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Promoting Investment Policy Reforms Amid Political Turbulence and Transition The Case of Tunisia and the Arab Spring

Policies to attract and retain private sector investment feature prominently in both developing and developed countries' growth strategies. Yet designing and implementing reform programs are particularly challenging for those facing prolonged political turbulence and transition. Countries may be tempted to focus on quick wins for short-term gains rather than tackle the more difficult, structural reforms that take longer to yield meaningful results. Despite the challenges, some countries, and notably Tunisia, have successfully designed comprehensive reform agendas using a gradual approach that includes extensive consultations and consensus building. The case of Tunisia shows that, even during long transitions marked by political and social tensions, investment policy reforms can be achieved.

Tunisia Before and After the Revolution

Following the October 2011 Constitutional Assembly elections, Tunisia enjoyed its first democratically elected government. This was less than one year after the "Jasmine Revolution," during which President Zine El Abidine Ben Ali and his "coercive apparatus" were ousted, triggering political movements in Tunisia and throughout the region.¹ In March 2012, the government of Tunisia embarked on an ambitious program of policy and regulatory reforms to make the country's economic environment more competitive and to attract and retain private investment.

Expectations for the economic reforms were high, particularly among Tunisian citizens and civil society. Tunisians now wanted to see the dividends of the democratic transition permeate society in the form of more employment opportunities, rule of law, and good governance.

But similar to other countries experiencing political transition, Tunisia underwent multiple changes in government and dynamic shifts of power during its reform process. Six ministers of investment were successively in charge, each with his own perspective, approach, and priorities. In addition, institutions retained numerous aspects of the old regime, with certain interest groups continuing to resist reforms. Despite this, the government kept private sector development—with investment policy a key pillar—at the center of its reform agenda.

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Investment Policy Reform in Tunisia

During the Ben Ali regime,² restrictions on foreign direct investment and authorization requirements enabled the government to regulate business entry and access to investment incentives and to control competition. Politically connected firms enjoyed significant economic gains compared to other businesses (Freund, Nucifora, and Rijkers 2014). Furthermore, Tunisia’s old investment framework lacked important guarantees, such as protection from unlawful expropriation and disadvantageous treatment of foreign investors. Certain government institutions with discretionary power over investment were linked to notorious abuses. The Higher Commission on Investment, for example, could preauthorize investments in several sectors and control economic activities on a case-by-case basis for investments in which foreigners would hold more than 49 percent of the capital. Tunisia’s investment incentives framework, moreover, was highly complex, contributing to red tape and allowing opportunities for authorities to exercise discretion (World Bank Group 2013 and 2014).

Tunisia’s new Investment Law (Law No. 71-2016), approved September 30, 2016, introduced a number of positive changes compared to the 1993 legislation, and it better aligned Tunisia with international best practices (see Table 1). **Investment entry** reforms opened several economic sectors previously closed to foreign investment (OECD 2015). In addition,

the law introduced the principle of “silent consent” for investment approval by the Tunisia Investment Authority and required written explanations for negative decisions (Article 4). Reforms on **investor protection** introduced a set of guarantees, including, among others: equal treatment of foreign and domestic investors in comparable circumstances (national treatment principle; Article 7); fair and equitable compensation for expropriation (except when done in the public interest; Article 8); free transfer of funds abroad (Article 9); and free convertibility of funds into foreign currency (Article 9). Finally, regarding **investment incentives**, the law distinguished between fiscal and financial incentives. The implementation of both types of incentives was mandated in specific decrees approved in March 2017. Fiscal incentives were also integrated into the tax legislation, in accordance with best practice.

Seven Principles of Investment Policy Reform

The Tunisian government’s initial steps toward extensively revising the Investment Law addressed a wide range of topics, from the sectors open for investment to investment incentives and promotion. Led by the desire for reform, balanced with the knowledge of the country’s political economy shortcomings, the government developed an iterative strategy. This note documents this approach and its significant parallels with the seven main guiding principles considered good practice for countries undertaking investment policy reforms.

TABLE 1: TUNISIA’S INVESTMENT LAW OF 2016: SUMMARY OF KEY REFORMS

Investment entry	<ul style="list-style-type: none"> ❑ Preauthorization by the Higher Commission on Investment no longer required for 45 sectors and economic activities ❑ Institution of the principle of “silent consent” investment approvals by the Tunisia Investment Authority ❑ Written explanations required when approvals are denied
Investor protection	<ul style="list-style-type: none"> ❑ Guarantees for investors, including: equal treatment of citizens and foreigners; fair and equitable compensation against expropriation (except when done in the public interest); free transfer of funds abroad; free convertibility of funds in foreign currency; and possibility of having 30% foreign management staff during the first three years of incorporation or effective entry into operation and 10% from the fourth year onward
Investment incentives	<ul style="list-style-type: none"> ❑ Fiscal and financial incentives distinguished; implementation of both types of incentives mandated in specific decrees ❑ Integration of fiscal incentives into the tax legislation

1. Leverage a common development objective presenting a consensus of key parties

In situations in which opposing parties continuously compete for political power and changes in government are frequent, it is important to identify points on which all parties can agree. This is particularly important in countries where reforms affect the interests of entrenched elites who may resist. Obtaining commitment from all contending parties on crucial fundamentals can help ensure the continuation of reforms despite changes in government.

In Tunisia, multiple governments were in power throughout the Investment Law reform process, including both secular and Islamist factions. Successive governments all wanted to send a strong signal to the local population and to the international community that the country was dismantling the old system of privileges and capture that had been reflected in its former investment framework. All were acutely aware of Tunisia's high unemployment rate—nearly 18 percent in 2011³—as an underlying factor in the revolution. Each government committed itself to implementing reforms to increase job creation via a productive private sector, moving away from reliance on the public sector and nonproductive firms connected to the elite.

2. Set ambitious yet realistic expectations: incremental steps rather than systemic changes

In highly polarized and unstable political settings, targeted interventions can help achieve concrete results in the short term, because large-scale reforms may be resisted by entrenched elites. It is important to regularly assess the context and players when identifying reforms with the highest chances of success by using techniques such as stakeholder mapping, in-depth political economy analysis, and so on. Incremental change can pave the way for broader reforms in the long run.

In Tunisia, the Jasmine Revolution created great optimism for reform among the population, civil society, and the international community. These supporters often favored systemic, “Big Bang” changes to bring Tunisia in line with international best practice and to confront the perils and residue of the old system. Some of these proposed dramatic reforms directly affected vested interests,

however, generating immediate resistance. To make progress, focus was shifted to achieving intermediate results through targeted interventions in specific areas of the investment policy and regulatory framework. Efforts regarding **investment entry**, for example, granted market access to only certain new sectors and activities, rather than to all sectors, which aligned with best practice. Similarly, reforms to the **incentives regime** focused on increasing predictability and improving the legal basis by moving fiscal incentives from the new Investment Law into the Tax Code. But this approach required tradeoffs; for example, on the **institutional dimension**, the Tunisia Investment Agency retained its regulatory functions, rather than focusing only on promotion, as per best practice.

3. Build “islands of effectiveness” as entry points for more systemic changes

When the inherited system of public institutions no longer fully functions, better results can be achieved by targeting specific agencies for reform. Focusing on these “islands of effectiveness” through narrowly channeled initiatives can provide entry points for improving the overall system. If the changes accomplished resonate in the overall system, demonstration effects can trigger change in other bodies.⁴

After the revolution, a multidisciplinary unit to manage the reform was created, with members from the Ministry of Investment and International Cooperation, the Ministry of Finance, the Ministry of Justice, and other public agencies responsible for investment. The unit took ownership of the reform, ensuring continuity despite government changes. It played a key role in pushing reforms within the government and in consulting externally with stakeholders across the private sector and with key players in civil society. This unit was able to organize consultations and meetings with more than 1,500 individuals. It also helped to analyze the different data and reports available on the investment scheme and ways to improve it. The unit led efforts on a benchmark analysis with 14 countries and drew on lessons learned to feed dialogue and the reform process. The unit's participatory approach and the outcomes it achieved set positive examples for other parts of the government and helped the unit attract reform leaders from civil society and the private

“Tunisia's approach to investment policy reform parallels seven good-practice principles.”

sector. Ongoing work and analytics provided by the World Bank Group and other donors also helped by offering neutral viewpoints to underpin difficult reforms and overcome vested interests, particularly among senior civil servants and with reform champions who worked throughout the political changes. (See Figure 1, showing the many actions of this unit and other reform participants in the context of government leadership changes and the progress of the Investment Law.)

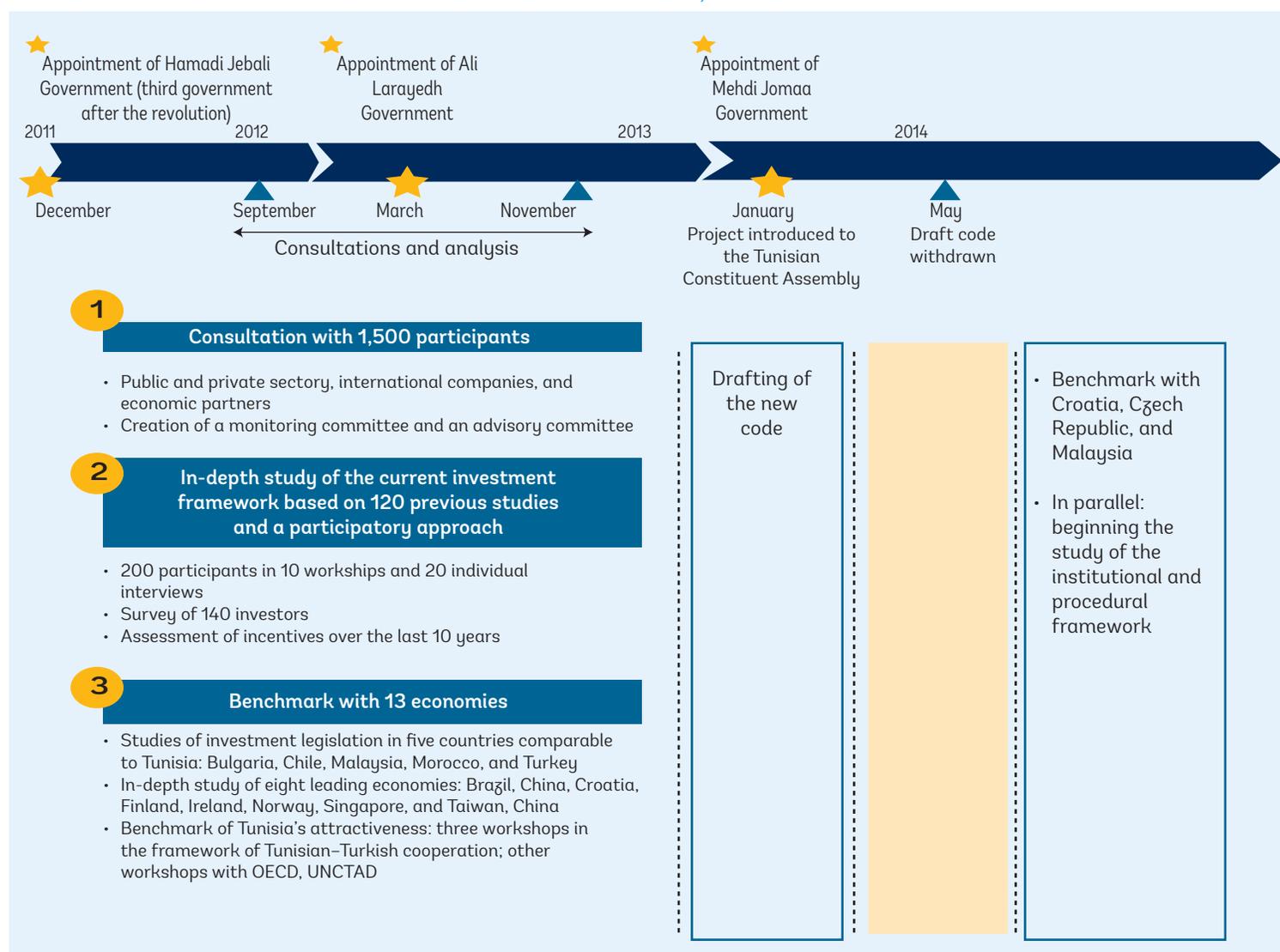
4. Use evidence to push reforms

Using empirical evidence to support proposed initiatives helps decrease resistance among key stakeholders and encourage their acceptance of the necessity for the changes. This can be

especially useful where political turbulence or other challenges make private sector reforms difficult.

Data, analytics, and lessons learned from other countries informed Tunisia’s decision making, grounding it in facts and convincing audiences with different backgrounds and perspectives. The government commissioned a series of studies, interviews, and investor surveys on the potential benefits of reforms to the current investment framework, building on 120 previous studies. A cost-benefit analysis of incentives, for example, revealed that tax incentives cost the government approximately 2.2 percent of gross domestic product, even though 79 percent of these incentives went to companies that would have invested without

FIGURE 1: KEY STEPS IN THE INVESTMENT LAW REFORM PROCESS, 2011–2017

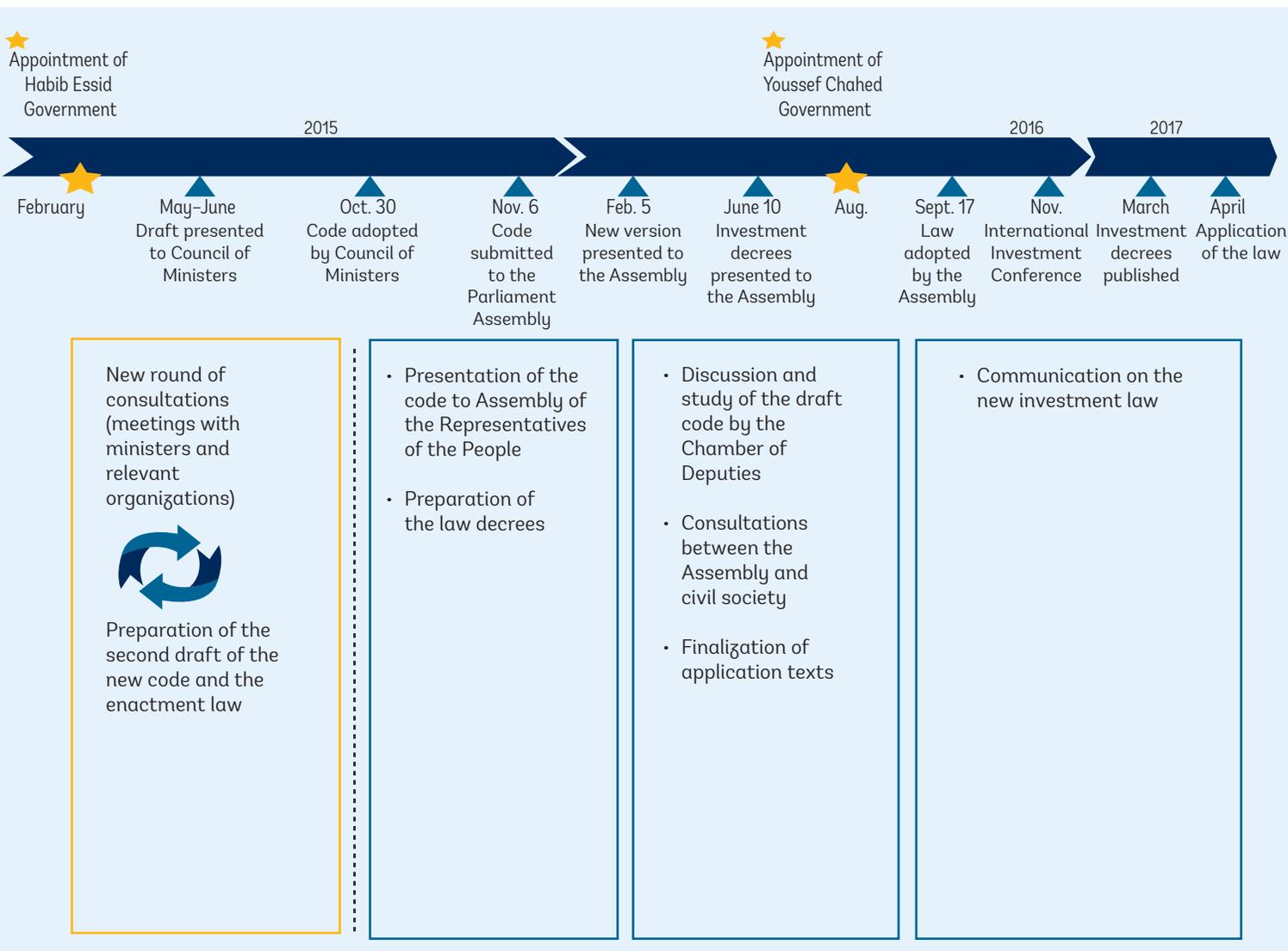


them (World Bank Group 2013). Similarly, the country benchmarked its legal and institutional framework against good- and best-practice countries across the globe, from Europe to Asia, before finalizing its own new structure. It broadcast these findings in 10 public workshops to build support for the reform agenda.

5. Build inclusive stakeholder coalitions to achieve results

In situations where vested interests from the former system have not been fully removed from institutions, changes affecting the status quo will often be adamantly resisted. In such situations, substantive mutually beneficial gains can be achieved by building alliances with other stakeholders sharing the same interests.

In Tunisia, the status quo benefitted multiple actors. Reforms to the investment policy and regulatory framework had the potential to infringe on the interests of many elements of domestic society, including local firms operating in closed sectors of the economy and public sector employees in institutions slated for restructuring. To overcome this resistance, external stakeholders, including international partners such as the Bank Group were used to support and justify unpopular, yet crucial reforms, including increasing market access for foreign investors in certain sectors and economic activities. Moreover, labor unions, working with revitalized business associations, were very important in “holding the center” throughout the process and helped



to push it forward in the face of predation by entrenched elites.

The Investment Law reform process benefitted from an exemplary broad-based consultation process, including active engagement by the private sector, civil society, and the international community. Two committees were created to facilitate the consultation process: an advisory committee with mainly private sector and civil society representatives, and a monitoring committee with public sector representatives. Both ensured efficient coordination among represented bodies and institutions. National figures and experts were also targeted to publicize the consultation process and champion the reforms. Figure 2 captures the main points of the consultation process, which involved more than 20 organizations, institutions, and entities through numerous

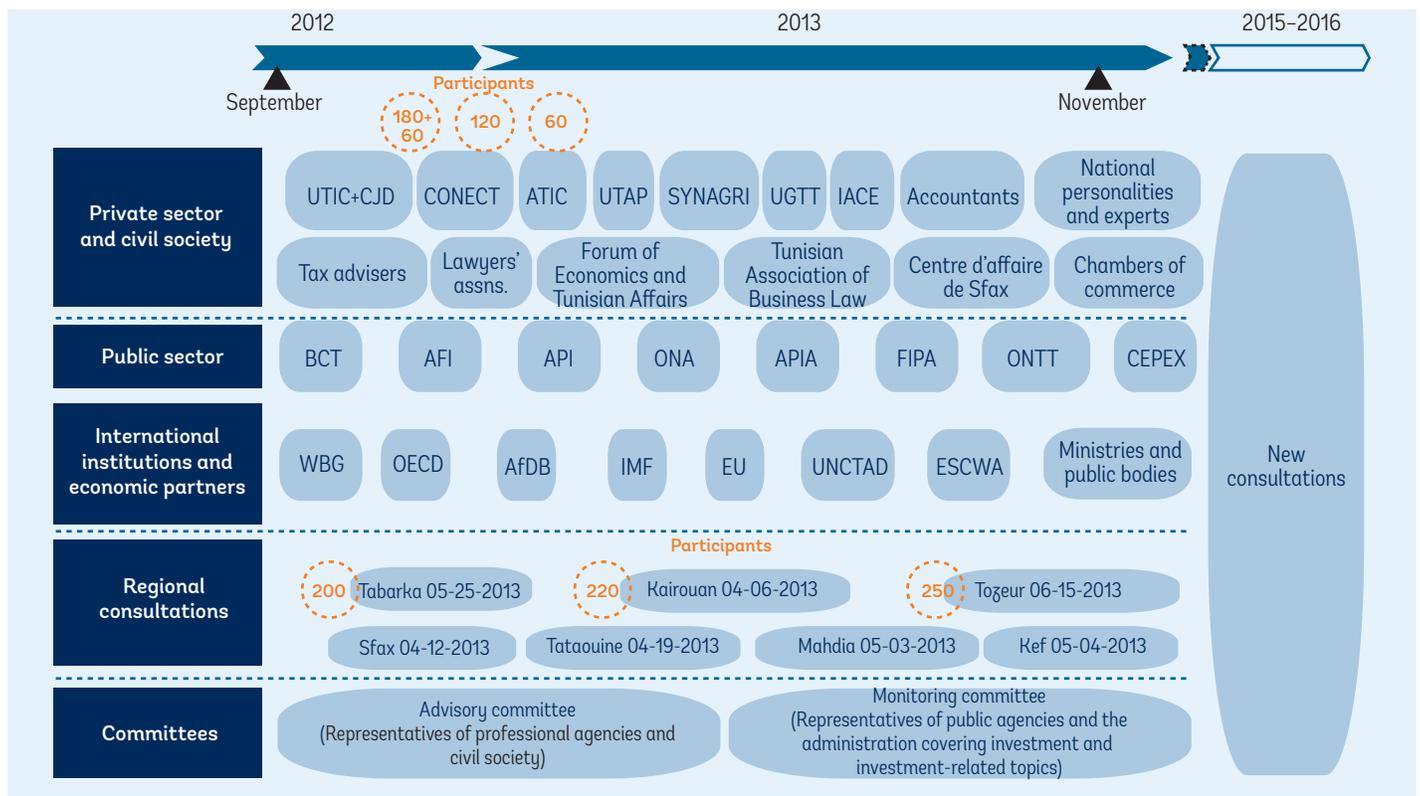
consultations held in two rounds during 2012–13 and 2015–16.

6. Boost the impact of reforms through an effective communication strategy

A comprehensive communication strategy is key to boosting the impact of reforms. Successful communications programs help raise awareness among stakeholders, including sending positive signals to private investors.

The government of Tunisia used communication as an effective tool to promote reform. The different steps in the adoption of the Investment Law were captured by the local press. Furthermore, the consultation process, with 1,500 participants representing numerous stakeholder constituencies, served as part of the communication strategy, with selected

FIGURE 2: MAIN STEPS AND STAKEHOLDERS IN THE CONSULTATION PROCESS, 2012–2016



Note: AfDB: African Development Bank; AFI: Industrial Land Agency; API: Agency for the Promotion of Investment and Innovation; APIA: Agency for the Promotion of Investment in Agriculture; ATIC: Tunisian Private Equity and Venture Capital Association; BCT: Central Bank of Tunisia; CEPEX: Tunisian Export Promotion Center; CJD: Centre des Jeunes Dirigeants; CONECT: Confederation of Tunisian Citizen Enterprises; ESCWA: United Nations Economic and Social Commission for Western Asia; EU: European Union; FIPA: Foreign Investment and Promotion Agency; IACE: Institut Arabe des Chefs d'Entreprises; IMF: International Monetary Fund; OECD: Organisation for Economic Co-operation and Development; ONA: National Office of Handicraft; ONTT: Tunisian National Office of Tourism; SYNAGRI: Tunisian Trade Union of Farmers; UGTT: Tunisian General Labour Union; UNCTAD: United Nations Conference on Trade and Development; UTAP: Tunisian Union for Agriculture and Fisheries; UTIC: Unit of Technologies of Information and Communication; WBG: World Bank Group.

national personalities and key opinion leaders playing an important role. Regional workshops and consultations were held throughout the country, including locations in northwest, southeast, southwest, and central Tunisia.

In a key undertaking, the Tunisian government held an international investment conference and committed itself to approving and adopting the Investment Law before it opened, using the conference to serve as a positive signal to private investors and the international community. The pressure exerted by this deadline was very effective, resulting in adoption of the Investment Law before the conference. During the conference, the government was thus able to point to the law as a major step toward improving the investment climate, and this argument was well received among both international and domestic investors.

7. Use reform results to trigger additional reforms and achieve development impact

Achieving intermediate results can initiate a “snowball effect,” setting in motion a pattern leading to greater, more challenging reforms. This is particularly true in contexts where institutions are still weak, power plays among rival factions are common, and reforms threaten the privileges of the elites. Intermediate reform results can also be used to reinforce the coalitions built with other stakeholders.

In Tunisia, important improvements in the legal framework for investment have been achieved. However, substantive issues remain, including the institutional setting for investment policy and promotion, full market access, and the rationalization of incentives. Nevertheless, the approval of the Investment Law has built momentum for initiating a series of additional reforms to improve Tunisia’s investment

climate. For example, the Foreign Investment Promotion Agency has been strengthening its investment promotion functions to attract foreign direct investment in strategic sectors. Meanwhile, the Ministry of Investment has started the process of simplifying business regulatory procedures for investment entry. Finally, in its efforts to rationalize its incentives policy, Tunisia undertook a cost-benefit analysis and has initiated steps to systematize assessment of the incentives’ effectiveness in the context of a Public Expenditure Review.

Conclusion

The case of Tunisia shows that, even during long transitions marked by political and social tensions, fundamental private sector development reform can be achieved incrementally. To successfully accomplish reforms, Tunisia leveraged a common development objective based on consensus among key parties. The reform process focused on three pillars: (i) setting ambitious yet realistic expectations, (ii) building “islands of effectiveness” as entry points for wider systemic change, and (iii) using empirical evidence to support reforms. An inclusive stakeholders’ coalition was also crucial in pushing the reform. Finally, the government of Tunisia used communication as an effective tool to urge reform adoption.

The experience of and techniques used in investment policy reform in Tunisia can help guide such efforts in other countries, including economies experiencing similar political and social challenges. The Tunisian experience shows that deliberate consensual reform efforts might be more effective than “Big Bang” approaches led by isolated clusters of reform champions, whose tenures often prove to be transitory.

(See back page for Notes and References.)

“The consultation process involved more than 20 organizations, institutions, and entities through numerous consultations in two rounds.”

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Notes

1. For a definition of *coercive apparatus* and discussion of its impact as it existed prior to the Arab Spring and as it stood after, see Bellin 2004 and 2012.
2. Brian Levy (2014) has developed a framework useful for explaining Tunisia's political economy at different points in its evolution.
3. The figure represents the number of unemployed workers as a percent of Tunisia's total labor force; see World Bank Group 2011.
4. See Levy 2014 for more on these concepts.

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