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History of Tunisia-EU Trade Relations: The Time of Disenchantment?

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Introduction

The negotiations for the Deep and Comprehensive Free Trade Agreement between the European Union and Tunisia officially commenced in October 2015 within the context of the degradation of Tunisia's trade balance. Since independence, Tunisia has focused the development of its foreign trade on a handful of European countries, thus neglecting its neighbors such as Algeria and Libya. This concentration of foreign trade on Europe, coupled with a model of economic development founded on Tunisia's integration into globalized trade, has concentrated the economic and social development of the country on the littoral regions, to the detriment of the interior regions. Since there are many voices calling on Tunisia to deepen its economic relationship with the EU[1], an evaluation must be made of Tunisia's commercial relationships with foreign partners.

The objective of this paper is to track, with the support of statistical data, the dynamics of Tunisia's long-term trade relationships from 1960-2015. We concentrate most particularly on trade relations with the European Union and Tunisia's principal European trade partners. We aim to bring to the reader's awareness to distortions caused by the foreign trading of non-resident offshore enterprises and the informal trade in the course of our analysis of Tunisia's international trade. We conclude by discussing the potential for diversification and alternatives for Tunisia's future trade policy.

Chafik Ben Rouine

Head of Quantitative Research

chafik.benrouine@economie-tunisie.org

The Insertion in deficit of Tunisia Into World Trade :

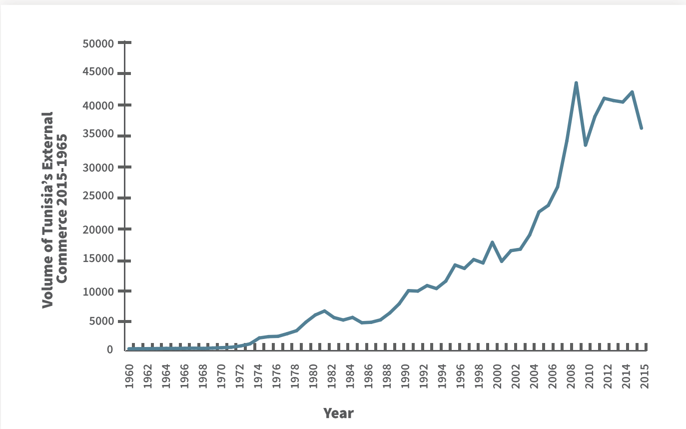

Figure 1a : Volume of Tunisia's External Commerce 1965-2015

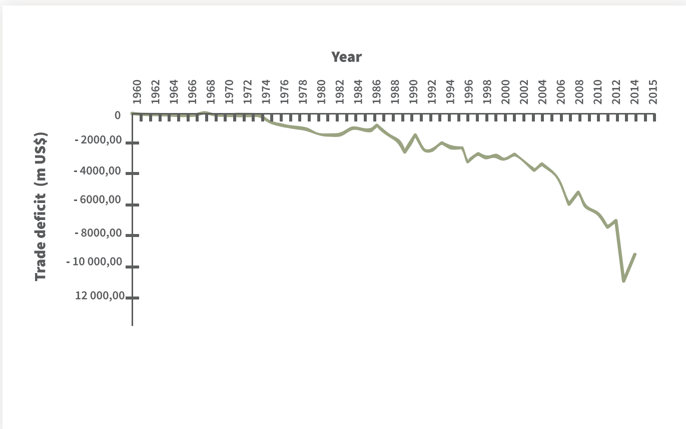

Figure 1b : Deficit from Tunisia's External Commerce 1965-2015

As illustrated in figure 1a, Tunisia's integration into the global economy and the liberalization of its foreign trade has been accompanied by an ongoing deepening of its trade deficit from 1960 to 2015. The volume of Tunisia's commercial exchanges reached a peak in 2008 with 43.1 billion US dollars. As for the trade deficit, it reached its maximum in 2014 with an amount of 10.6 billion US dollars. A historical perspective shows that Tunisia's commercial exchanges first took off at the beginning of the 1970s with the installation of offshore regimes under Law 72. Subsequently, the IMF's 1986 Structural Adjustment Plan required foreign trade liberalization as one of its main conditionalities. This plan nearly tripled the volume of commercial exchanges

[1] *Hamza Meddeb, Peripheral Vision: How Europe Can Help Preserve Tunisia's Fragile Democracy (ECFR, 13 January 2017) <http://www.ecfr.eu/publications/summary/peripheral_vision_how_europe_can_preserve_tunisias_democracy_7215> [accessed 21 March 2017].*

for Tunisia over the decade ending in the late 1990s. Commercial exchanges were then tripled once more between 2000 and 2008, finally reaching their peak in the year 2008.

This last increase is primarily explained by China's entry into the WTO in 2001. However, since 2008, Tunisia's commercial exchanges have stagnated at around 40 billion US dollars, and this even after the 2010-2011 revolution. Yet the impact of globalization on Tunisia must be viewed in tandem with its worsening deficit.
In fact, according to figure 1b, Tunisia's trade deficit increased exponentially between 1972 and 2015. Even the stagnation of commercial exchanges observed since 2008 did not stop the persistent deterioration of the country's trade deficit between 2008 and 2015. Quite to the contrary, the trade deficit between 2008 and 2014 practically doubled to the total of -5.9 to -10.6 billion US dollars during this last period.

An Analysis Of The Commercial Exchanges With The European Union :

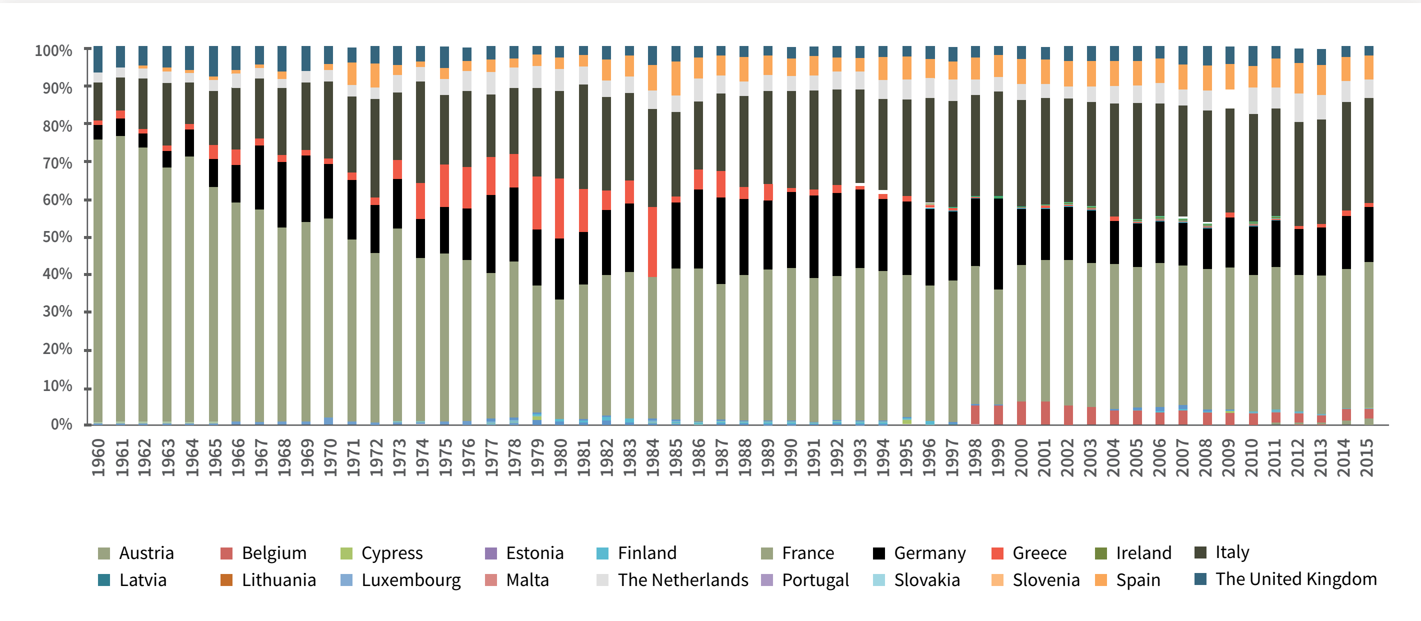

Figure 2 : Volume of the Commercial Exchanges for EU Countries with Tunisia, 1960-2015
Source : IMF

Figure 2 represents the commercial exchanges between Tunisia and the European Union, recording each country's share in these exchanges between 1960 and 2015. At first glance, what stands out the most from these numbers is the dramatic shifts in commercial exchanges with France following Tunisian independence in 1956. We can see that France's share in these dropped from 75% in 1960 to 35% in 1980. After its political independence, Tunisia consequently sought to gain its commercial independence from its former colonizer. After 1980, France's share stayed stable at around 40% throughout the next 35 years up until 2015. Between 1960 and 1980, Tunisia's search for commercial independence was principally realized through increasing Italy's share of trade, which went from 10% in 1960 to 25% in 1980.

Since then, Italy's place has remained stable at around 25-30% of the commercial exchanges. Trade with Germany has also grown since independence, reaching a maximum share of 20% in the 80s and 90s and then falling back down to around 10-15% starting in the 2000s.

Notably, after the 1998 Cooperation Agreement between Tunisia and the European Union, the structure of commercial trade with EU member states has hardly changed- with the exception of a minimal increase in trade with Belgium. To date, Tunisia has failed to fully exploit the potential opportunities provided by this agreement to diversify commercial exchanges with states that have not been Tunisia's traditional trading partners inside European Union.

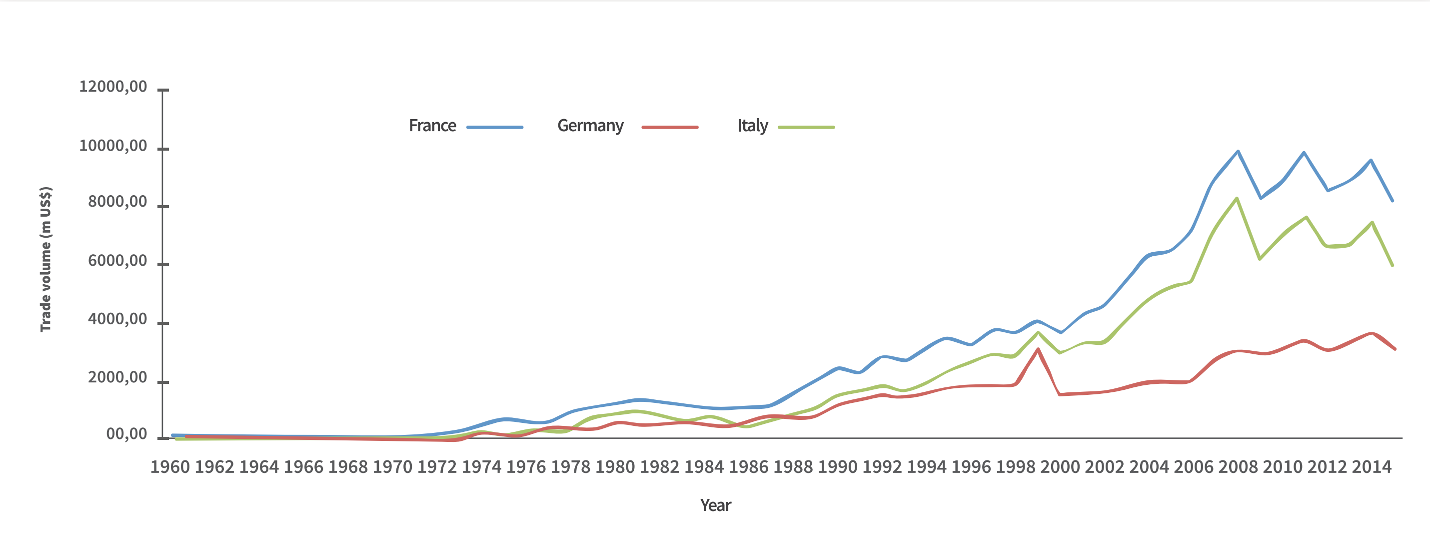

Figure 3 a : Volume of Tunisia's External Commerce with France, Italy, and Germany 1960-2015
Source : IMF

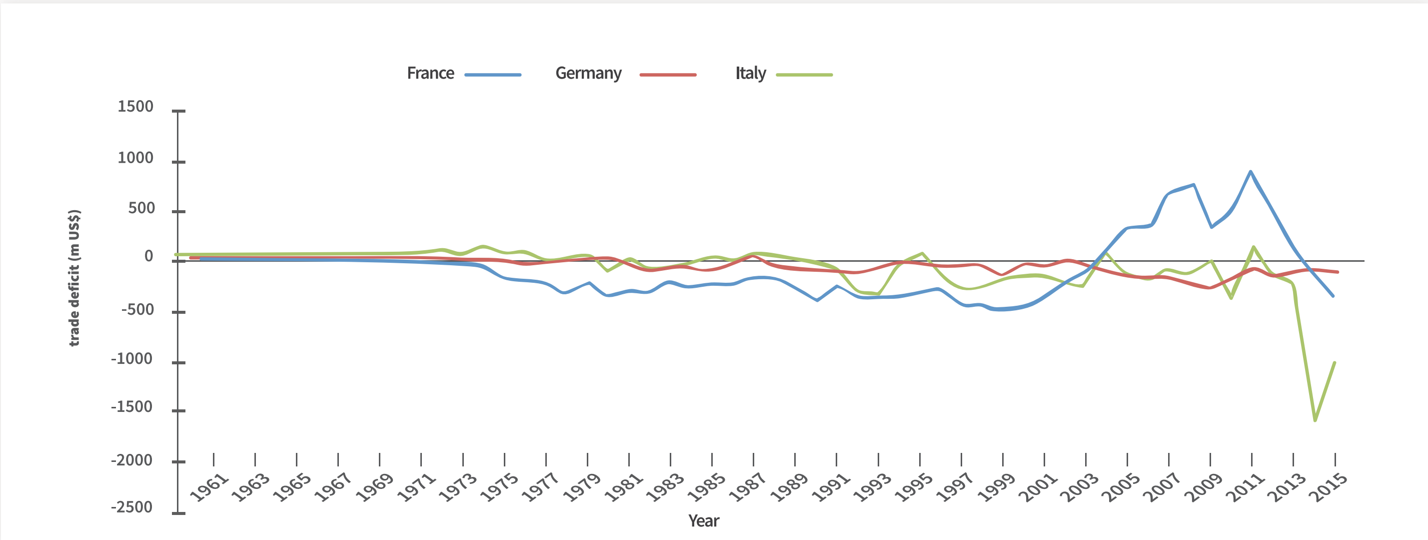

Figure 3 b : Deficit from Tunisia's External Commerce with France, Italy, and Germany, 1960-2015
Source : IMF

Focusing on commercial trade with Tunisia's top three European partners-France, Italy, and Germany - one can notice several patterns. First, there is a marked similarity between Tunisia's exchanges with both France and Italy (Figure 3a), especially in the last ten years where the graph takes on a sawtooth pattern. This similarity disappears when it comes to the trade deficit with these two countries. In particular, while Tunisia has maintained a constant trade deficit with Italy, from 1999-2000, there appears to be a reduction of its trade deficit with France. From 2004 to 2013, Tunisia even had a surplus of trade with France, with an astonishing peak- in 2011 as the revolution was at full swing. Since 2011, this trend has been reversed and, starting from 2014, Tunisia has found itself back in a trade deficit in relation to France.

Although Tunisia has always held a trade deficit with Italy, it saw its trade deficit with this particular country expand significantly between 2013 and 2014, where the deficit went from -0.4 billion US dollars to -2.2 billion US dollars - a historic record for bilateral relations with Italy. However, on the other side, the volume of trade with Germany has remained quite stable, at around 3 billion US dollars, and at the same time the deficit has been kept low at a level of around -300 million US dollars. As such it seems that- apart from the recent deterioration of trade with Italy- historically Tunisia has been able to keep its trade deficit with its three primary European partners under control, and has also been able to find a way to benefit from its trade relations with France, maintaining a trade surplus for almost a decade. However, these numbers mask a reality linked to the particular status of a majority of Tunisian export-only enterprises, which will be the focus of the next section.

The Mirages Of the Off-Shore Regime

The off-shore regime, established by Law 72 (see Box), distorted the understanding of Tunisian foreign trade. Specifically, confusion stems from the contradictions around how residence is defined within this law.

Box: The Offshore Regime- Non-Residence: Do These Words Still Have Meaning?

The famous Law 38-72 passed in April 27, 1972- provided the juridical base for establishing and defining offshore regimes more commonly known in Tunisia by "Law 72", - it brought into being a specific system for the export producing industries. This law established a system of exceptions in tax, exchange rate and trade regimes for companies classified as export-only.
Definitions

Offshore Regime: An enterprise is considered to be subject to the offshore regime when it is "export-only" regardless of the structure of its capital. According to Article 3 of Law 72, enterprises under the offshore regime are completely exonerated from the Corporate Income Tax (CIT) for 10 years, after which they are subject to a reduced rate of 10% for the following ten years. It is the exoneration from IS that creates a dichotomy, from a tax standpoint, between offshore enterprises and onshore enterprises.

Non-Resident Enterprises: According to Article 5 of Law 72, enterprises are "considered non-residents, for their establishments duly recognized as producing exclusively for exportation, when their capital is owned by non-residents by means of an importation of convertible currencies equal to 66% of capital." Thus, by definition, all non-resident enterprises also come under the offshore regime (export-only), with the reverse, however, not being true. Enterprises can be offshore (export-only) without having at least 66% of capital owned by non-residents. According to Law 72, Article 6, the defining feature of non-resident enterprises is that they "are not required to repatriate their export products, service provisions, and revenues." This means that these enterprises are not required to deposit within the Central Bank of Tunisia (CBT) the money that they have earned in Tunisia but can, rather, leave these revenues abroad for safekeeping- an action which causes an earning loss for Tunisia's treasury reserves.

However, there is a contradiction between the way non-residence is defined in Law 72 and how it is defined by the IMF. In fact, according to the sixth edition of the IMF's Balance of Payments and International Investment Position Manual (BPM6), "in general terms, an enterprise is a resident of an economic territory when it produces a significant quantity of goods or services using an area in the territory as its base of operations." Thus, enterprises that are defined as non-resident according to Law 72 are in reality resident enterprises according to the IMF. Despite their status according to the IMF definition, their exchange rates regime corresponds to that of the IMF's definition of non-resident enterprises.

It is this paradox which allows Tunisian authorities to record non-resident enterprises- as defined by Law 72- in the accounts books for external payments (imports, exports), even though their revenue does not have any impact on the country's exchange accounts (e.g. treasury reserves, the exchange rate for the dinar).

Export-Only: The notion of "export-only" is at the heart of the definition of an off-shore regime. But the two words of this notion pose additional problems. Law 72 logically defines export-only enterprises as being those which produce exclusively for exportation. However, later Article 16 of the 1993 Investment Code gave authorization to export-only enterprises to sell a part of their production or services on the local market, with a maximum limit of 30% of their revenue. This option has since been amended with many new additions, with the most notable change occurring in 2011 under the framework of Article 8 of the decree Law 28-2011 from April 18, 2011, where the limit for domestic sales was raised to 50%. At this level it becomes very difficult for these export companies to justify the "only" in their title.

Another issue raised by the "export-only" category is its expansive application. In addition to the required sale of products and services abroad, the sale of products and services to "export-only" enterprises also qualifies as export operations. As a result, Article 10 of the 1993 Code of Investments Incentive came to define enterprises who sell their products or services exclusively to "export-only" companies as being themselves "export-only"- even when those products and services have never left the Tunisian territory for export operations.

Summary

- Under the Offshore Regime in Tunisia:
- An enterprise may be qualified as export-only even if it sells 30-50% of its revenue on the domestic market. It may also be qualified as export-only even if all of its sales are made on Tunisian soil (if its clients are exclusively export-only or are situated in a free zone).
- An enterprise may be qualified as non-resident even if it is considered as resident according to international norms. It nonetheless benefits from the advantages of a true non-resident enterprise (non-submission to the exchange rates regime).
- A product or service may be classified as "export" even if it never leaves the country's borders. In view of such confusion, it seems reasonable to ask if these words still have meaning?

In September 2016 the CBT estimated that 75% of offshore enterprises were non-resident enterprises. In other words, 25% of offshore enterprises benefit from exceptions in the tax regime, but not from exceptions within the exchange rates regime, and they must thus repatriate their income from exports. Inversely, enterprises classified as non-resident by Law 72 (but residents by international norms) are not required to repatriate their income from exports, nor do they draw from official exchange reserves for their import. They thus do not have any impact on the reserves of the country, nor on the exchange rate for the Tunisian dinar. According to the CBT[2], in 2016 around 60% of Tunisian exports were produced by non-resident offshore enterprises, the capital of which was held onto mainly by non-residents. In tandem, these non-resident offshore enterprises were responsible for only 28% out of all of Tunisia's imports in 2016. This same year the net profit between exports and imports for non-resident offshore enterprises was a positive 5.5 billion Tunisian dinars. However, from the perspective of the balance of payments and trade balance, because these 5.5 billion Tunisian dinars were not required to be repatriated with the CBT, they did not have any real positive impact. As nearly all the non-resident offshore enterprises trade with the European Union, the trade balance between Tunisia and the European Union is artificially inflated by 5.5 billion dinars (at most). As this sum is not being returned into the CBT's treasury reserves, it cannot be utilized for covering the cost of imports from the European Union for resident enterprises.

[2] *Analyse Des Échanges Commerciaux de La Tunisie- Année 2016', Banque Centrale de Tunisie<https://www.bct.gov.tn/bct/siteprod/actualit*

This grotesque situation where resident enterprises in Tunisia are qualified as non-resident in order to avoid to be ruled by the exchange rates regime places all the superficial analyses for Tunisia's foreign commercial trade into perspective, especially its trade with the European Union. In this manner, the trade surplus with France, for example, must be analyzed after having taken care to make the distinction between exchanges undertaken by resident enterprises and those undertaken by non-resident enterprises[3].

[3] *Information non disponible au 22 mars 2017.*

A Necessary Diversification, But Risky

As Figure 4 shows, between 1960 and 2015 the European Union represented an average of 70% for Tunisian commercial exchanges.

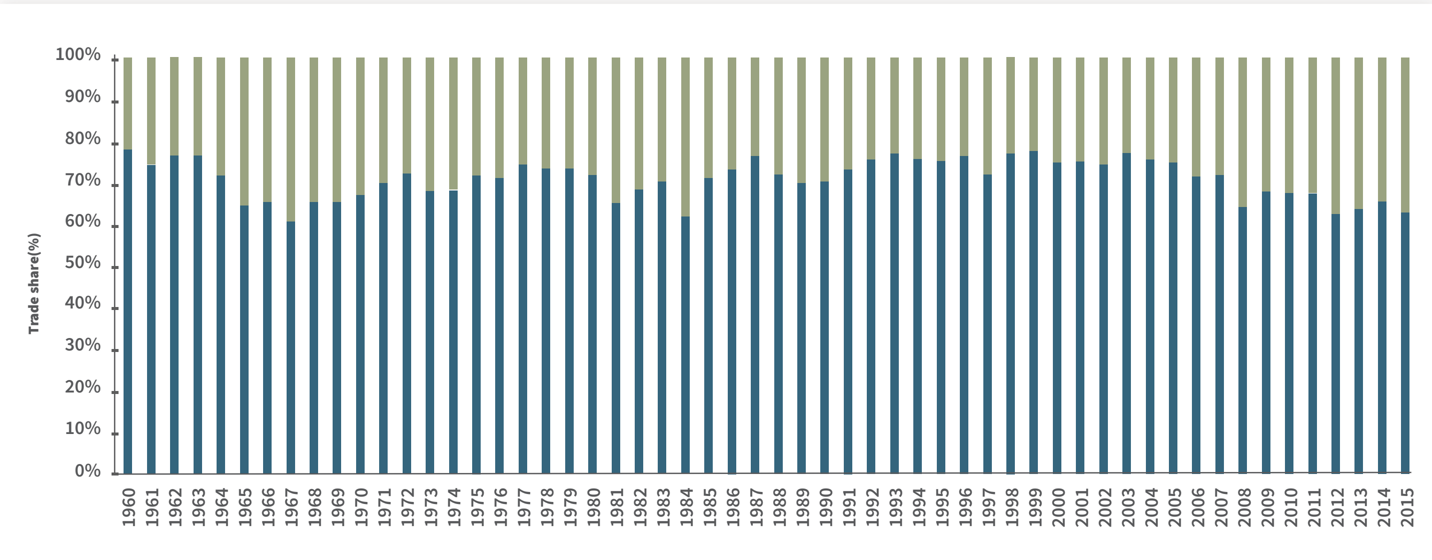

Figure 4 : The European Union's Share in Tunisian Commercial Exchanges

[4] *Kristina Kausch, The End of the (Southern) Neighbourhood, EuroMeSCo Paper (IEMED) <http://www.euromesco.net/index.php?option=com_content&view=article&id=1922%3Aeuromesco-paper-18-the-end-of-the-southern-neighbourhood&catid=61%3Aeuromesco-papers&Itemid=48&lang=en> [accessed 22 March 2017].*

The stability of the EU's share in Tunisia's commercial exchanges demonstrates the solidity of connections between the two sides- as well as the absence of will for significant diversification for Tunisian commercial exchanges. Between the years 1990 and 2007, the European Union's share stayed at above 70% of Tunisia's commercial exchanges. According to Kristina Kausch[4], Tunisia is the country from the Southern neighborhood who is the most economically dependent on the European Union, and it is for this reason that Kausch has decided to classify it as a "satellite" country of the European Union. However, we have observed that since 2003 the EU's share in Tunisia's commercial exchanges has steadily been decreasing. It went from 78% in 2003 to 63% in 2015, which is a decrease in trade shares of 15 points. This trend could explain the EU's eagerness to deepen its trade relationship with Tunisia through the negotiations for the Deep and Comprehensive Free Trade Agreement (DCFTA)- a move to keep Tunisia in its "lap." Similarly, Figure 1a shows a stagnation of commercial exchanges with the European Union since the 2008 crisis, as if Tunisia has reached a glass ceiling for commercial exchanges with its traditional European partners.

Tunisia thus has every interest in diversifying its trade partnerships, especially with more dynamic markets in terms of growth. However, the question is whether the Tunisian government is adequately informed and capable of shifting gears when it comes to accelerating the initially slow start to diversifying its commercial exchanges.

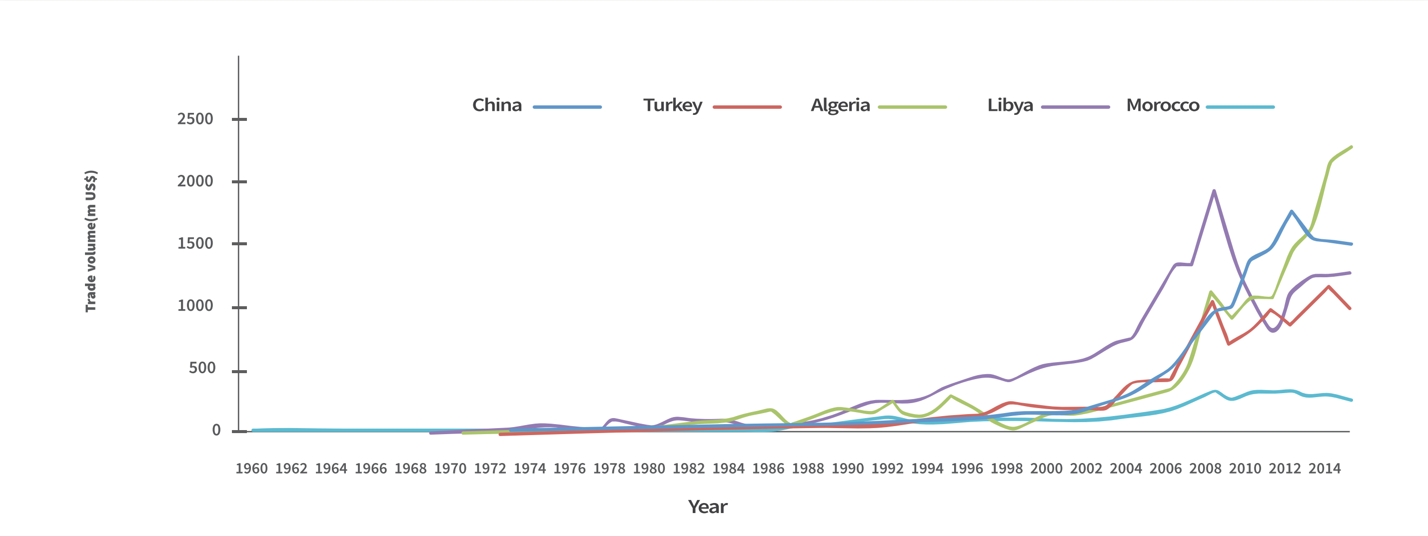

Figure 5 : Volume of Commercial Exchanges with Tunisia 1960-2015

We have decided to focus on Tunisia's commercial exchanges with five countries: Morocco, Algeria, Libya, Turkey and China. As indicated in Figure 5, apart from Libya, from the early 2000s the volume of commercial exchanges with the four other countries has taken off. Beginning at that time we can distinguish two periods in terms of the volume of trade. The first period, between 2000 and 2008, is where we can observe exponential growth for Tunisia's commercial exchanges, with Libya topping the chart and with Turkey, Algeria, and China following at equal levels. The second period, between 2008 and 2015, saw trade with Algeria rapidly expands with an acceleration after 2001. We can likewise observe an evolution in commercial exchanges with China that is just as rapid as that of Algeria's until 2011, and then a stagnation of trade with China after 2011.

A stunningly sharp drop in trade with Libya can be seen up until 2011, followed by a more timid recovery. Finally, we can observe a near-stagnation in Tunisia's commercial exchanges with Morocco and Turkey in this 2008-2015 period.

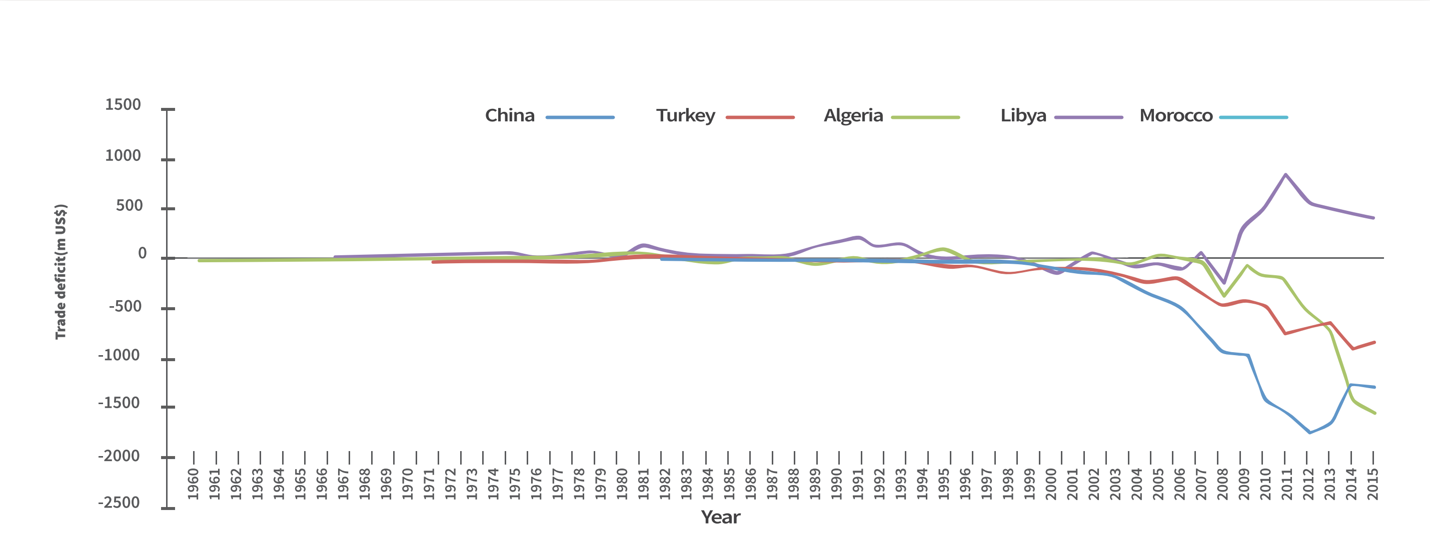

Figure 6 : Deficit for Tunisia's Foreign Trade with China, Turkey, Algeria, Libya, and Morocco 1960-2015

Figure 6 shows Tunisia's trade balance with these five countries. Regarding the countries with which Tunisia is in a trade deficit, it is worth noting that Tunisia exports very little to China (the threshold of $100 million US dollars for exports to China was surpassed in 2014), and thus the shape of the line graph is partially a result of Tunisia's imports from China. The deficit markedly increased between 2001, the date of China's entry into the WTO, and 2012, and it has been decreasing ever since. Trade with Turkey follows a similar pattern- but to a lesser degree- with the deficit increasing steadily since 2005, the date the Free Trade Agreement between Turkey and Tunisia came into effect[5]. The acceleration of trade with Algeria after 2011 is accompanied by a very rapid expansion of the deficit with Algeria, which even ended up surpassing the trade deficit Tunisia has had with China starting from 2014. On the other hand, the drop in commercial exchanges with Libya between 2008 and 2011 corresponded with a large increase in surplus trade in Tunisia's favor. After 2011, Tunisia succeeded in maintaining its surplus trade with Libya, rendering Libya the best trade partner for Tunisia from the perspective of a balance of trade. Even though the volume of commercial exchanges with Morocco is not very high as compared to the other countries, Tunisia has maintained a trade surplus with them since the 2000s.

[5] *Relations Bilatérales Tunisie - Turquie', Ministère Des Affaires Etrangères - République Tunisienne.*

It is important to note that, unlike those of others which have already been mentioned, the commercial exchanges with these five countries are not hidden under the cover of distortions. What instead distinguishes trade with these countries is that the official figures represent a small section of the actual trade in light of the breadth and scope of informal trade across the land-based, aerial, and- above all- maritime borders. Contrary to the overvalued commercial exchanges with the European Union, there is a strong chance that trade with Algeria, China, Turkey, or Libya, for example, is being underestimated if we take into account the phenomenon of the informal economy in Tunisia (trade and informal currency exchange).

As such, diversification of Tunisia's trade partnerships is principally focused on a diversification of imports (passive method) rather than on a diversification of exports (active method). What is more, this diversification has actually worsened Tunisia's trade deficit, and Libya remains the only important partner in terms of the volume of trade in which Tunisia is in a surplus. This situation is explained in part by the high number of enterprises classified as offshore, of which 75% are also categorized as non-resident with European capital, and whose design is to profit from a system of exceptions (Taxes, for exchange rates, trade, and social) in order to improve their ability to compete at an international level and who have a natural tendency to concentrate on the European market. It is explained also in part by the apathy of the authorities and of the Tunisian private sector in searching access to new markets.

Conclusion

The numbers show that the European Union is a long-time trade partner with Tunisia and is very important for the country. However, since the 2000s Tunisia has begun to diversify its trade partnerships, especially in regards to the level of imports. Stagnation in commercial exchanges between Tunisia and the European Union since 2008 encourages the search for a new candidate for external growth with whom Tunisia could increase its trade balance (Libya, for example). Many options for diversification have presented themselves to Tunisia, including neighboring countries as well as those within the European Union (but outside of the traditional partners). However, the Tunisian authorities should be more motivated to clarify the issues surrounding residence and exportation in order to develop a more accurate picture of the actual situation of its balance of payments. They must also, as a matter of urgency, clarify the situation of non-resident offshore enterprises. These companies should either be categorized as resident enterprises, and therefore subjected to the exchange rates regime, or considered as non-resident enterprises (which is more difficult to justify) and no longer entered into Tunisia's imports and exports accounts. The fact that 60% of Tunisia's exports are carried out under this problematic system is troubling. Removing the veil of confusion will allow for the construction of a trade policy that is more active in exportation and based on an accurate diagnosis of the country's foreign trading.

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