Nine years after the end of dictatorship: Making international financial aid to Tunisia more effective

Tunisia is still the only functioning democracy in the Arab world. But the country urgently needs structural reforms. Europe should make its future financial injections dependent on the implementation of reform steps, recommend Christian-P. Hanelt and Isabelle Werenfels (SWP).

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Since 2011, Tunisia has succeeded in making the transition from dictatorship to democracy. The last parliamentary and presidential elections took place in autumn 2019 and were assessed by internal and external observers as transparent and free. To a degree unseen in other Arab countries, international human rights organizations work independently in Tunisia, local watchdog groups influence effectively the behavior of politicians and sexual minorities fight openly for their rights.
These positive developments were by no means self-evident. Domestic political turbulence following two political murders in 2013, Islamist attacks on tourists in 2015 and the consequences of the civil war in Libya, which are again particularly relevant at the beginning of 2020, have jeopardized the political process and aggravated the country’s economic problems. The fact that democratization efforts were not derailed was largely due to the constructive role played by civil society organizations. Technical, diplomatic and economic support and close security cooperation with European partners were also important factors.

Europe remains Tunisia’s most important cooperation partner – despite the growing role of states such as Turkey and China. Germany plays a prominent role in this; together with Paris, Berlin is at the forefront of bilateral donors. The German government alone has invested around €240.5 million in development cooperation with Tunisia (as of 2018). Moreover, €46.5 million were used within the framework of a reform partnership and €147 million supplied as loans for near-market conditions.

However, it has not yet been possible to make substantial progress with regard to structural reforms in the administrative apparatus, the judiciary and the financial and tax systems. More generally, Tunisia has not succeeded in enhancing the capacity of the state to deliver services to its citizens equitably and thus to reduce regional and social disparities (https://www.afdb.org/en/documents/african-economic-outlook-2020). Changes are sorely needed if the economy is to become more dynamic and state institutions more performant and reliable: Public opinion surveys in 2019 (https://www.iri.org/sites/default/files/wysiwyg/final - 012019_iri_tunisia_poll.pdf) showed a low level of trust among citizens towards the state administration, the judiciary and political institutions. Protests against corruption, lack of jobs, poor services, rising prices and stagnating wages have been on the rise for years.

Enormous expectations

The result of the elections in autumn 2019 clearly reflected the desire for a new beginning. Anti-establishment parties performed strongly, and with Kais Saied, a constitutional lawyer without political experience but with a reputation for great personal integrity and modesty, was elected president. However, efforts to form a government proved difficult due to deep-seated animosities and a lack of cooperation within the fragmented party landscape. After a first government proposal failed to gain the parliament’s approval, President Kais Saied in mid-January appointed a new prime minister of his own choosing, Elyes Fakhfakh, to give it a second try and avoid new elections – the
Fakhfakh’s government finally received parliamentary approval in late February 2020 – nearly five months after the elections. The long and protracted process of forming a new government has put a damper on the public’s high expectations and post-electoral optimism. Moreover, it remains open how well the broad coalition will be able to function, as it includes parties with opposing political programs, particularly those targeting economic reform.

The previous government had not used its grand coalition and its legitimacy to tackle structural reforms. In the latest ranking of the World Economic Forum’s “Global Competitiveness Report” (2019), the Tunisian government scored poorly on the “long-term vision” indicator (overall, Tunisia ranks 87th out of 141). It was not only political trench warfare and deficient coordination between ministries that prevented improvement, but also actors of the old system who resist and have no interest in competition and transparency, as well as resistance from veto forces such as the trade union Union Générale Tunisienne du Travail (UGTT) and the employers’ Union Tunisienne de l’Industrie, du Commerce et de l’Artisanat (UTICA).

Meanwhile, risks stemming from debts of public budgets and social security funds are increasing. In 2018, public debt equaled 77 percent of the country’s GDP, up from 53 percent at the beginning of June 2016, due to increased budget deficits, low growth and currency depreciation. The international financial institutions (IFIs) and European donors have so far shouldered the liquidity shortfalls and contribute well over half a billion euros to the budget every year. In return for loans, the International Monetary Fund (IMF) is dictating reform measures. These are primarily aimed at budget cuts in the public sector, as well as structural reform in the financial sector and the tax regime, but much less at public sector effectiveness. Yet, achieving a more developed private sector, higher investment rates and a fast and efficient cash outflow require approval processes, administrative procedures and transparency to be enhanced and corruption reduced. For instance, a survey conducted by the German-Tunisian Chamber of Industry and Commerce in 2019 showed that companies operating in Tunisia regard bureaucratic hurdles as a major problem.

**No budget support without reform steps**

In order to counteract renewed disappointment among Tunisia’s population and the threat of internal turbulence, Europe should try to support reform-oriented forces in their push to enhance the state’s capacities and change the cost-benefit calculations of status quo actors. Ultimately, it is a matter of
persuading the political elites to cooperate in a results-oriented manner in the interests of the country. We recommend that external partners move away from the practice of budget support despite lack of progress in reform, and consistently link financial injections and tranche disbursements to verifiable steps towards structural reform.

Germany’s so-called reform partnerships, which were introduced in 2017, employ such a mechanism. Berlin engages in financial cooperation with Tunis in areas such as administrative reform (e.g. decentralization), sustainable economic development and protection of resources, especially water and energy. However, funds are distributed only after steps agreed on by both sides have been implemented. Whether the benchmarks have been ambitious enough remains open to discussion. But first results of this partnership are encouraging and funds were transferred to Tunisia in 2018 and 2019. In addition, the German government agreed to convert part of Tunisia’s debt into financing for projects that focus mainly on areas such as administrative reform, economic development, employment, governance and the water sector.

International financial assistance is channeled in large quantities to Tunisia, yet much of it still falls either under a framework in which funds for reforms flow prior to implementation of reform steps or in which conditions for disbursement focus strongly on austerity measures. Neither has been particularly successful in generating significant reform impetus in Tunisia and encouraging the government to take on more ownership and self-initiative.

Since 2015, the European Union has invested €800 million in so-called Macro-Financial Assistant (MFA and MFA-II) programs for the country. In October 2019, it agreed on a third injection of funds to Tunisia within MFA-II, with a loan of €150 million. The main goal is to contribute to political transition and to strengthen economic structures. These funds came with a long list of conditions, ranging from respecting human rights and full compliance with the rule of law to full financial and administrative independence for the Tunisian court of auditors, reforms to the tax system, and elaboration of schemes for reducing unemployment and social transfer programs. But it remains unclear how binding these broad conditions are and what the exact relationship between their implementation and the transfer of financial aid to Tunisia is. Theoretically, the funding mechanism still is “more for more,” meaning that reform progress is being rewarded with more EU support.

For its part, the IMF has a long-standing practice of tying financial support to implementation of austerity and specific reform measures. It negotiated an agreement with Tunisia in 2016, which provides the country with a sum of $2.8 billion under the so-called Extended Fund Facility (EFF). This sum is to be paid
out within four years and the agreement is therefore to end in May 2020. To date, $1.6 billion have been distributed, but $1.2 billion have been withheld. The latter is partly due to insufficiently rapid progress on the agreed reforms. At the same time, the Tunisian government has tried – as a result of IMF pressure – to improve the budgetary situation by reducing the deficit, and by enhancing tax revenues significantly in 2018 and 2019. This implies that conditionality can work. Yet, the strong focus on budget rigidity has a downside, which is two-fold: Austerity measures do not automatically lead to better performance and greater trust by citizens in the capacity of the state. And it does not allow Tunisia to “spend for the future,” namely on education, health care and social welfare systems.

A combination of pressure to act and incentives can work very well, something demonstrated by the international Financial Action Task Force on Money Laundering (FATF): When the EU placed Tunisia on the money laundering “blacklist” in 2017, the Tunisian government, which prior to the blacklisting remained passive on the issue, reacted swiftly, implementing promised measures. As a result, Tunisia was removed from the list in October 2019.

A change of mechanism in direct aid to the national budget would have to be accompanied by greater incentives for reforms, for example by more systematically converting public debt into project funds or granting visas to more Tunisian trainees to enable them to learn or work in the EU for a few years. In addition, opportunities for importing certain Tunisian agricultural products into the EU should be improved rapidly, flexibly and generously – without waiting for the conclusion of the EU’s comprehensive trade agreement, which is highly controversial in Tunisia.

Ultimately, the aim at the beginning of 2020 is to send a clear message to the political elites in Tunis in general and the new government in particular: Europe will continue to stand in solidarity with Tunisia and pursue its current cooperation policy – with one exception: From now on, a precondition for direct aid to the national budget is implementation of mutually agreed on structural reform steps, which are considered indispensable for sustainable economic and social stabilization – so-called “resilience.” If these actions succeed, Tunisia can count on even more European support. It goes without saying that such an approach would imply involving a broad set of stakeholders, including civil society actors, in outlining precise reform steps and benchmarks – and, last but not least, it would require greater coordination between the EU, the bilateral donors and the IFIs.

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