invested in informal activities. Moreover, many sectors go beyond the 60%, reaching the highest value of 86% of informal unemployment in agriculture. In this framework here the duality in the labour market is clear, where informality can be associated to a "buffer", meaning that it absorbs all the unemployed that have lost their jobs in the formal sector (Belgacem & Vacher, 2023; Vacher et al., 2022). Furthermore, the informality levels persist since the transition rate from informality to formality remain low, due to the lack of sufficient incentive (OECD, 2022a). Hence, it may be argued that informality in the labour market is a result of a many factors: weak job creation in the private sector, precarious working conditions offered, and labour tax wedges. In fact, having a tax and social security contribution of 35% of gross salary does not create enough incentive for informal workers to enter the formal market (Vacher et al., 2022), hence further widening the gap between labour demand and supply and skill mismatch affecting enterprises in the private sector (see section 2).

Informality however has crucial implications also for entrepreneurship, increasing the cost of doing business for firms. In fact, entering the formal sector means having additional costs, such as fixed entry costs, revenue, and labour taxes, but also compliance to strict regulations. Furthermore, having a large section of informal firms, it means that those compliant with the rules are in a disadvantageous position and distort competition. This is particularly relevant, since above 60% of firms compete with informal firms, an amount that is above the MENA average and lower-middle income countries (World Bank, 2020b). Moreover, studies argue that when firms decide to remain in the informal sector, they have to remain small not to be detected by the authorities (Ulyssea, 2018). In addition to the fact that this hinders productivity growth of the company and decreases the competitiveness in the formal sector, the size of the firms is also manipulated for tax evasion. The Tunisian tax system allows for firms under a certain threshold to pay a smaller amount of taxes (*régime forfaitaire*). However, since the gap between this amount and the standard tax regime is wide, there is no incentive for firms to comply to the regulation, also because of a lack of proper enforcement (Vacher et al., 2022). On the one hand this policy was able to increase firm registries, reducing a small amount of informal businesses, but at the same time bigger firms under declare their turnover in order to stay below the flat tax threshold and benefit from lower costs. This behaviour reflects another important factor to consider, that has been highlighted by Ulyssea in his study on informality. According to his research, informality is not only driven by the rigidity of policies, but also from the different kind of firms present in the economy. In fact firms that are productive enough to be in the formal sector and those that are not capable respond differently to an elimination of policy barriers (Ulyssea, 2018).

Therefore, it can be observed that informality has important implications both on the labour market and at firm level, distorting competition and increasing further the skill mismatch affecting the Tunisian labour force. This phenomenon is driven mainly by all government regulatory barriers, unattractive tax regimes, and inefficient enforcement.

2.2.4 Governance and Corruption

Alongside all economic variables at both micro and macro level, an important impact is also attributable to the levels of corruption and aspects of governance. In Tunisia, these aspects ought to be considered in the analysis of firm growth. In fact, corruption in the country is perceived as a major obstacle for firm growth, creating instability and uncertainty in the market. However, together with governance variables, it is necessary to assess their effects on the cost of doing business.

Corruption is considered by firms to be one of the most important constraints, together with access to finance and political instability (World Bank, 2020b). In 2022, this perception was true for 56% of firms (World Bank, 2022). Despite these negative depiction from businesses, studies that have conducted analyses on the impact of corruption on economic growth suggest that there is not a significant direct effect, but it is a significant negative contributor through private investment and public spending (Hayet & BEN ZINA, 2022). Therefore, on one side the bigger the public sector, the bigger the influence corruption on growth. On the other, corruption can hinder a proper implementation and effectiveness of private investments, thus decreasing GDP in the long run. Especially at firm-level, corruption increases uncertainty on the return of investment, hence it may contribute to a discouragement in pursuing big financial contributions in the country.

Although corruption does not have direct effects on GDP growth, it is particularly relevant when adopting the firm-level behaviour perspective. In the context of corruption and firm innovation, there are in the literature two opposing theories: “sanding the wheels” hypothesis and “greasing the wheels” hypothesis (Goedhuys et al., 2016). While the latter considers corruption as an instrument to get through administrative burdens quicker, thus accelerating innovation; the former argues that corruption is an additional constraint for promoting innovation by generating many business environment distortions. In Tunisia there are contrasting forces generated by corruption. On one side, corruption has a negative impact on firm innovation for two reasons: firstly, it increases transaction costs because resources that could have been invested in research and development are spent on briberies; secondly it decreases the level of trust entrepreneurs have in economic authorities and institutions that should ensure proper and effective investments in innovation (Goedhuys et al., 2016; Pirtea et al., 2019). On the other side, it has been tested that due to the high administrative barriers and reglementary constraints, a small bribery eases the entirety of the process, making innovation more accessible (Goedhuys et al., 2016). In fact, some also argue that one of the reasons why corruption is rampant in Tunisia is because of the cumbersome administrative and bureaucratic procedures (World Bank, 2022).

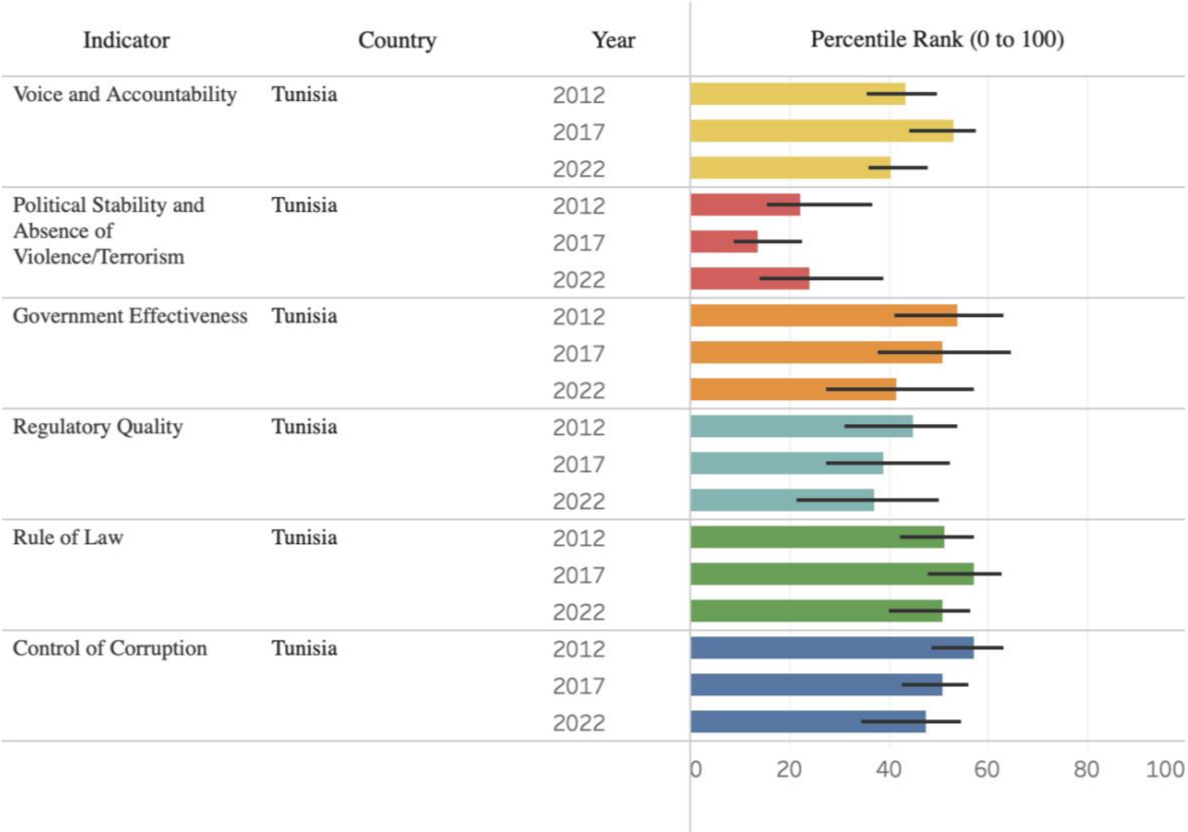
Although there may be some benefits in using corruption as an instrument to bypass institutional constraints, it does not describe a healthy business environment. In fact, to achieve growth and development in the long run, corruption practices cannot be sustainable. Therefore, this analysis supports the idea that corruption is a consequence of costly barriers for doing business in the country, and as such the regulatory framework and institutions’ efficiency are the priority. Especially when today Kais Saied’s discourse on anticorruption seems an instrument to attack his political opponents (Al Jazera, 2023; Boussen & Lakhal, 2023), corruption is still rampant, as the paradoxical decline after 2021 of the “control of corruption” indicator shows in Figure 9. Nevertheless, effective and precise anti-corruption practices ought to be taken to make a business environment more and more friendly for enterprise growth.

Finally, the role of governance indicators in shaping business incentives must be assessed. A good summary of Tunisia’s performance in this field is given by the World Governance Indicators by the World Bank. From their empirical analysis, the main trend emerging is a worsening of the governance performance over the last years (World Bank, 2022). More specifically, there is a decline in “regulatory quality” and “government effectiveness”[18], and also for “Control of Corruption” (in relation to the poor effectiveness of

[18] “Regulation quality” refers to the “ability of the government to formulate and implement sound policies and regulation that permit and promote competition and private sector development”. While “government

the existing anti-corruption policies) (Figure 9). The fundamental information to extrapolate from the graph is that it is exactly the indicators referring to business promotions that are worsening as time goes on. As a result, unless proper measures are taken to reverse the ongoing trend, the cost of doing business in Tunisia will deteriorate, making it increasingly challenging for enterprises to grow and enhance the productivity of the Tunisian market.

Figure 9: Governance Indicators, Tunisia 2022



Source: Worldwide Governance Indicators (World Bank, 2024)

To conclude, all the evidence presented in these sections all demonstrate that there are important constraints disincentivizing the creation and/or growth of entrepreneurial activities in the country. Not limiting to mere economic values, both cultural and governmental variables are crucial in shaping the business environment. However, not all kinds of barrier have the same weight on economic growth. In other words, particular constraints are more binding than others since they have significant spillover effects across the whole economy, hence they are

effectiveness" refers to the quality of public services, quality of independence of civil service, quality of policy formulation and commitment to implementation" (World Bank, 2022).

the most crucial to tackle. In the following chapter, this analysis will be conducted using the Hausmann-Rodrik-Velasco model (HRV model), for which the “most binding” regulatory barriers will be found, and some recommendations will be proposed with the aim of easing entrepreneurship in Tunisia.

Chapter 3: Application of the HRV Model

In this chapter, the Growth Diagnostic model will be applied to figure out what is the "most binding constraint" among all the market distortions analysed in Chapter 2[19]. After briefly presenting in Section 1 the theoretical framework of Hausmann, Rodrik and Velasco's approach (HRV approach), the diagnostic will be adopted in the analysis of the Tunisian case. However, it must be highlighted that this model is used here not to observe the causes of the underperformance of the Tunisian economy as a whole, but it will be applied specifically to constraints affecting the cost of doing business in the country. Finally, in Section 3 recommendations and possible solutions will be listed to improve the specific constraints that are considered the most binding.

Section 1. The Growth Diagnostic approach

When dealing with development policies, there is no one unique answer, differently from what is proposed by the mainstream approach of the Washington Consensus and the neoliberal ideology. In fact, the application of the "one size fits all" solution in most cases can create more harm than good, since it does not consider the context in which market and non-market failures are embedded. Hence, the development policy that is proposed in this research is an eclectic, self-discovery approach, where the context is the main driver towards the individuation of the main institution hindering growth incentives. The Growth Diagnostic method introduced by Hausmann, Rodrik and Velasco in 2004 is founded exactly on this idea: finding a strategy to prioritize policies based on the diagnosis of the cases of underperformance.

In the evaluation of a country's economic growth, the market imperfections and distortions are multiple. However, it is nearly impossible to implement reforms in all of them at the same time, and even addressing the biggest distortion does not guarantee a more positive impact than tackling smaller yet crucial constraints. As a result, the objective of the study is to find the "most binding constraint", defined by the authors of this model as the "distortions that have the higher magnitude of direct effects" (Hausmann et al., 2004). Their line of reasoning is thus acting on the distortions that have the highest marginal welfare benefit on the economy.

[19] This chapter is based on the methodological framework presented in the 2004 Growth Diagnostics paper by Hausmann, Rodrik and Velasco (Hausmann et al., 2004)

In other words, by improving the distortion that is the most binding leads to higher benefits compared to addressing other non-fundamental distortions of the economy. Therefore, reforming this specific constraint allows for higher benefits compared to reforms made in addressing other non-binding constraints, even if considered bigger.

In practical terms, the identification of the most binding constraint is done following a tree scheme (graph in ANNEX 3). The first step is identifying if the problem comes from a high cost of finance or from a low return of the economic activity. Then, a more specific distortion must be found behind one of the two cases. Hence, if the issue resides in the high cost of finance, this can be attributable to either a bad international finance or bad local finance, the latter due to low domestic savings or poor intermediation. Alternatively, low returns are driven by low social returns (geographical constraints, low human capital or bad infrastructure), or by low appropriability, which is given either by government or market failures. Going deeper into this last portion of the tree diagnosis, government failures refer to macroeconomic instability or to micro risks (corruption, lack of protection of property rights, excessive taxes). On the other hand, market failures include coordination failures or information externalities.

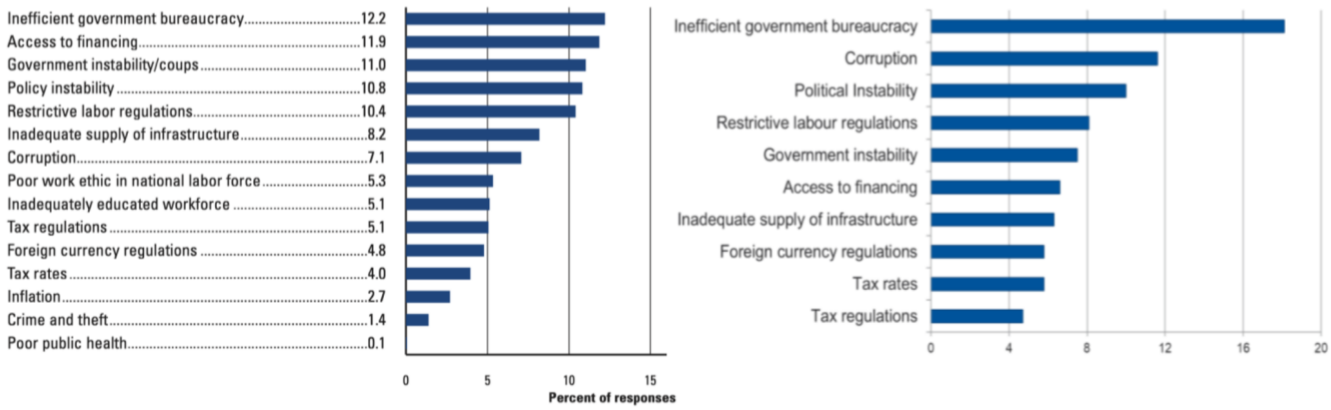
Therefore, following the logic of the diagnostic tree, the most binding constraint can be found, and therefore appropriate reforms are able to medicate in the right way, generating beneficial incentives for growth.

Section 2. Most Binding Constraints on the Cost of Doing Business in Tunisia

This section will describe the application of the Growth Diagnostic model on the Tunisian case. The question behind the diagnostic is: what are the most binding constraints on entrepreneurial activity in the country that hinder incentives? By following the logic of the diagnostic tree, every element will be observed, and the most binding constraint will be identified.

Useful to this research, data from the entrepreneurial surveys will help identify from the eyes of the entrepreneurs themselves what are the major obstacles that their activities face. Moreover, it is interesting to compare results 10 years apart, in order also to track the trend and possible improvements in some areas of incentives.

Figure 10: Most problematic factors for doing business



Source: Global Competitiveness Index 2011-2012 (World Economic Forum, 2011)
World Economic Forum 2018 (EBRD, 2020)

As the two graphs show, the most problematic factor for doing business in the country according to the World Economic Forum's (WEF) survey is inefficient government bureaucracy. Not only it kept the first place also in 2018, but also the percentage of firms that feel it being a strong barrier increased, going from around 12% to nearly 20%. Furthermore, it is interesting to note how access to finance was the second most constraining issue, while after 6 years it lost priority, while still causing important market distortions. Instead, corruption is the element that more and more disincentivize businesses, followed also by a constant presence of political instability and stringent labour market regulations. Surprisingly, tax rates and regulations are still relevant, but at the bottom of the list.

Keeping in mind this entrepreneurial perspective, the rest of the chapter will enter in detail in the most crucial barriers of the economy, while trying to select the issue that is the most binding constraint.

3.2.1 Not binding constraints: access to finance, macroeconomic stability, poor infrastructure, and low human capital

Taking as an instrument the HRV diagnostic tree (ANNEX 3), it is possible to state that high cost of finance, low social returns, and macroeconomic stability are not binding constraints, even if they represent important weaknesses for the generation of private investments and entrepreneurship.

Firstly, let's consider access to finance. In Section 2.1.1, financial accessibility was presented as a major barrier for businesses, due to the absence of collateral registries, interest rate caps, requirements of administrative approvals, and unreliable regulatory and legal framework. An application of the HRV model on Tunisia from the IMF in 2011 confirms access to finance as the main binding constraint: firstly banks privileged only bigger, established companies; secondly the lack of collateral registries led to high non-performing loans and finally inadequate bankruptcy regulations made difficult collateral recovery (IMF, 2016). This evidence is in line with Figure 10, where access to finance in 2011 was among the most challenging components in the establishment of a productive and efficient business activity. However, evolutions and reforms in the sector have contributed to an improvement, for which, although still weak and problematic, access to finance can be excluded as a binding constraint. More recent studies have also confirmed this last statement, arguing that lending volumes are increasing and interest rates falling and in line with similar countries (African Development Bank et al., 2013; Millennium Challenge Corporation, 2018). Although the data on which these reports rely on is quite outdated, recent data seem to confirm the positive trend in financial accessibility. In fact, according to the Central Bank's statistics the volume of loans to the economy has increased (73278788 in 2018 to 105654837 in 2023 thousands of TD) (Banque Centrale de Tunisie, 2023) and more specifically also medium-long term loans grew from MTD 46145 in 2017 up to MTD 57401 in 2022 (Banque Centrale de Tunisie, 2022). Additionally, the GDP percentage of domestic credit to the private sector by banks rose (from 58% in 2011 to 64% in 2022) and improvements have been registered for the public credit registry coverage (from 27% of adults in 2011 to 36,4% in 2019) (World Bank, n.d.-b). Therefore, it can be stated that access to finance does not classify as a binding constraint for businesses in Tunisia.

Secondly, considering other branches of the diagnostic tree, neither macroeconomic stability, human capital, or bad infrastructure seem to be binding constraints. In fact, even if the macroeconomic indicators are not flourishing, they didn't seem to pose a crucial barrier for business incentives neither in 2018 (Millennium Challenge Corporation, 2018), neither in the last years since inflationary rates have been declining and stability recovering after the pandemic (see Chapter 1). Furthermore, even some infrastructure weaknesses do not constitute the main issues disincentivizing business activities. In fact, despite the lack of innovation and investments in the transportation and electricity supply increase transaction costs, poor infrastructure does not constitute the element that blocs the entrepreneurial activity altogether.

In conclusion, access to finance, macroeconomic stability, poor infrastructure, and low human capital are not binding constraints for enterprises, even if they heavily contribute to the increase of the cost of doing business.

3.2.2 The binding constraints: inefficient government administration, lack of competition and stringent labour market regulations

Eliminating cost of finance, bad infrastructure, human capital, and macroeconomic stability, what is left in the tree that indicates a binding constraint is government and market failures. Also supported by the results of the survey of the WEF, for enterprises burdensome regulations and interventions of the institutions in the economy seem to be the heaviest barriers, due to the creation of important market distortions that disincentivizes business activities. Therefore, the most binding constraints are inefficient government bureaucracy and labour market regulations.

Firstly, market distortions are important barriers to entry for businesses. In particular, competitiveness is hindered by the persistence of the informal sector and by the monopoly of poor performing SOEs in crucial sectors, notwithstanding the inefficient performance of the competition institutions. As mentioned in Section 2.1.2, the cumbersome authorizations and permits required to pursue entrepreneurial activities have a heavy binding constraint, since they drive the incentives for firms to grow or to go formal. In fact, the most damaging impact of this significant intervention of the state is the creation of a dual economy, whereby the informal sector grows in parallel to the formal one, and as mentioned beforehand, this environment only hinders competitiveness and becomes a barrier to entry. In other words, the burdensome authorizations don't incentivize business to stay in the formal sector, as it significantly increases transaction costs and time. Furthermore, attempts to improve burdensome authorizations and licences by the 2016 Investment Law and the 2018 Decree have not been effective in reaching the intent. Another crucial flaw of competitiveness in Tunisia is SOEs monopoly. In fact, the incentive to participate in the sector is nearly absent due to the persistence of the state regulation that allows the persistence of the inefficient public enterprises. To make the sector productive again, the economy should reduce the monopoly of these SOE and increase its competitiveness allowing other firms to enter the market and bring innovation.

Secondly, stringent labour market regulations are another binding constraint. In addition to the fact that this regulation framework has not changed over the years, the wide gap between the conditions of permanent and temporary contracts is a major incentive to hire temporarily and informally, to also avoid the high labour contribution taxes. Consequently, informal employment becomes more and more frequent, and businesses tend to remain small, because there is no incentive to hire more workers due to high EPL. Moreover, as firms remain small, there is a lower possibility to increase its productivity and efficiency, and thus be competitive not only in the domestic market, but also internationally.

Continuing the discourse on international outlook, another important binding barrier due to institution-set regulations is the duality of the onshore-offshore incentives. In fact, the willingness to create a friendly business environment for foreign investments by lifting important tax and authorization requirements had a negative impact reversing itself in the competitiveness for the onshore sector to export. Thus, the inefficiency of the onshore businesses is the result of heavier regulatory requirements and higher costs than the offshore sectors. Here again it is possible to see that the main constraints for businesses in Tunisia are outcomes of burdensome regulatory and bureaucratic frameworks.

Therefore, in both cases the binding constraints are market distortions that are generated by the heavy influence of the state with regulations that don't create a favourable business environment and push businesses to resort to informality or to remain smaller in size, hence hampering the possibilities to increase their productivity.

Section 3. Recommendations

To conclude this deep analysis on the cost of doing business in Tunisia, some recommendations will be given to the binding constraints outlined in the previous section. To this end, policy proposals will be given first to authorizations and administrative burdens, second, to competition distortions together with the quality of competition authorities, and finally to employment protection legislation and informality. It must be however underlined that the focus of these recommendations is strictly related to the easiness of the cost of doing business, by lifting the heavy performance barriers, rather than focusing on policies that are needed to boost economic growth as a whole.

3.3.1 Administrative burdens

Being the most binding constraint for business growth in Tunisia, administrative and bureaucratic burdens will be dealt with first. In general, the main goal of reform policies is lifting unnecessary authorizations and licenses required for the performance of the entrepreneurial activity to increase incentives and lower the cost of doing business.

Firstly, as mentioned above, the Investment law of 2016 set an important goal to refrain the cumbersome authorizations, by selecting restrictions that do not fall in the category of public interest protection. However, the implementation of this regulatory framework has not been effective in eliminating all unnecessary bureaucratic constraints (World Bank, 2022). Thus, the Tunisian institutions should put priority on the pursuit of the lifting of all the other restrictions highlighted by the Investment law. An approach that could be adopted in this framework is the "automatic authorization" for non-crucial sectors, together with *a-posteriori* controls (OECD, 2022a). This change would on the one hand reduce the number of authorization requirements, lightening the heavy bureaucratic burden, while on the other it would keep the possibility of state control over the performance of the activity.

Going more into details, possible examples of unnecessary bureaucratic restrictions could be made. First, in the context of trade, some imported products need prior authorization. In this case, especially products that are not a threat for public interest could be removed from the list (OECD, 2023). Together with product constraints, also activities need authorizations to commence. In particular, the reference is to the merchant card (OECD, 2023), which could be lifted to reduce the barrier to entry and incentivize the birth of new enterprises and attract investments.

Many of the burdensome authorizations and constraints are applied to onshore businesses, creating a duality of the market between the offshore enterprises facilitated by the numerous tax and bureaucratic incentives that however don't apply to onshore sectors. In this perspective, to allow the integration of domestic businesses into the international market, it is important to lift the excessive differences between the two sectors. To achieve this aim it is important to create a balanced incentive framework equal for both parties. To this end, reforms that could be put in place must ease custom procedures and complement tax divergences (OECD, 2022a).

Therefore, in order to generate incentives and reduce barriers to entry for businesses Tunisian authorities must prioritize the alleviation of excessive restrictions and bureaucratic requirements, in particular to heal the gap between the onshore and offshore sectors.

3.3.2 Competition distortions

Another binding constraint for businesses that characterizes a big barrier to entry is heavy competition distortion. More specifically, the three main issues that are the root causes are the quasi-monopolistic position in most of the crucial sectors of the economy, the low legal quality of competition law, and the poor performance of competition institutions (see Section 2.2.1). In this section, some recommendations are proposed to address these significant market distortions.

Looking at the heavy presence of the SOEs in specific sectors of the economy, competitiveness is absent, thus excluding altogether private sector participation. Therefore, to reduce the monopolistic position in the market and push for the entry of private businesses there are two required reforms: firstly, the privatization of SOEs that are considered "non-essential", and an enhancement of transparency and analysis mechanism (OECD, 2022a). The latter more specifically would be beneficial to better control the performance of the public enterprises to be able to act on possible violations of competition and ensure private sector participation. As a result, the SOE influence would be limited, and enterprises would be incentivized to enter the market.

To further generate incentives and entrepreneurship not hindered by a lack of competition in the market, there is a need to increase legal quality, clarity, and predictability, together with an empowerment of competition institutions to ensure a proper guarantee of the well-functioning of competition framework. In particular, the OECD suggests interesting legal reforms involving the Competition Council and law enforcement: increase fines for deterrence effect; strengthen the Competition Council's independence from other political bodies; provide guidelines to "enhance legal certainty and predictability" and market studies to point out significant market failures; remove obsolete legislation; and finally improve transparency and accessibility by publishing all legal texts and making them visible on the institutions' platforms (OECD, 2022b, 2023).

Therefore, by strengthening the clarity of the legal texts and their enforcement, competition can be promoted more easily, thus allowing for a more business friendly environment.

3.3.3 Employment Protection Legislation and Informality

Third and last binding constraint to address is the stringent labour regulation framework. In this case, policies should be devoted to increase labour market flexibility to generate incentives for firms to employ more workers formally and thus reduce informality, increase productivity and promote business growth.

As mentioned above, the EPL greatly contributes to the increase on the cost of doing business in Tunisia, especially due to the wide difference between regulations applicable to permanent and temporary hiring contracts, leading businesses to employ workers temporarily, hence affecting training and productivity per worker. Therefore, to facilitate business efficiency and easing the significant constraint, Tunisian authorities must reduce the protection conditions' differences between the two types of contracts, incentivizing more the long-term employment. Additionally, since labour market regulations have not been updated since 1996, a legal reform to adapt to the more current economic situation would be beneficial in guaranteeing a fair and updated legal framework.

Since flaws in the labour market regulations reverse themselves on the informal sector, it is crucial that informality as a market distortion is addressed as well, since it affects competitiveness and unequal opportunities for all enterprises. However, reducing informality means not only reforming the employment legislation, but also implementing policies promoted at incentivizing businesses to adhere to the conditionalities imposed in the formal sector, such as reducing administrative burdens and barriers to entry (see Section 3.3.1). More specifically, reforms to contain the risk for firms to resort into informal activities could be aimed at reducing the wide gap that exists between the flat tax regime and the standard tax discussed above, but also at limiting the great weight of the social security contributions and personal income tax (Vacher et al., 2022). Although it is crucial to converge the public and private wages to re-equilibrate the labour force supply towards the private sector (OECD, 2022a), the latter must be in the conditions to provide employment without restrictions imposed by the Tunisian institutions. For this reason, the reform priority must be on the alleviation of stringent employment protection and at the same time reducing the cost of doing business through improvements on competitiveness and product market regulations.

Therefore, it can be clearly stated that to tackle the high cost of doing business in the country due to employment protection, constraints must be balanced to favour both the employer and the employee. In this regard, while tax wedges could be reduced, also the wide gap between the flat and standard tax must be made favourable to avoid the opposite effect: going towards informality to find a quick solution.

CONCLUSIONS

Tunisia has been for years the main destination for tourists from all over the world, but also for entrepreneurs, that saw in the country a favourable environment to start their business due to its proximity to Europe, to a similar culture as the Mediterranean populations and to a great climate. However, since the 2011 revolution, the friendly business environment has deteriorated by the heavy influence of the state in overregulating activities, hence leading to stringent constraints and entry barriers for smaller and new businesses. Consequently, this research was aimed at analysing, in terms of incentives, the restrictions and constraints imposed by the Tunisian institutions that increase the cost of doing business in the country.

Restrictions on entrepreneurial activity are mainly comprised by a limited financial access. This limitation is the result of the absence of a collateral registry, lending constraints, interest rate caps, required administrative approvals for specific foreign investment restrictions, and lack of adequate information. Furthermore, administrative and bureaucratic constraints for authorizations and licenses also for trading across borders, are a great disincentive for entrepreneurial activity. This excessive burden, that is not justified by the protection of public interest, was addressed with the 2016 Investment Law, that however was not effective in lifting most of unnecessary authorizations and licences that disincentivize business activities. Another crucial constraint is stringent Employment Protection Legislation and high taxation that greatly affect the size and productivity of firms. Lastly, a significant factor often overlooked is the Tunisian entrepreneurial culture that greatly influences choices made to start a business.

Subsequently, it is argued that important market distortions represent heavy barriers to entry for entrepreneurial activity in Tunisia. In fact, the poor legal quality and weak performance of the competent institutions are the main causes of a lack of proper enforcement of competition law, which is crucial to ensure a predictable and well-functioning business environment. More specifically, market distortions are related to the dominance of inefficient state-owned enterprises on crucial sectors of the economy, limiting private sector participation, and to the onshore-offshore duality tied to unequal incentives and opportunities. Additionally, it is also assessed that the impact of the informal sector is significant in distorting competition in the market. Finally, the cost of doing business is affected also by the high levels of corruption in the country, that, despite the “greasing effect” in the short run, cause uncertainty, mistrust, and a significant increase in transaction costs.

Although all the issues observed are relevant in hampering entrepreneurial activity in Tunisia, using the Growth Diagnostic model by Hausmann, Rodrik and Velasco, the most binding constraints among all are the heavy bureaucratic burdens imposed by the state, distortion of competition due to the monopoly of the SOEs, and the stringent employment protection legislation. Consequently, recommendations are aimed at addressing these three main barriers for entrepreneurs by reforming the regulatory framework to generate greater incentives to increase the number of businesses, their growth, and their productivity.

To conclude, although recent political events may lead towards uncertainty in the stability of the country itself, it is possible to state that Tunisia holds a great potential to foster entrepreneurial activities if adequate reforms are implemented.

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ANNEX 1: Energy Subsidies

A specific section must be dedicated to the energy subsidies, that represent an important and peculiar element of the Tunisian economy. While energy production decreases and renewable energy fails to be implemented, the government sets electricity, fuel, and Liquefied Petroleum Gas (LPG) prices below their actual cost. Therefore, energy subsidies refer to the price difference paid by the government itself. Not only this has been an important part on government expenditure, but also it will tend to increase simply due to the increase of international prices on these goods.

In Tunisia the energy sector is managed by two big state-owned enterprises (SOE): STIR and STEG. STIR is the *Société Tunisienne des Industries de Raffinage*, and it holds the monopoly of crude and refined oil imports and refining. So, STIR imports the oils at the international market prices, and then sells it to public and private companies for distribution at a price below cost. STEG instead stands for *Société Tunisienne l'Électricité et du Gaz* and holds the monopoly of electricity and natural gas distribution, sold as well at price below cost. Therefore, the difference accumulated by these companies is paid for by the government.

Looking at numbers, energy subsidies accumulated have reached in 2022 15% of public expenditures and 5.3% of GDP. This jump from a 6.4% of public expenditure in the period 2011-2021 is due to the skyrocketed international prices. However, the prices have become so unmanageable, that the government itself is no longer capable of financing the SOEs, thus increasing the unpaid subsidies.

The debt has major implications in the energy sector. STEG's debt and vulnerability hinders three main dimensions. Firstly, the efficiency and quality of their infrastructure due to lack of investment will lead to more frequent shortages of electricity. Secondly, there is no room for the purchasing of renewable energy. Furthermore, the low electricity prices discourage enterprises to invest in renewable energy. Despite these negative effects, the subsidy system still holds a major part of the population above poverty, and by eliminating it without any kind of additional reform will generate other and more important problems.

ANNEX 2: Labour Market Skill Mismatch

In considering the cost of doing business, one of the main market distortions affecting business incentives and growth can be found in the labour market. As many reports have pointed out, skill mismatch is a very relevant barrier to entry for businesses (EBRD, 2020), especially in cases when the bulk of job creation is not in the same sector where the biggest share of unemployment is (World Bank, 2020c). In other words, while the majority jobs for high productivity sectors are offered by the State-owned companies (Belgacem & Vacher, 2023), firms with the low skill intensive labour force, such as textile, construction, tourism and agriculture, are not able to fill their vacancies (OECD, 2022a) (see Section 2). Therefore, the alignment between the labour demand and supply is crucial for improving firms' productivity and efficiency levels.

There are many fundamental reasons for this mismatch. Firstly, the education institutions are not capable for creating the bridge between job seekers and graduate student, complicating the availability of information needed to efficiently build a productive and skilled labour force. Although labour supply is positive and increasing, with a high number of university graduates, the educational system is not directed to provide the necessary skills requested in the private sector due the vocational educational training (VET) and the tertiary education do not favour sufficient integration with companies seeking workers, nor they supply relevant soft skills. This lack is also reflected by the inefficiency of job placement services, such as ANETI (where registered are only 17% of unemployed) due to understaffing and high administrative burdens (OECD, 2022a). Secondly, an important role is played by the economic regional concentration together with limited labour mobility in between regions of the country. In fact, most of the job creating sector are dominant in the coastal regions, yet, due to cultural background, lack of proficient transport communication and affordable housing, and most of all "lack of comprehensive unemployment insurance and assistance programs"[20] (OECD, 2022a), most unemployed do not have the incentive to move towards the job seeking areas of the country. Finally, another explanatory variable can be explained by the domination of the

[20] Wage subsidies programs have not included any form of activation component. This means that they were not granted on any job-seeking conditionality, thus creating no incentive to find a vacancy nor to move out of the low-skill intensive activity proposed by the support program. Moreover, these activation policies did not encourage any regional labour mobility since they were based in a single area, not allowing the job seeker to find a position elsewhere (OECD, 2022a).

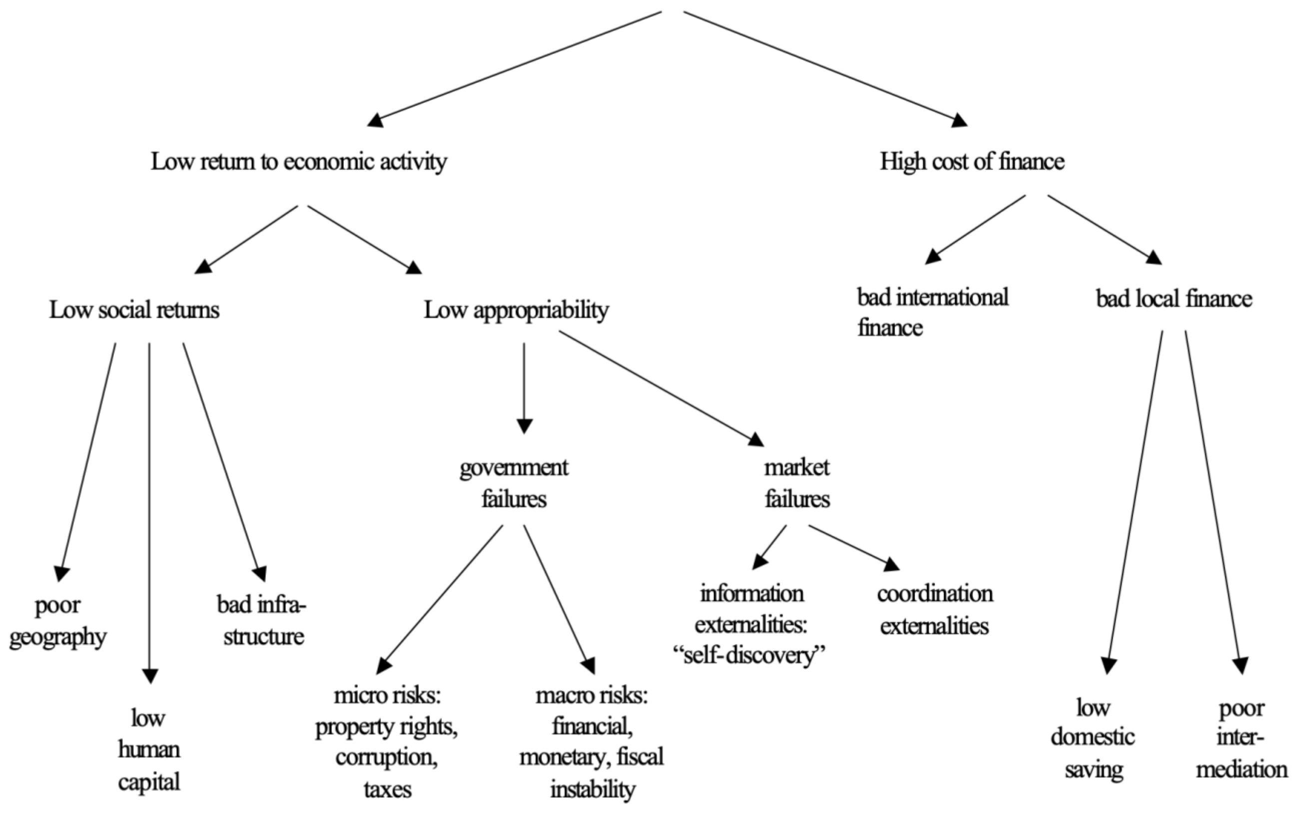
public sector and the non-attractiveness of the private sectors due to lower wages and poor working conditions. In fact, due to the many benefits provided by public institutions, such as higher wages and more stability compared to the private sector, many unemployed seek comfort in the public employment. As a result, a twofold effect occur: on one side it enforces a cultural mindset that is far from an entrepreneurial culture, crucial to favour a more friendlier business environment. On the other, it has major consequences in the macroeconomic sphere, generating on of the highest and increasing public wage bills.

ANNEX 3: Growth Diagnostic Model

Figure 11: Growth Diagnostic Tree

Problem: Low levels of private investment and entrepreneurship

$$\frac{\dot{c}_t}{c_t} = \frac{\dot{k}_t}{k_t} = \sigma\left[r\left(1-\tau\right)-\rho\right]$$



Source: HRV Growth Diagnostics (Hausmann et al., 2004)