

Grumiller, Jan et al.

Research Report

The economic and social effects of the EU Free Trade Agreement (DCFTA) with Tunisia

Research Report, No. 9/2018

Provided in Cooperation with:

Austrian Foundation for Development Research (ÖFSE), Vienna

Suggested Citation: Grumiller, Jan et al. (2018) : The economic and social effects of the EU Free Trade Agreement (DCFTA) with Tunisia, Research Report, No. 9/2018, Austrian Foundation for Development Research (ÖFSE), Vienna,
<https://www.oefse.at/publikationen/research-reports/detail-research-report/publication/show/Publication/The-economic-and-social-effects-of-the-EU-Free-Trade-Agreement-DCFTA-with-Tunisia/>

This Version is available at:

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The economic and social effects of the EU Free Trade Agreement (DCFTA) with Tunisia

Vienna, July 2018

Jan Grumiller, Werner Raza, Cornelia Staritz, Bernhard Tröster,
Rudi von Arnim, Hannes Grohs

Acknowledgement:

The authors would like to express their thanks to all interview partners for their time, knowledge and insights, in particular to all persons that we met during our research in the respective focus countries. All comments and feedbacks during the drafting process were highly appreciated. The authors are, of course, fully responsible for all remaining errors.

Disclaimer:

The study has been facilitated by the German Federal Ministry for Economic Cooperation and Development (BMZ) as part of the research project "Preferential market access and sustainable development: the case of value chains". All views expressed in the study are the sole responsibility of the authors and should not be attributed to BMZ or any other institution or person.

**AUSTRIAN FOUNDATION FOR
DEVELOPMENT RESEARCH**

**The economic and social effects of the
EU Free Trade Agreement (DCFTA) with Tunisia**

**Jan Grumiller, Werner Raza, Cornelia Staritz, Bernhard Tröster,
Rudi von Arnim, Hannes Grohs**

Final Report, 12 July 2018

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ABBREVIATIONS

ALECA	Accord de Libre Échange Complet et Approfondi
ASC	Aquaculture Stewardship Council
ATC	Agreement on Textile and Clothing
BIT	Bilateral Investment Treaty
BMZ	Federal Ministry for Economic Cooperation and Development
BV	Business Visitor
CARIFORUM	Forum of the Caribbean Group of African, Caribbean and Pacific States
CBA	Collective Bargaining Agreement
CEE	Central and Eastern Europe
CEPEX	Centre de Promotion des Exportations de la Tunisie
CETA	Comprehensive Economic and Trade Agreement
CGE	Computable General Equilibrium
CLO	Core Labor Standards
CMEA	Council for Mutual Economic Assistance
CMT	Cut-Make-Trim
CN8	Combined Nomenclature (8 digits)
CoC	Codes of Conducts
CSR	Corporate Social Responsibility
CSS	Contractual Services Suppliers
DAG	Domestic Advisory Group
DCFTA	Deep and Comprehensive Free Trade Area
DFQF	Duty-free-Quota-free
EAC	East African Community
EAEU	Eurasian Economic Union
EBA	Everything but Arms
EC	European Commission
ECI	Economic Complexity Index
EPAs	Economic Partnership Agreements
EU	European Union
EU-MUTRAP	European Trade Policy and Investment Support Programme
EUR	Euro
FDI	Foreign Direct Investment
FOB	Free on Board

FOPROHOC	Fonds de promotion de l'huile d'olive conditionnée
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GlobalGAP	Global Good Agriculture Practice
GPA	Government Procurement Agreement
GSP	Generalized System of Preferences
GTAP	Global Trade Analysis Project
GVC	Global Value Chains
ICTs	Intra-Corporate Transferees
IEC	International Electrotechnical Commission
IFC	International Finance Corporation
ILO	International Labor Organization
IPs	Independent Professionals
ISDS	Investor to State Dispute Settlement
ISO	International Organization for Standardization
ITCEQ	Institut Tunisien de la Compétitivité et des Etudes Quantitatives
LDC	Least Developed Country
LEAP	Livelihood Empowerment against Poverty
MARD	Ministry of Agriculture and Rural Development
MENA	Middle East and Northern Africa
MFA	Multi-Fibre Arrangement
MFN	Most Favoured Nation
MOLISA	Ministry of Labor
MOR	Morocco
MRA	Moisture Retention Agents
NGO	Non-Governmental Organization
NIF	Neighbourhood Investment Facility
NTB	Non-Tariff Barrier
NTM	Non-Tariff Measure
OBM	Original Brand Manufacturing
ODM	Original Design Manufacturer
OECD	Organization for Economic Co-operation and Development
OEM	Original Equipment Manufacturer
ÖFSE	Austrian Foundation for Development Research

OHS	Occupational Health and Safety
PCA	Partnership and Co-operation Agreement
PCSD	Policy Coherence for Sustainable Development
RoO	Rules of Origin
ROW	Rest of the World
SMEs	Small and Medium Enterprises
SOEs	State-owned Enterprises
SPS	Sanitary and Phytosanitary Standards
SSA	Sub-Sahara Africa
T&A	Textile and Apparel
TBT	Technical Barriers to Trade
TCE	Trade Cost Equivalent
TND	Tunisian Dinar
TRQ	Tariff Rate Quotas
TSD	Trade and Sustainable Development
TTIP	Transatlantic Trade and Investment Partnership
TUN	Tunisia
TUR	Turkey
UGTT	Tunisian Trade Union Confederation
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNECE	United Nations Economic Commission for Europe
UNIDO	United Nations Industrial Development Organization
US	United States
USD	US Dollar
UTICA	Union of Industry, Trade and Handicrafts
WTO	World Trade Organization

EXECUTIVE SUMMARY

The EU has recently concluded or is currently in the process of negotiating a number of bilateral free trade agreements with both industrialized countries, e.g. Japan, and developing as well as emerging economies. Negotiations with the latter group include Tunisia, where negotiations on the Deep and Comprehensive Free Trade Area (DCFTA) were formally launched in October 2015. Until July 2018, two negotiation rounds have taken place, the conclusion of the agreement is expected for 2019.

Based on the EU trade strategy “Trade for All. Towards a more responsible trade and investment policy”, published in October 2015, these so-called new generation bilateral trade agreements are deliberately designed as ‘deep and comprehensive’. In other words, while also targeting remaining traditional trade barriers, such as tariffs and quotas, above all they aim at tackling other issues that are deemed relevant for trade. Amongst these figure investment liberalization and protection, intellectual property rights, public procurement, competition law and state aid, as well as non-tariff-measures. The latter include SPS-standards, technical barriers to trade, but also sector regulation and administrative procedures. In addition, it is emphasized by the EU that sustainable development aspects, in particular as they relate to human rights, labor standards as well as environmental aspects also need to be integrated into modern trade policy.

Furthermore, in the case of trade negotiations with developing countries, the agreements should also take into account the specific situation and needs of these latter countries, so as to be complementary and supportive of their development priorities. In other words, adherence to the principle of policy coherence for sustainable development (PCSD), as recently defined by the UN Agenda 2030 for Sustainable Development and subsequently adopted by the new European Consensus on Development, is required. New generation FTAs are therefore primarily to be assessed against this yardstick, which is the approach adopted in this study with respect to the EU FTA with Tunisia.

The methodological approach of this report combines both quantitative and qualitative methods. While the economic assessment is based on simulations with the ÖFSE Global Trade Model, a structuralist Computable General Equilibrium model, the qualitative analysis on the agreement and its implementation challenges as well as the case studies draw on text and data analysis, a literature review and interviews in Tunisia. The interviews were conducted with diverse stakeholders from the government, the private sector and civil society, and complement other data sources used throughout the report (see a list of interviewees in Appendix). The sector case studies selected were focusing on important export-oriented industries in the country, with textiles & apparel representing manufacturing industries and olive-oil production representing agriculture.

The **main findings and key policy recommendations** of the study can be summarized as follows:

1. Estimated economic effects of trade liberalization for Tunisia are negative:

Since tariffs on manufacturing products between the EU and Tunisia have been already liberalized in the existing Association Agreement, lowering the overall tariff protection of the Tunisian economy to only about 2% of trade volume, the impact of the DCFTA will be mainly determined by changes in the agricultural sector, where imports are still subject to significant tariffs and quotas. In the case of full tariff liberalization by the EU and Tunisia, the Tunisian sectors cereals and foods & beverages will be negatively affected by higher import competition from EU products, while only selected sectors in Tunisia (vegetable oils

and vegetables/fruits) benefit slightly. Overall, real GDP in Tunisia will decline by 0.52% in the case of full tariff liberalization in both FTA partners. Thus, if the EU is serious about striving for an asymmetrical agreement with Tunisia, it should apply a differentiated approach with respect to specific agricultural sectors in order to mitigate potential negative effects. In these cases, exemptions from tariff reductions on selected products and sectors should be considered during the negotiation process. Further, sectors that are negatively affected by trade liberalization and particularly if they concern such important sectors for the livelihood of farmers and consumers as cereals and foods & beverages would require adjustment assistance to cushion any negative effects. Because of strong differences with respect to the sectoral labor intensity of production, overall employment levels will remain roughly unchanged.

Given the stronger emphasis of the DCFTA on regulatory harmonization, the effects of trade cost reductions triggered by alignment of non-tariff measures (NTMs) are also simulated. Though resulting in long-term cost savings for Tunisian exporters, NTM alignment will mainly be based on regulatory harmonization of Tunisian standards towards EU standards. This will involve adjustment costs for the Tunisian economy. Regulatory harmonization towards EU standards should thus be supported by EU Aid for Trade programs.

2. Public revenue losses will negatively affect Tunisia and need an EU policy response:

In the case of Tunisia, the effects of tariff liberalization on the public budget need to be carefully considered. An increase of the public budget deficit of up to 1% of GDP in the case of full liberalization of tariffs on imports from the EU will not be easily compensated in a situation, where the country already gets macro-financial assistance from the IMF and the EU in order to control the size of the deficit. The latter reached 6% of GDP in 2016 and is not likely to return to balance in the near future. In the short to medium term, trade liberalization should thus be accompanied by additional budget support. With respect to the long-term, EU Aid for Trade should support reforms to broaden the fiscal basis.

3. Promotion of export sectors needs pro-active policies for upgrading:

Given that trade liberalization should positively contribute to growth and employment creation, a careful consideration of the potentials for increasing exports in selected sectors is important. Based on a detailed analysis of the leading agricultural export sector of olive oil as well as the textiles & apparel sector, our analysis points to the need for policy interventions in two priority areas:

- a) *Export potentials for food products depend on investment in processing and branding activities and in quality infrastructure:* given that most GVCs for agricultural and food products are buyer-driven, increases in export revenues need an approach that aims at extracting more value-added from each unit exported. This is particularly the case, where further increases in export volume are constraint by production conditions, e.g. water scarcity, and/or lead to negative environmental externalities. Export-oriented upgrading activities, in particular production of bottled olive oil for final consumers, do not only need investment in processing facilities, but in particular marketing and branding strategies in order to gain access to retailers and become attractive to final consumers. Trade policy can support upgrading both by improving market access, e.g. by eliminating remaining tariffs and quotas, and furthermore, by supporting to meet standards, both public SPS and private standards of lead firm in GVCs, in particular quality standards and certifications for organic products.

- b) *Promotion of upgrading and of the textile sector is of strategic importance in the apparel sector:* against the background of continuing preference erosion in the apparel sector as more countries are receiving preferential market access due to the proliferation of FTAs, reduced lead-times and the trend to fast fashion, the sustained competitiveness of the apparel sector in the future will not primarily rest on the availability of cheap labor and DFQF market access, but on the availability of a flexible and high-quality production system that extends from the production of yarns and fabrics, the availability of accessories and finishing services to modern logistics and transport services. Apparel producers in Tunisia should thus increase their efforts to position themselves as more developed apparel suppliers, extending their role from CMT production and lower value products to increasing local value-added and linkages. This will involve investments in the build-up of a domestic textile sector, but also extend to other supporting services, e.g. increasing the availability of working capital for FOB production and productive investment credits as well as improving the technical skills of T&A workers.

4. Trade policy should foster policy coherence for sustainable development and be context-specific

Sustainable development as defined by the UN Agenda 2030 and adopted by the European Consensus on Development, calls for the promotion of sustainable economic growth that is socially inclusive, respects ecological boundaries and promotes peace and democracy. Trade liberalization should thus be considered as a means to achieve the objective of sustainable development. Due to different geographical conditions, economic structures, political and institutional systems, trade liberalization outcomes for individual countries are however variegated, and it cannot be taken for granted that effects are exclusively beneficial, neither at the aggregate nor at the sectoral level. Thus, any approach to trade policy in compliance with the principle of policy coherence for sustainable development must take the specificities of a partner country systematically into account and adapt trade policy measures accordingly. The Sustainability Chapters are an important step forward in this regard but they need to be mainstreamed throughout the chapters of the core agreement. Further, where these chapters already exist such as in the case of the EU-Vietnam FTA, their formulation is rather weak and the political interest to implement them and fund the necessary dialogue processes has been weak on both sides.

Given the exceptional characteristics of contemporary Tunisia, which is in the difficult and protracted process of consolidating its democratic transition in a complex regional environment, the report suggests a significantly modified negotiating approach that prioritizes the safeguarding of socio-territorial cohesion and a focus on short-term benefits for its struggling economy.

ZUSAMMENFASSUNG

Die EU hat in letzter Zeit oder verhandelt derzeit eine Reihe von bilateralen Freihandelsabkommen sowohl mit Industrieländern wie zum Beispiel Japan, als auch mit Entwicklungs- und Schwellenländern. Zu letzterer Gruppe gehört Tunesien, wo die Verhandlungen über eine „Tiefe und Umfassende Freihandelszone“ (DCFTA) im Oktober 2015 formell aufgenommen wurden. Bislang (Juli 2018) fanden zwei Verhandlungsrunden statt, der Abschluss der Gespräche ist für 2019 in Aussicht genommen.

Auf Grundlage der EU Handelsstrategie „Handel für alle. Hin zu einer verantwortungsbewussteren Handels- und Investitionspolitik“ von Oktober 2015, sind diese sogenannten bilateralen Handelsabkommen der neuen Generation bewusst als „tief und umfassend“ konzipiert. So sollen sie neben dem Abbau traditioneller Handelsbarrieren, wie etwa Zöllen und Quoten, vor allem andere handelsrelevante Themen in den Fokus nehmen. Zu diesen gehören Investitionsliberalisierung und -schutz, geistige Eigentumsrechte, das öffentliche Beschaffungswesen, Wettbewerbs- und Beihilfenrecht, sowie die nicht-tarifären Handelshemmnisse. Zu Letzteren gehören sanitäre Standards bei Lebensmitteln (SPS), technische Bestimmungen, aber auch Sektorregulierungen und administrative Verfahren. Dazu kommen noch als wichtiges Element moderner Handelspolitik laut EU Aspekte nachhaltiger Entwicklung, insbesondere der Schutz und die Förderung der Menschenrechte, internationaler Arbeitsstandards und der Umweltschutz.

Im Hinblick auf Verhandlungen mit Entwicklungsländern, sollen die Abkommen auch die besondere Situation und die Bedürfnisse dieser Länder berücksichtigen, um damit einen Beitrag zur Umsetzung entwicklungspolitischen Zielsetzungen der jeweiligen Länder zu leisten. Darin kommt die Anwendung des Prinzips der Politikkohärenz für nachhaltige Entwicklung zum Ausdruck, wie es zuletzt von der UN Agenda 2030 für nachhaltige Entwicklung vorgegeben und von der EU im neuen Europäischen Konsens für die Entwicklungspolitik bekräftigt wurde. Die Einschätzung der Auswirkungen von Handelsabkommen der neuen Generation hat daher vor allem anhand dieses Referenzrahmens zu erfolgen, und diesem Ansatz folgt auch die vorliegende Studie im Hinblick auf die Abkommen zwischen der EU und Tunesien.

In methodischer Hinsicht kombiniert die Studie quantitative mit qualitativen Ansätzen. Während die wirtschaftlichen Effekte der Handelsliberalisierung mit Hilfe von Simulationen mit dem ÖFSE Global Trade Model untersucht wurden, erfolgte die qualitative Untersuchung der Abkommen und der Herausforderungen in der Umsetzung in den untersuchten Ländern und Sektoren auf Basis einer Auswertung der Abkommenstexte, der wissenschaftlichen Sekundärliteratur, statistischer Daten sowie von Expert/inn/eninterviews in Tunesien. Die Interviews wurden mit Expert/inn/en aus staatlichen Einrichtungen, dem Privatsektor, der Zivilgesellschaft und der Wissenschaft geführt und ergänzen damit die anderen Datenquellen, welche für die Studie verwendet wurden.

Die Fallstudien umfassen die exportorientierten Sektoren Textilien & Bekleidung sowie Olivenöl, beides Sektoren von zentraler Bedeutung für den Außenhandel mit der EU.

Die Hauptidee und wichtigsten Politikempfehlungen der Studie lassen sich in den folgenden Punkten zusammenfassen:

1. Die Effekte der Handelsliberalisierung für Tunesien sind insgesamt negativ:

Aufgrund der Tatsache, dass die Zölle auf verarbeitete Produkte zwischen der EU und Tunesien schon im Rahmen des seit 1995 bestehenden Assoziierungsabkommens weitestgehend abgeschafft wurden, und damit der durchschnittliche Importzollsatz in Tunesien bereits auf rund 2% des Handelsvolumens gesunken ist, werden die Effekte des DCFTA hauptsächlich von den Zollveränderungen im Agrarbereich bestimmt. Letzter ist nach wie vor sowohl in der EU aber vor allem in Tunesien durch Zölle und Quoten geschützt. Im Fall einer vollständigen Liberalisierung der EU und Tunesiens werden daher vor allem die tunesische Getreideproduktion sowie der Bereich Lebensmittel und Getränke von höherer Importkonkurrenz durch EU-Produkte betroffen sein, während nur wenige tunesische Sektoren, insbesondere Pflanzenöle und Gemüse/Obst leicht profitieren können. Insgesamt wird das tunesische BIP im Fall einer vollständigen Zoll- und Quotenreduktion aufseiten beider Länder um 0,52% sinken. Wenn die EU daher ihren Ansatz, ein asymmetrisches Abkommen mit Tunesien zu erzielen, ernst meint, sollte sie einen differenzierten Zugang hinsichtlich bestimmter landwirtschaftlicher Sektoren wählen, um mögliche negative Effekte abzuschwächen. In diesen Fällen sollte die Gestaltung von großzügig gehaltenen Ausnahmebestimmungen für bestimmte Produkte und Sektoren der Landwirtschaft im Verhandlungsprozess gewährleistet werden. Des Weiteren würden Sektoren, welche durch die Handelsliberalisierung negativ betroffen sind und insbesondere dann, wenn dies so für den Lebensunterhalt von Bauern/Bäuerinnen und Verbraucher/innen wichtige Sektoren wie Getreide und Lebensmittel & Getränke betrifft, Anpassungshilfe benötigen, um die negativen Effekte abzufedern. Aufgrund der sektoral unterschiedlichen Arbeitsintensität der Produktion wird das durchschnittliche Beschäftigungsniveau weitgehend unverändert bleiben.

Aufgrund des stärkeren Schwerpunkts des DCFTA auf den Bereich der regulatorischen Harmonisierung wurden die Effekte der Angleichung von nicht-tarifären Handelshemmnissen (NTMs) ebenfalls untersucht. Auch wenn die NTM-Anpassung in langer Frist eine Kostenersparnis für tunesische Exporteure bedeutet, wird diese vor allem durch eine regulatorische Angleichung der tunesischen Standards an jene der EU passieren. Dies wird Anpassungskosten für die tunesische Wirtschaft zur Folge haben. Die regulatorische Angleichung an EU-Standards sollte daher von der EU im Rahmen ihrer ‚Aid for Trade‘ Programme unterstützt werden.

2. Der Verlust öffentlicher Einnahmen wird Tunesien negativ betreffen und erfordert Unterstützungsmaßnahmen der EU:

Im Fall Tunesien müssen die Auswirkungen von Zollsenkungen auf den öffentlichen Haushalt berücksichtigt werden. Eine Zunahme des Budgetdefizits von bis zu einem Prozent des BIP im Falle einer vollständigen Liberalisierung der Zölle auf EU-Importe ist möglich. Angesichts der bestehenden fiskalischen Lage, in der das Land bereits makrofinanzielle Hilfe vonseiten des IWF und der EU in Anspruch nehmen muss um sein Budgetdefizit unter Kontrolle halten zu können, stellt dies kein zu vernachlässigendes Problem dar. Das Defizit erreichte 6% des BIP im Jahr 2016 und ein kurzfristiger Abbau ist nicht absehbar. Kurz- und mittelfristig sollte eine Handelsliberalisierung durch zusätzliche Budgethilfe seitens der EU begleitet werden. In langfristiger Perspektive sollte die EU im Rahmen von ‚Aid for Trade‘ Programmen Maßnahmen zur Verbreiterung der Steuerbasis im Land unterstützen..

3. Die Förderung von Exportsektoren braucht aktive Politiken für Upgrading:

Zur Förderung von Wachstum und Beschäftigung im Kontext von Handelsliberalisierung ist es wichtig, die Möglichkeiten zur Steigerung der Exporte in ausgewählten Sektoren in

den Blick zu nehmen. Auf Basis einer eingehenden Untersuchung der führenden Exportsektoren Olivenöl sowie Textil & Bekleidung verweist unsere Untersuchung auf die Notwendigkeit wirtschaftspolitischer Interventionen in zwei prioritären Handlungsfeldern:

- a) *Exportpotenziale für Nahrungsmittel brauchen Investitionen in Weiterverarbeitung, Markenbildung und qualitativer Infrastruktur:* Da die meisten globalen Wertschöpfungsketten für agrarische Produkte und Nahrungsmittel käufer-orientiert sind, braucht es einen Ansatz zur Erhöhung von Exportumsätzen, der darauf abzielt, die Wertschöpfung pro exportierter Einheit zu steigern. Dies ist vor allem sinnvoll, wenn weitere Steigerungen von Exportmengen aufgrund der natürlichen Produktionsbedingungen, z.B. aufgrund von Wasserknappheit, nur beschränkt möglich sind, oder zu negativen Umweltauswirkungen beitragen. Export-orientierte Aktivitäten zur Steigerung der Wertschöpfung (upgrading), zum Beispiel im Bereich der Abfüllung von hochwertigem Olivenöl in Flaschen für Endverbraucher/innen, benötigen jedoch nicht nur Investitionen in Produktionsstätten, sondern vor allem Marketing und Markenbildungsstrategien, um den Zugang zu Abnehmern zu finden und den Bekanntheitsgrad bei Endverbraucher/innen zu steigern. Die Handelspolitik kann solche Upgradingprozesse unterstützen, sowohl durch erleichterten Marktzugang aufgrund der Reduktion von Zöllen und Quoten, als auch vor allem durch Unterstützung zur Erreichung sowohl von öffentlicher Gesundheits- und Hygienestandards als auch von privaten Standards und Zertifizierungen, etwa für biologische Produkte, wie sie von Abnehmern wie z.B. Supermärkten verlangt werden.
- b) *Die Förderung von Upgrading und der Textilproduktion ist von strategischer Bedeutung im Bekleidungssektor:* vor dem Hintergrund voranschreitender Präferenzerosion im Bekleidungssektor – indem immer mehr Länder aufgrund der Ausweitung von FTAs bevorzugten Marktzugang erhalten –, verringerter Produktionszeiten und dem Trend zu ‚fast fashion‘, wird die nachhaltige Wettbewerbsfähigkeit der Bekleidungsindustrie in Zukunft nicht mehr allein auf billigen Lohnkosten und DFQF-Marktzugängen beruhen, sondern zunehmend von der Verfügbarkeit eines flexiblen und qualitativ hochwertigen Produktionssystems, das von der Herstellung von Garnen und Stoffen, der Verfügbarkeit von Accessoires und spezifischen Dienstleistungen bei der Endbearbeitung von Textilien, bis zu modernen Logistik und Transportdienstleistungen reicht. Die Bekleidungsindustrie in Tunesien sollte daher ihre Anstrengungen intensivieren, sich als leistungsfähige und qualitativ hochwertige Produzenten international zu positionieren, die sich weg von der Rolle als Lohnfertiger von Bekleidung (CMT – cut, make and trim) hin zu wertschöpfungsintensiveren Produkten unter Ausnutzung lokaler Vorleistungen entwickeln. Dafür erforderlich sind Investitionen für den Auf- und Ausbau einer lokalen Textilproduktion, aber auch das Bereitstellen von anderen Dienstleistungen. So zum Beispiel die Verfügbarkeit von Betriebskapital für die FOB-Produktion, günstige Finanzierungskredite und die Förderung von Ausbildungsmaßnahmen für Arbeitskräfte.

4. Förderung nachhaltiger Entwicklung durch die Handelspolitik braucht kohärente und kontextabhängige Strategien

Nachhaltige Entwicklung, wie von der UN Agenda 2030 definiert und vom Europäischen Konsens für Entwicklungspolitik bekräftigt, zielt auf die Förderung von wirtschaftlicher Entwicklung ab, die sozial inklusiv ist, die ökologischen Grenzen des Planeten respektiert und Frieden und Demokratie unterstützt. Handelsliberalisierung sollte daher primär als ein Mittel zur Erreichung des Ziels der nachhaltigen Entwicklung begriffen werden. Aufgrund spezifischer geografischer Bedingungen, ökonomischer Strukturen, politischer und institutio-

neller Systeme, sind die Auswirkungen von Handelsliberalisierung je nach Land unterschiedlich, und es kann nicht generell davon ausgegangen werden, dass die Effekte ausschließlich positiv sind, weder gesamtwirtschaftlich noch auf Ebene einzelner Sektoren. In Übereinstimmung mit dem Prinzip der Politikkohärenz für nachhaltige Entwicklung sollte Handelspolitik daher auf die Spezifika der Partnerländer eingehen und die handelspolitischen Maßnahmen dementsprechend abstimmen. Die Kapitel zu Nachhaltigkeit sind in diesem Zusammenhang ein wichtiger Schritt, allerdings müssten diese durch sämtliche Artikel des Vertragstexts hindurch berücksichtigt werden. Außerdem, sofern diese Kapitel – wie im Falle anderer EU Handelsabkommen (z.B. EVFTA zwischen EU-Vietnam) – bereits existieren, sind sie in ihrer Ausformulierung verhältnismäßig schwach und der politische Wille, sie zu implementieren und die notwendigen Dialogprozesse zu finanzieren, ist bislang auf beiden Seiten wenig ausgeprägt.

Inmitten eines schwierigen regionalen Umfelds befindet sich Tunesien derzeit in einem komplexen und langwierigen Prozess des Aufbaus eines demokratischen Systems und dessen Konsolidierung. Daher empfiehlt die vorliegende Studie, den handelspolitischen Ansatz der EU im Rahmen der DCFTA-Verhandlungen dahingehend anzupassen, dass die Sicherung der sozio-territorialen Kohäsion und die Erzielung kurzfristiger ökonomischer Vorteile für die schwächelnde Wirtschaft des Landes ins Zentrum gestellt werden.

1. INTRODUCTION

The EU has recently concluded or is currently in the process of negotiating a number of bilateral free trade agreements with both industrialized countries, e.g. Japan, and developing as well as emerging economies. Negotiations with the latter group include Tunisia, where negotiations on the Deep and Comprehensive Free Trade Area (DCFTA) were formally launched in October 2015. Until July 2018, two negotiation rounds have taken place and the conclusion of the agreement is expected for 2019.

Based on the EU trade strategy “Trade for All. Towards a more responsible trade and investment policy”, published in October 2015, these so-called new generation bilateral trade agreements are deliberately designed as ‘deep and comprehensive’ (EC 2015). In other words, while also targeting remaining traditional trade barriers, such as tariffs and quotas, above all they aim at tackling other issues that are deemed relevant for trade. Amongst these figure investment liberalization and protection, intellectual property rights, public procurement, competition law and state aid, as well as non-tariff-measures. The latter include SPS-standards, technical barriers to trade, but also sector regulation and administrative procedures. In addition, it is emphasized by the EU that sustainable development aspects, in particular as they relate to human rights, labor standards as well as environmental aspects also need to be integrated into modern trade policy.

The new EU approach to trade policy has however not remained uncontested. In relation to the now suspended negotiations on a FTA between the EU and the US, the so-called Transatlantic Trade and Investment Partnership (TTIP), as well as to the negotiations between the EU and Canada on the Comprehensive Economic and Trade Agreement (CETA), various stakeholders from EU civil society have both criticized the negotiation process and also voiced concerns with respect to the substantive provisions of the new generation agreements.

As is also stressed by the EC, trade liberalization in the extended definition of the new EU trade agenda must promote sustainable development both in the EU and the partner countries, i.e. economic growth that is socially inclusive and respects ecological boundaries. Furthermore, in the case of trade negotiations with developing countries, the agreements should also take into account the specific situation and needs of these latter countries, so as to be complementary and supportive of their development priorities. In other words, adherence to the principle of policy coherence for sustainable development (PCSD), as recently defined by the UN Agenda 2030 for Sustainable Development and subsequently adopted by the new European Consensus on Development, is required.¹ New generation FTAs are therefore primarily to be assessed against this yardstick, which is the approach adopted in this study with respect to the EU FTA with Tunisia (DCFTA).

The methodological approach of this report combines both quantitative and qualitative methods. While the economic assessment is based on simulations with the ÖFSE Global Trade Model, a structuralist Computable General Equilibrium model, the qualitative analysis on the agreement and its implementation challenges as well as the case studies draw on text and data analysis, a literature review and interviews in Tunisia. The interviews were

¹ For the UN 2030 Agenda for Sustainable Development see: http://www.un.org/ga/search/view_doc.asp?symbol=A/RES/70/1&Lang=E; for the new European Consensus on Development see: http://www.consilium.europa.eu/en/press/press-releases/2017/06/pdf/European-Consensus-on-Development-2-June-2017-Clean_final_pdf/ (12.07.2017).

conducted with diverse stakeholders from the government, the private sector and civil society, and complement other data sources used throughout the report (see a list of interviewees in Appendix).

The report assesses the DCFTA between the EU and Tunisia, starting with an economic overview and an analysis of the trade patterns between the EU and Tunisia (Section 2). In the following section, the key contents of the FTAs are assessed (Section 3). This includes a detailed analysis of the market access offer and other key issues, as well as a discussion of the trade and sustainable development aspects of the respective agreement, and finally of EU development cooperation in the partner country. Due to the on-going negotiations of the DCFTA with Tunisia, the discussion in Section 3 is necessarily based upon the published initial EU textual proposals and thus reflects a very preliminary state of affairs. In its discussion of the potential trade liberalization and the likely key issues of the DCFTA, it hence focusses particularly on issues that are deemed relevant for the further negotiation process. Section 4 analyzes the economic implications of the FTAs on Tunisia. The section starts with an assessment of the potential economic impacts of the agreement, based on simulations with the ÖFSE Global Trade Model. Based on interviews with stakeholders and field research in the partner country, negotiating concerns and implementation challenges associated with the agreement are detailed in the subsequent sections. Further, different sectoral case studies are analyzed in order to investigate the potential of the DCFTA on the export side, highlighting the opportunities and challenges for export promotion policies in the context of global value chains and related lead firm strategies as well as local competitiveness conditions. The sectoral case studies include the textile and apparel sector as well as the olive oil sector in Tunisia.

Section 5 provides a summary of the main findings with respect to economic impacts, the sectoral case studies and the sustainability concerns. Upon that basis, key policy recommendations are proposed in the areas of adjustment assistance and productive development promotion.

2. TUNISIA: ECONOMIC OVERVIEW AND TRADE RELATIONS

Tunisia has experienced a long period of solid and stable economic growth up to the Arab Spring in 2011. GDP growth rates averaged 5% in the 1990s and 4.3% between 2000 and 2011. The manufacturing and service sectors contributed largely to this upswing, also due to the strong influx of foreign investment. Tunisia's economy showed strong resilience to the global and European economic crises starting in 2008/09. The economic complexity of Tunisian exports, measured by the Economic Complexity Index (ECI), reflects this structural change of the Tunisian economy. Tunisia increased its country ranking from 71st in 1995 to 48th in 2011 and 2012 (The Atlas of Economic Complexity 2015). Thus, Tunisia ranked higher than other peer countries in Northern Africa such as Morocco and Egypt in the ECI, but lower than other middle-income countries such as Malaysia (IMF 2016).

Since the Arab Spring in 2011, Tunisia has gone through a political transition and has experienced significant social uncertainty and a difficult security situation. Despite real GDP growth and further FDI inflows between 2012 and 2014, the economic dynamic has slowed down significantly and international institutions, in particular the IMF and the EU, provided substantial financial support (ECA 2017) after the 2011 revolution. The current account deficit widened drastically after 2011 to around 9% of GDP in 2014/15 – the highest level since the 1980s (Table 1). In particular, the tourism sector – Tunisia's most important service export sector – suffered from terrorist attacks in 2015. In addition, high levels of unemployment (around 15% in 2016/17) and risks in public budgeting are seen as major challenges for the expected recovery (IMF 2016). On a global scale, Tunisia was re-classified by the World Bank as a lower middle income country in 2014 and therefore lost its status as higher middle income country, which Tunisia had achieved in 2010.

Table 1: Key economic indicators of Tunisia

	2010	2011	2012	2013	2014	2015
Nominal GDP (current TND, billion)	63.1	64.5	70.4	75.2	80.8	84.4
Nominal GDP (current USD, billion)	44.1	45.8	45.0	46.3	47.6	43.0
GDP per capita (current USD)	4,140	4,258	4,140	4,203	4,277	3,822
Real GDP growth (annual %)	3.5	-1.9	4.0	3.0	2.9	1.0
Inflation, consumer prices (annual %)	4.4	3.5	5.1	5.8	4.9	4.9
Current account (net, % of GDP)	-4.8	-7.4	-8.3	-8.4	-9.1	-8.9
Foreign direct investment, net inflows (% of GDP)	3.0	0.9	3.5	2.3	2.2	2.2
Exchange rate (TND per USD, period average)	1.4	1.4	1.6	1.6	1.7	2.0

Source: WB-WDI 2017

With regard to trade, Tunisia's economic development is largely influenced by the economic outlook of its major trading partners, in particular the EU. With an average share of 77% between 2000 and 2015, the EU is the major destination for Tunisia's exports in goods. Exports to the Middle East and Northern Africa (MENA) region have gained more significance lately and accounted for 10.9% of merchandise exports in 2015. On the import side, the inflow of goods from the EU has decline from 71.7% in 2000 to 55.7% in 2015. In particular, imports from East Asian countries have increased to a share of 12.7% in 2015 (Table 2).

Table 2: Tunisia's merchandise trade by destination and origin (shares in %)

Export	2000	2005	2010	2015	Imports	2000	2005	2010	2015
EU	80.3	80.1	73.2	74.6	EU	71.7	69.7	61.2	55.7
MENA	8.4	9.3	10.9	10.9	MENA	8.0	7.8	7.9	8.9
East Asia	0.7	0.7	1.0	1.0	East Asia	5.5	6.6	10.8	12.7
SSA	0.8	1.3	2.4	2.5	SSA	0.6	0.5	0.4	0.5
Turkey	0.9	1.0	1.3	0.7	Turkey	1.8	2.3	2.8	3.9
North America	0.8	1.0	0.8	0.7	North America	4.9	2.7	4.5	3.9
Russia	0.1	0.0	0.0	0.0	Russia	1.9	2.8	4.7	4.0

Source: UN Comtrade 2017

Due to the diversification with regard to countries of origin on the import side, Tunisia's trade deficit in goods with the EU declined in absolute terms from EUR 1.7 billion in 2000 to EUR 1.2 billion in 2015 and also relative to the trade volume. In particular, intra-sectoral trade in electronic machinery and equipment (HS 85) increased significantly resulting in a surplus for Tunisia. Other major export goods from Tunisia to the EU include apparel, footwear and mineral fuels. Processed mineral fuels, machinery and motor vehicles dominate the import side (Table 3).

Table 3: EU-Tunisia trade by products (million EUR, HS 2 level)

		2000	2005	2010	2015
Total EU-Imports from Tunisia		5,569	6,827	9,539	9,489
HS Code	Product				
85	Electrical Machinery and Equipment	755	1,137	2,442	2,957
62	Apparel, not knitted	1,972	1,814	1,645	1,426
61	Apparel, knitted	612	655	687	569
27	Mineral Fuels	490	809	1,493	605
64	Footwear	321	356	488	395
Total EU-Exports to Tunisia		7,322	7,935	11,097	10,698
HS Code	Product				
85	Electrical Machinery and Equipment	768	1,054	1,810	1,769
27	Mineral Fuels	473	911	1,107	1,094
84	Machinery	966	918	1,287	1,009
87	Motor Vehicles	600	528	792	743
39	Plastics	243	347	511	601

Source: Eurostat 2017

Trade in services has developed to an important source of export earnings for Tunisia until recently. In particular, the sectors travel, communication services and other business services showed trade surpluses. Overall, the surplus in services trade (USD 1.6 billion in 2013) rebalanced the deficit in merchandise trade to some degree. However, with the breakdown in export revenues from tourism and transportation, the positive contribution from service exports to the overall current account balance disappeared almost entirely in 2015 (UN Comtrade 2017).

3. ASSESSMENT OF KEY CONTENTS OF THE DCFTA

Negotiations on the DCFTA started in October 2015. So far, only one negotiation round in April 2016 has taken place, and, as of July 2017, no schedule for the negotiations has been agreed upon. Similar to other recent EU trade agreements, the DCFTA is a 'deep and comprehensive' trade agreement. The currently published textual proposals for the DCFTA (June 2017) suggest 11 chapters, including a trade in agricultural and fisheries products chapter and topics directly affecting trade flows (e.g. TBT, SPS, RoO, etc.) as well as chapters on services, investment, government procurement, competition, intellectual property rights and sustainability. Given the substantial trade flows between Tunisia and the EU and the latter's role as a source of FDI to the country, the DCFTA has an important role for the future development of the Tunisian economy. The focus of this chapter is to analyze the key contents of the DCFTA with a focus on provisions that directly affect trade in agricultural and manufacturing goods. However, the analysis is constrained by the fact that progress in the negotiations has so far been very limited.² Thus, precise information on the specifics of negotiating offers and requests is so far lacking. Any assessment exercise has hence to be considered preliminary and provisional. Given that current DCFTA negotiations depart from the basis of an active bilateral trade relationship during the last decades, we will first consider the recent evolution of that bilateral relationship.

3.1. Bilateral trade relations prior to the DCFTA

An important legal base for bilateral trade between the EU and Tunisia was set in 1976 with a cooperation agreement. In order to foster the Tunisian exports, the EU granted tariff free access for almost all Tunisian industrial products except certain textiles. With the expansion in terms of member states and functions, the EU aimed for closer cooperation and integration with neighboring countries. Thus, Tunisia concluded an Association Agreement (AA) in 1995 with the EU. The three main features of the Agreements include: (1) the liberalization in merchandise trade, in particular in industrial goods, (2) the harmonization of Tunisia's regulatory framework including norms and standards, trade-related policies, rules on competition and intellectual property rights, and (3) enhanced cooperation on economic, social and ecological issues (De Bock et al. 2010).

While all tariffs and quotas on industrial goods were dismantled over a 12 year implementation period starting in 1998 with a quicker and more extensive market opening by the EU, the remaining trade barriers in agricultural sectors were reviewed in 2001. For selected agricultural products concessions on quotas were agreed, for instance on olive oil (Boughzala, 2010). Today, tariff protection or quotas exist only in agricultural sectors. The level of ad-valorem equivalents of tariffs and quotas is generally higher on imports from the EU to the Tunisian market (see Table 4).

² All information on the initial textual proposals for the 11 chapters is taken from the DG Trade website on the DCFTA negotiations, see <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1380> (10.07.2017)

Table 4: Import Tariffs and Quotas in bilateral EU-Tunisia Trade (2015)

Tunisia		EU	
Tariffs on imports from the EU (in %)		Tariffs on imports from Tunisia (in %)	
Total goods imports	1.7	Total goods imports	0.6
1 - Raw materials	12.6	1 - Raw materials	0.5
2 - Intermediate goods	0.4	2 - Intermediate goods	3.6
3 - Consumer goods	1.0	3 - Consumer goods	0.2
4 - Capital goods	0.0	4 - Capital goods	0.0
by Sectors		by Sectors	
Animal	32.7	Vegetable	21.1
Vegetables	26.7	Foods	5.3
Foods	11.2	Animal	0.0
Textile Clothing*	1.2	Chemicals	0.0
Chemicals	0.0		

Notes: Classification (by type of product) based on World Custom Organization (WCO); Classification by sector based on Harmonized System (HS); Quotas are included as Ad-Valorem Equivalents. Tunisian tariff data exclude data from Eastern and Central European countries as UNCTAD TRAINS still reports tariffs on products from these countries.

* Tariffs on carpets/other floor coverings and worn clothing

Source: UNCTAD TRAINS

In addition to the bilateral trade agreements, Tunisia is member of the Euro-Mediterranean partnership between the EU and 11 Mediterranean countries, which aims for trade liberalization and cooperation in connection with the EU and among the non-EU members. This also includes specific RoO which aim for the development of more regional integrated value chains (see also case study III on textile and apparel in Tunisia).

The development cooperation between the EU and Tunisia has been enhanced via financial support of the upgrading program '*Mise à Niveau*' as part of the Association Agreement and has targeted programs in the framework of the European Neighborhood Policy since 2005. Since the start of the political transition in 2011, financial support and cooperation has been intensified further, in order to stabilize the political and economic situation in Tunisia.

Finally, the progress in harmonization of the regulatory framework in Tunisia towards the one in place in the EU has been limited, as indicated by the negotiation proposals for the DCFTA by the EU. In particular, the regulatory approximation and the reduction of non-tariff barriers in all sectors are a key objective of the DCFTA.

3.2. Market access offer

Trade in manufactured as well as partly in agricultural goods is governed by the AA, which the EU and Tunisia signed in 1995. This agreement established a free trade area, which focused on eliminating customs duties for industrial products. The AA envisaged that the EU and Tunisia undertake further trade liberalization in respect of agricultural, processed agricultural and fisheries products. Since this liberalization has been limited so far, the EU and Tunisia have decided to include them within the broader DCFTA exercise. Thus, with respect to tariff and quota liberalization, the DCFTA will clearly focus on agricultural products.

While trade in manufactured products has thus been already liberalized with trade weighted average duties at 1.7% for Tunisia and 0.6% for the EU subsidizing at already very low levels, trade in agricultural products is still subject to tariff and quota restrictions. As illustrated in Table 4, Tunisia is levying tariff rates of up to 33% on imports of animals and animal products from the EU, while tariff rates on the EU side peak at 21% for vegetables, and some other products, in particular olive oil, are still subject to tariff rate quotas.

According to the DCFTA textual proposal, tariff and quota liberalization will be comprehensive and ambitious, but asymmetrical. The latter refers in particular to transition periods of up to 10 years granted to Tunisia, while it should be noted that the burden of effective tariff and quota liberalization rests mostly with the Tunisian side. With respect to sectors and product lines covered, a negative list approach will be applied. In other words, sensitive products will have to be included in a list of exemptions. More specifically, negotiations will thus focus on (i) establishing a list of sensitive products, (ii) the treatment of these sensitive products, in particular the fixation of tariff rate quotas, (iii) the liberalization schedules for the sensitive products, and finally (iv) adjustments to the entry price regime.

Although currently no precise information is available with respect to the extent and scope of liberalization envisaged by the negotiating parties, it should be noted that tariff liberalization is already at a very high level. 93.6% of the value of EU imports entering Tunisia DFQF, and 97.3% of the value of Tunisian exports enjoy DFQF access to the EU market (own calculation, based on UNCTAD TRAINS data). Given the high level of already achieved liberalization, the macroeconomic effects of further tariff elimination will thus be small, even though single products or sectors can be affected more substantially.

3.3. Key issues

Like all FTAs, the DCFTA will also reduce the **policy space** for economic policies in signatory countries. The FTA between the EU and Vietnam (EVFTA), for example, includes a non-revisable standstill-clause (Chapter 2: Article 7), a national treatment provision in accordance with Article III of the GATT 1994 (Article 12) and a limitation on the application of export taxes (Article 9). Article 9 of the EVFTA states that no new export taxes shall be introduced and existing export taxes shall be reduced within a maximum of 16 years, however, export taxes on specific goods are excluded or are only partially affected (esp. various resources such as ore, gold and oil) (see also Grumiller et al. 2018). It is thus likely that the EU will adopt a similar approach in the DCFTA with respect to the standstill-clause and export taxes, though no specific information is available at this stage.

According to the EU textual proposal,³ the scope for applying **trade defense instruments** in the DCFTA is subject to disciplines. The EU textual proposal states that the EU intends to (i) clarify and simplify certain provisions of the existing Association Agreement; (ii) increase the transparency of trade defense procedures; (iii) improve the exchange of information and the quality of the documents relating to each stage of an investigation; and (iv) ensure mutual market access on fair terms, by choosing the least disruptive measures (safeguard instrument); and finally and perhaps most significantly, (v) share certain practices that go beyond minimal WTO requirements, in particular applying the lesser-duty rule and the public interest test.

Under a lesser-duty rule, authorities impose duties at a level lower than the margin of dumping but still adequate to remove injury. Thus, the lower duty would help reduce the burden on the downstream industry, which has to pay a higher price for its inputs because

³ See http://trade.ec.europa.eu/doclib/docs/2016/april/tradoc_154490.pdf (10.07.2017)

of the anti-dumping duty. The public interest test goes in the similar direction of avoiding excessive economic costs for downstream industries. Here, the benefit of a trade defense measure for the affected industry is compared to the disadvantages arising for the downstream industry. Consequently, a measure less trade restrictive than a duty might be applied (e.g. a quota). Given the fact that state-owned enterprises in Tunisia are highly concentrated in primary production industries, while the sectors with high shares of foreign ownership (mostly from the EU) are down-stream industries, in particular apparel as well as electrical machinery and equipment, as a tendency these stipulations would thus favor the latter industries over the former. In the textual proposal, no economic justification is provided by the EU for this proposal other than aligning Tunisian to EU trade practices.

Changes in the **rules of origin** (RoO) may also have important impacts on trade relationships. In general, strict RoO limit the flexibility of companies to source their inputs in order to qualify for DFQF exports to the EU. In the case of Tunisia, this is of particular relevance for the textile and apparel sector. So far, however, no negotiating proposal for RoO has been put onto the table by the EU. Arguably, this has to do with the existing framework for RoO between the EU and its Southern and Eastern neighbors. Currently, RoO regulations are governed by the Regional Convention on Pan-Euro-Mediterranean Preferential Rules of Origin (PEM Convention). This convention allows for diagonal cumulation between the EU, EFTA, the Western Balkan States, Turkey, the Faroe Islands as well as the signatory states to the Barcelona Declaration. Provided for that it has itself an FTA with these countries, it is already possible for Tunisia to source inputs from all these countries for domestic processing to export products DFQF to the EU market (EC 2015a). In addition, between the EU, Tunisia, Algeria and Morocco the principle of full cumulation can be applied. It is the declared intention of the EU to harmonize the existing PEM regulations further in a revised framework that aligns the RoO regulations for the EuroMed region with the respective regulations of its stabilization and association agreements (Dorey 2014). Consequently, if the EU intends to grant Tunisia any specific bilateral RoO treatment within the DCFTA, such concessions will have to be eventually extended to all other bilateral EU partners under the common RoO regulations. This makes it unlikely that the EU will extend a far-ranging negotiating offer on RoO in the DCFTA. It is thus possible that the expectations of Tunisia with respect to the introduction of single transformation for Tunisian apparel exports will be disappointed (see case study III for a detailed discussion), since the EU would have to extend any such offer to the other countries under the PEM convention. Even if introduced, any such offer would thus only confer a temporary advantage to Tunisian apparel exporters.

The DCFTA also will include **chapters on TBT, SPS, customs and trade facilitation** issues as well as **transparency** with the goal to enhance market access and trade between the parties. This shall be achieved by either (i) cooperation between the parties, (ii) alignment to international standards, or (iii) alignment to the EU regulatory framework. Though arguably advantageous for the Tunisian economy in the long run, the implementation of these issues will put the burden of adjustment on Tunisia, since the EU regulatory regime is either the benchmark or the EU already applies the relevant international standards. Consequently, support from the EU in order to modernize the respective technical infrastructure for conformity assessments, certification procedures etc. as well as improving the capacities of the competent administrative bodies will be important both for timely implementation and for improving market access for e.g. Tunisian agricultural export products.

The DCFTA also contains a rather extensive chapter on the liberalization of **services and investment**.⁴ Liberalization of services, in particular cross-border provision of services (Mode 1), as well as investment liberalization shall be pursued via a negative list approach. In addition, the EU demands the harmonization of sector regulations for (i) computer services, (ii) postal and courier services, (iii) financial services, (iv) electronic communications, (v) international maritime transport, and (vi) tourism services. Effectively, this will require the alignment of Tunisian regulations to the EU regulatory framework in the respective sectors. A detailed analysis of the potential implications of these proposals for regulatory alignment goes beyond the scope of this study. During negotiations, due attention should however be paid to safeguarding the social and public policy objectives of regulation in the sectors concerned. This is particularly pertinent for services of general (economic) interest like postal and courier services, which besides providing infrastructure services to the economy are also important for social and territorial cohesion.

While in general, the EU proposes an ambitious and progressive liberalization of services, audio-visual services, several air transport services as well as subsidies shall be exempted from any liberalization obligations. Similarly, the EU proposal on Mode 4 (temporary presence of services suppliers) does not go beyond defining general principles and reiterating the right of the parties to define their entry regimes. As far as specific types of Mode 4 service suppliers are concerned, the text contains the standard provisions for intra-corporate transferees (ICTs: managers, specialists, trainees), business visitors (BVs) and contractual services suppliers (CSS), however without specifying any numerical ceiling with respect to the number of services suppliers allowed to enter the EU under the agreement. So far, no proposal for independent professionals (IPs) is included, besides CSS arguably the category with the highest commercial value for Tunisia. Given that Tunisia's nascent business service industries, in particular in information technology and communication services, depend on easy access to the EU for effective service delivery, expectations towards the respective Mode 4 offer are high on the side of Tunisia (Marrakchi Charfi (n.d.b.): 6).

The DCFTA also includes a chapter on investment liberalization, which will replace the existing 17 bilateral investment treaties with EU Member States. Besides the standard definitions on what constitutes an investment, the chapter enshrines the principles of MFN-treatment as well as market access and national treatment for investors. However, a proposal on investment protection is still missing. Against the background of the recent controversial debate in the EU on ISDS and the new Commission proposal for an investment court system (ICS), an offer similar to the EVFTA and CETA investment chapters should eventually be expected with regard to investment protection.

Given that with a total FDI stock of EUR 4 billion, the EU is by far the most important source of FDI for Tunisia, the investment chapter bears a certain importance for the future development of bilateral economic relations. Because of the political regime change in 2011, FDI inflows have slowed down markedly, which has made the relative importance of EU FDI, now accounting for 70% of total FDI stock, even more pronounced. The most important EU sources of FDI are France, Italy and Germany. FDI is concentrated in electrical machinery and equipment, textiles and apparel, as well as metals and chemical products. Because of the slow-down of FDI, the Tunisian government has stepped up its efforts to improve investment conditions in the country by in particular introducing a new investment code (*Loi sur l'investissement 2016*), which entered into force on 1 April 2017. The new

⁴ For the textual proposal see http://trade.ec.europa.eu/doclib/docs/2016/april/tradoc_154487.pdf (10.07.2017)

code abolishes or alleviates certain restrictions for investors, for instance by making it possible to purchase land for non-agricultural purposes, or by reducing quota requirements for the employment of Tunisian nationals in the management of foreign owned enterprises. In addition, it strengthens the protection of property rights of investors and legally enshrines possibilities for preferential treatment of foreign investors in terms of tax and other incentives (Invest in Tunisia 2016).

Though the full implementation of the investment code is still pending, and thus the benefits conferred upon investors still need to materialize, it is doubtful whether the DCFTA investment chapter will add much in terms of additional material privileges for investors. Instead, the rights unilaterally granted under the new investment code will become enshrined as international obligations. While this will confer a layer of additional safety to investors, it should be emphasized that the short-term conditions for investment are largely determined by the political and economic situation in the country. Unfortunately, for the time being the latter remain fragile in particular because of persisting threats to public security posed by militant fundamentalism. This has severely damaged the important tourism industry and will likely hamper economic recovery in the near future.

The EU has also proposed to liberalize **public procurement** under the DCFTA. The EU proposal aims in particular at (i) integrating into the DCFTA selected provisions of the WTO Government Procurement Agreement (GPA); (ii) agreeing on rules to maximize transparency in the publication of tenders for public contracts; and (iii) enabling EU and Tunisian firms to participate in public tenders at all levels of government (i.e. at both central and regional level), without facing discrimination. To this end, *de-minimis thresholds* shall be defined, above which the provisions of the chapter have to be applied. By including government entities at all levels and demanding strict non-discrimination, the EU proposal is rather ambitious. While allowing EU companies to participate in public tenders in Tunisia *at a par* with local companies will arguably increase competition and thus reduce costs for the public sector, the effect will likely be asymmetrical in attracting more EU companies to compete in the Tunisian procurement market than vice versa. This ultimately might drive Tunisian companies out of business and increase unemployment in a country where unemployment is already at very high levels. Besides, using public procurement for regional policy and supporting the local economy, as is frequently done by the governments of developing as well as industrialized countries, will become more difficult. Given both the high level of unemployment and the strong asymmetries in territorial economic development between the coastal and interior regions of Tunisia, similar to the case of the EVFTA, the DCFTA negotiations should at least allow for certain flexibilities for local governments and other sub-central entities, either through outright exemptions or generous *de-minimis* thresholds. Alternatively, it might bind non-discriminatory participation in public tenders to the requirement for establishment of foreign companies in the country in order to foster local employment creation. In terms of addressing existing competitive disequilibria between Tunisian and EU companies, preferential price margins in favor of domestic companies should be introduced, similar to the respective provisions proposed in the EU-Mercosur negotiations.

The DCFTA will also contain a chapter on **competition and state aid**.⁵ Since such a chapter was already part of the AA, the DCFTA aims at updating the existing provisions by in particular (i) completing and clarifying the provisions in force, and (ii) having in place an antitrust and merger legislation in line with the EU *acquis*. However, the negotiating

⁵ For the textual proposal see http://trade.ec.europa.eu/doclib/docs/2016/april/tradoc_154481.pdf (10.07.2017).

proposal also goes further by demanding (i) to set up an operationally independent Tunisian competition authority with sufficient resources and powers to ensure effective enforcement of competition rules; by (ii) having in place state aid legislation in line with the EU *acquis* and setting up an operationally independent state aid authority in Tunisia, and by (iv) phasing out within a period of five years any discriminatory privileges conferred upon public monopolies as well as public companies and companies with exclusive rights. Against the historical background of a large sector of state-owned enterprises (SOEs), for instance in the extractive industries, banking and public utilities, harmonizing competition and state aid rules to the EU *acquis* is not only demanding on a technical level, but a politically sensitive issue for the Tunisian government. For instance, state aid to loss-making SOEs in the extractive sector is an issue that above and beyond considerations of economic efficiency involves delicate political trade-offs. Such companies may offer scarce employment opportunities in economically backward areas of the country, which furthermore are prone to infiltration by militant fundamentalists trying to attract disenchanted adolescents to their cause. Thus, although the economic case for subjecting state aid to certain disciplines is generally accepted, the exceptional economic and political situation of Tunisia needs to be taken into account when negotiating the chapter. This might be accomplished by either introducing certain exemptions from the application of the state aid provisions for particular sectors and regions, respectively, or specific SOEs, on a temporary or a permanent basis.

3.4. Chapter on trade and sustainable development

As has been the case with all new EU trade agreements since the EU – Korea FTA in 2011, the DCFTA will also contain a chapter on trade and sustainable development.⁶ The provisions of this chapter as proposed by the EU are in conformity with the standard template used for all recent new generation trade agreements. Thus, provisions cover the ILO core labor standards, multilateral environmental agreements as well as a monitoring mechanism (for a comprehensive discussion of the elements of the standard template see section 3.3. on the case of the EVFTA).⁷

The recent academic discussion on the EU trade and sustainable development chapters has scrutinized the efficacy of these chapters and highlighted some of the main challenges for effective implementation.⁸ These relate for instance to the discrepancy between focusing on the ILO core labor standards and the real problems on the ground, the latter often pertaining to issues not covered by the ILO Core Labor Standards (CLS), such as e.g. health and safety standards, wage levels or working time regulations. Similarly, the focus on dialogue and cooperation as the main implementation mechanism becomes ineffective in situations of severe conflict between governments and trade unions, where recourse to dispute settlement and/or sanctions would be needed. Alternatively, where interest representation via trade unions or civil society organizations is not possible due to low rates of membership. Finally, the effective operation of the civil society consultations needs institutional and financial support and thus a more pro-active commitment from the EU (Campling et al. 2016). Aid for trade programs could for instance be used to support the

⁶ For the textual proposal see http://trade.ec.europa.eu/doclib/docs/2016/april/tradoc_154482.pdf (10.07.2017)

⁷ As of now (February 2018), it is not clear, in which way human rights will enter the DCFTA agreement. The textual proposal on the TSD chapter does only refer to human rights by way of the ILO core conventions.

⁸ See a summary of the recent ESRC-funded project entitled “Working beyond the Border: European Union Trade Agreements and International Labour Standards” at: <http://www.geog.qmul.ac.uk/media/geography/docs/research/working-beyond-the-border/Governing-Labour-Standards.pdf> (10.07.2017).

institutionalization and capacity building of the consultative bodies (Domestic Advisory Groups, Civil Society Forum) set up by most EU FTAs (see also Ebert 2016).

Given the “awakening” of civil society due to the democratization of the political system in Tunisia since 2011, and the pivotal role that the social partners and in particular the Tunisian trade union confederation UGTT have assumed during the democratic transition, the framework conditions for establishing a forceful and effective implementation mechanism are promising. Tunisia has ratified all conventions covering ILO core labor rights, the country applies a system of collective wage agreements (*Convention Collective Cadre*), signed by both the employers association UTICA and UGTT, and trade unions are active in addressing problems arising from the lack of application of fundamental labor rights. Though the situation with respect to the application of core labor rights is certainly far from being perfect (for a detailed analysis see Ben Sedrine and Amami (2014)), arguably the most pressing social problems relate in particular to the ILO’s decent work agenda. Here deficits pertain especially to the following areas (Ben Sedrine/Amami 2014; Wohlmuth 2016):

- 1) Unemployment is at very high levels, in particular amongst the young and high-skilled population. Though showing a downward trend, general unemployment stood at 14% in 2016, while youth unemployment is generally still above 30%. Regional unemployment in the interior regions of the country can reach some 25% (general rate) and over 50% for young workers (OECD 2015). Similarly, unemployment is positively associated with the skill level, thus reflecting the low demand for skilled labor due to the low-skilled export specialization profile. Male persons with a university diploma have suffered from an unemployment rate between 16% and 24%, and female persons between 33% and 45% in the period since 2010 (Zouari 2014).
- 2) Low wage levels: the minimum wage in Tunisia is amongst the lowest in the whole Maghreb region (with the exception of Mauritania). Average wage increases in the private sector have deteriorated since the mid-1990s. Wage conflicts are the primary cause for strikes in Tunisia. Interestingly, there is no difference in strike incidence between the export-oriented industries (offshore sector) and sectors oriented towards the domestic market (onshore sector).
- 3) High weekly working hours: working hours per week are still fixed at 48 hours in most industrial sectors, including e.g. textile and apparel, most food processing industries and many labor-intensive service sectors such as tourism and gastronomy.
- 4) Deteriorating working conditions: though this dimension relates to various issues, which have seen increasingly precarious developments, it is worth noting in particular that the stability of work has deteriorated significantly over the last 10 years. Work contracts are now in their majority temporary. Only a minority of working contracts is still concluded for an unlimited period. Various forms of atypical and precarious work are on the rise in parallel to the expansion of the informal economy, which according to estimates accounts for roughly 40% of the economy.

Though the government, employers and trade unions have demonstrated their will to social dialogue and cooperation by signing a new social contract on 14 January 2014, the structural problems for advancing on a decent work agenda are formidable. Tunisian expectations with regard to the DCFTA are thus particularly oriented towards overcoming the current specialization profile of the economy, which is based upon a low-wage and low-skilled integration into global value chains. Only to the extent that functional, product and process upgrading can be achieved, will the room for maneuver in terms of employment creation, wage increases etc. broaden. Thus, dialogue between Tunisia and the EU under the

framework of the sustainable development chapter of the DCFTA will have to focus on this broader agenda, if it wants to contribute to socially inclusive development.

3.5. Development cooperation

With Tunisia remaining the only country in the MENA region, which after the Arab Spring uprisings has been able to consolidate a democratic political regime, the geopolitical importance of the country for the EU has risen significantly. To this has to be added the threat to the security of the EU, posed by the expansion of militant fundamentalist forces in the whole Northern African region and more recently, the increase of migration flows to Europe via the Maghreb countries, in particular Libya.

Therefore, the EU has offered Tunisia a privileged partnership within the framework of the EU Neighborhood Policy and consequently substantially increased its development cooperation and financial assistance. Also Germany, France and Italy as the major bilateral donors with long-standing relations to Tunisia have increased their bilateral programs by significant amounts. Within the European Neighborhood Instrument (ENI), financial assistance was increased during the period 2011 – 2016 to EUR 2 billion in total, against an amount of EUR 207 million disbursed between 2007 – 2010 (EC 2016a, EC 2016b). Of the total, EUR 800 million were designated as macro-financial assistance, i.e. budget support, the other EUR 1.2 billion were devoted to program activities in the areas of (i) socio-economic reforms for inclusive growth, competitiveness and integration, (ii) strengthening fundamental elements of democracy, and (iii) sustainable regional and local development. To this have to be added another EUR 2.6 billion of preferential loans for infrastructure and private sector development granted by the EIB and other development finance institutions (EC 2016a). Besides, Tunisia profited from participation in other EU programs and funds like e.g. ERASMUS+, TAIEX, SIGMA and the Neighborhood Investment Facility (NIF). Both the EU and the leading bilateral EU donors have pledged to continue financial assistance at current levels at least until 2020.

Under the umbrella of the strategic partnership, the efforts of the Tunisian government to accelerate economic growth and employment creation have received explicit support from the EU. To this end, a EU action plan for the period 2013 – 2017 aims at supporting the implementation of the current five-year plan of the Tunisian government (*Plan Quinquennal 2016 – 2020*) (EC n.d.). The economic strategy of the Tunisian government aims at triggering economic growth via an enforced external opening of the economy in general and the deepening of economic integration into the EU single market in particular. Against the background of profound regional disparities and the expanding influence of militant fundamentalism in the southern regions of the country, this is complemented by investment in infrastructure, regional development and measures to consolidate democratic institutions. Within this setting, the DCFTA shall assume the particular role of both increasing economic integration via trade and investment and facilitating the necessary regulatory alignment of the Tunisian regulatory regime with the EU's *acquis communautaire*.

It is thus important to realize that the DCFTA is but one element of a comprehensive political and economic relationship between the EU and Tunisia, which over the last years has assumed strategic importance for both partners. The value-added of the DCFTA has hence to be judged in terms of the contribution it is able to make to the political and economic consolidation of Tunisia as a democratic and prospering country in the southern neighborhood of the EU. Effectively, this reverses the usual hierarchy between EU development cooperation and EU trade policy. While typically development cooperation is intended to complement trade liberalization by supporting aid for trade and mitigating any

negative effects, in this case trade liberalization must not negatively affect the developmental objectives of the strategic partnership with Tunisia. In other words, this requires an EU agenda strongly oriented towards promoting policy coherence for sustainable development (PCSD).

4. IMPLICATIONS OF THE DCTFA ON TUNISIA

The assessment of potential effects of the implementation of the DCFTA on Tunisia has four parts: First, we report and interpret the results of simulations with the ÖFSE Global Trade Model with regard to macroeconomic as well as sectoral changes due to the tariff liberalizations agreed in the DCFTA. Second, the general perceptions on the DCFTA including opportunities and constraints are discussed. Finally, two case studies on Tunisian export sectors most affected by the agreement are presented, including a discussion on potential benefits and challenges. The sectors include the textile and apparel sector and the olive oil sector in Tunisia.

4.1. ÖFSE Global Trade Model: Simulation results for the DCFTA

4.1.1. Description of methodology and calibration

The potential changes on macroeconomic and sectoral parameters are simulated with the ÖFSE Global Trade Model, a structuralist Computable General Equilibrium (CGE) model. A detailed model description elucidating the differences to standard CGE models is provided in Box 1, Part A.

In the case of Tunisia, the assessment goes beyond tariff liberalization and includes the reduction of non-tariff measures (NTMs) which impacts on liberalization effects in goods and service sectors. In the ÖFSE Global Trade Model, the methodological approach with respect to NTM liberalization is described in Box 1, Part B.

Box 1: ÖFSE Global Trade Model

A) Methodology

The applied ÖFSE Global Trade Model is a structuralist Computable General Equilibrium (CGE) model. The difference of this model to standard CGE models is the macroeconomic causality applied. In the ÖFSE Global Trade Model, output and income are determined by aggregate demand, rather than through a neoclassical clearing labor market. In other words, the underlying macroeconomic model is that of an income-expenditure framework, rather than a full employment model.

Standard, neoclassical trade CGE models presume to be based on microeconomic theory. Their focus lies on reallocation of economic activity across sectors instead of aggregate activity levels. Economic gains then emanate from productivity increases through such reallocation effects, in combination with price decreases. Similarly, they assume a constant public deficit, and thus do not assume revenue effects from trade policy changes – the public household is just an extension of the optimal allocation of the aggregate household. In consequence, standard CGE models speak neither to employment nor to public balance effects of trade policy, even though these are arguably of central importance.

The ÖFSE Global Trade Model seeks to address these weaknesses by shifting the focus. A multi-sectoral income-expenditure framework determines equilibrium in the goods market, and employment levels follow therefrom, given labor productivity changes. Wages, in turn, are functions of labor market tightness, and prices are mark-ups on intermediate, import and labor costs. In this sense, macroeconomic causality conforms to an AS/AD structure: first, demand determines output, and output drives employment; second, wages and prices are the outcome of bargaining in a non-clearing labor market.

Thus, a neoclassical model assumes a full employment steady state and focuses on sectoral reallocation, but does not claim to describe the adjustment path towards such an equilibrium. The income-expenditure framework, in contrast, assumes under-employment and focuses on demand effects, but does not claim to describe a full employment equilibrium. One could thus consider the resulting equilibrium as a medium-run Keynesian under-equilibrium that, at best, suggests adjustment costs on the path towards the ultimate new full employment equilibrium.

The model causality assumes that the immediate effect of policy and resulting price changes is a change in expenditures. Only in the very long run, and only if there are strong tendencies towards full employment steady states, does the reallocation equilibrium, supported by the necessary price changes, come about. When that happens, and whether it does, is not clear at all. Even though countries are typically not in a liquidity trap, they are nowhere near a full employment steady state.

The simulation results depend on various factors including the production and trade structure, size and current tariff protection level of the economies and sectors involved in trade liberalization. A corollary of the assumed causality is that unilateral liberalization will tend to have negative effects as long as trade price elasticities are sufficiently high and one-sided price changes lead to an import surge that is not balanced by export or consumption increases. However, import price elasticities might be zero if imports (in a particular sector) are strictly complementary to domestic production. Under this assumption, the importing country would not respond at all to relative price changes on the import side. Then the aggregate effect of unilateral liberalization will tend to be positive, since the public balance deteriorates – implying an injection. On the aggregate level, zero elasticities are however not a realistic assumption for developing countries. We scrutinize the importance of elasticities for determining simulations results by way of sensitivity analysis.

See also Raza et al. 2016 for further details on the model.

B) Modelling liberalization of Non-Tariff Measures (NTMs)

Liberalization of NTMs is methodologically demanding to implement in a CGE model. The primary reason is that the trade costs of NTMs need to be estimated. There is no NTM equivalent to a “tariff schedule.” A further reason is that NTMs have multiple effects. As they rest on border measures as well as *domestic regulations*, which can be quite broadly conceived, they have societal costs and benefits. Most modeling applications do however not consider benefits. Thus, NTM liberalization benefits shown in conventional simulations must be seen as a ceiling, from which potential losses of societal benefits must be deducted.

A third major issue is that it is not clear where the NTM “costs” arise. Standard CGE applications distinct between rent-generating and cost-generating NTMs. The former imply a lack of competition and hence higher mark-ups for companies, which result in higher market prices. The latter are conceived of as “iceberg trade costs,” which are presumed to imply “pure friction.” Crucially, these iceberg NTM costs do not have an income counterpart: the CGE modeler introduces a parameter that is adjusted in the liberalization scenario such as to trigger ‘free’ gains from trade. Rent-generating NTM barriers, on the other hand, trigger a loss of income with redistributive effects, when removed. In the importing country, these income losses are related to the removal of protection and the associated lower mark-ups and profit flows. In the exporting country, the loss of income is related to lower factor costs, which in turn are driven by reduced activity for compliance with regulations in the destination country.

The ÖFSE Global Trade Model focuses on one of these channels, namely on rent-generating NTMs. Rents are income that somebody receives, and compliance with any regulatory requirements, e.g. on the design of seat belts, imposes costs on firms. Removal (or harmonization) of standards reduces these costs, and therefore the value added generated in firms. Thus, it is assumed that no such thing as “pure friction” exists as in the approach with “iceberg trade costs”, as there simply is no economic cost that does not have an income counterpart. Moreover, the majority of costs (or rents) arises in the importing country: NTMs represent protection from import competition.

Thus, a simple, straightforward and transparent strategy is to model NTMs analogous to tariffs. Tariffs are a cost barrier as well as income for the government. That income, in turn, represents leakage in the form of public savings in the macroeconomic balance equation. The ÖFSE Global Trade Model conceives NTMs in analogous terms: as a cost barrier, with related income earned by the private sector, and as a leakage in the form of private savings in the macroeconomic balance equation. Put differently, and obviously, *any unit cost* must be covered by the unit price, and NTMs generate an income flow that the representative firm distributes to households. This is in analogy to the tariff cost, which the firm distributes to the government.

An advantage of this approach is that, *ceteris paribus*, equivalent reductions in a tariff or NTM rate have the exact same effects, except for their expression in public and private accounts, respectively. A disadvantage is that the model does not account for the income loss in the exporting country due to firm expenditures for compliance with a specific standard. It is therefore crucially important to interpret simulation results with this context in mind.

The database for the assessment are multi-country data for the year 2011 provided by GTAP (Global Trade Analysis Project, Version 9).⁹ The regions for the DCFTA analysis include the EU, Tunisia (TUN), Morocco (MOR), other Northern African countries (NAfr, incl. Algeria and Egypt) and Turkey (TUR). In addition, South East Asia (SEA, incl. China), other Asian countries (OAS), the United States (US), other OECD countries (OECD), Sub-Saharan African countries (SSA) and the Rest of the World (ROW) are included. For all countries/regions, 20 sectors are covered including four service sectors (see also Table 2A in the Appendix for correspondence with GTAP sectors).¹⁰ Table 25 provides the import shares and tariffs applied in the base year for bilateral imports between Tunisia and the EU per sector.

As described in section 6.1., tariffs are already fully liberalized for all industrial products based on the Association Agreement in 1995. According to the GTAP database, the trade weighted average of tariffs amounts to 2.1% in Tunisia, and 0.7% in the EU due to the dominance of DFQF trade in industrial goods and services.¹¹ Nevertheless, tariff protection in selected agricultural sectors is still high, in particular in Tunisia (see Table 5).

To simulate potential liberalization outcomes of the DCFTA, four scenarios are simulated. For the case of tariff liberalization, two extreme cases are considered. In scenario 1 (“Full”) all tariffs are eliminated by both trading partners, while scenario 2 (“Unilateral”) assumes an asymmetric liberalization by the EU only. In a third scenario, the liberalization of NTM

⁹ The base year data are not projected to a future year, as we focus on reporting percentage changes.

¹⁰ The sector tourism is not specified in GTAP. Here, the GTAP sectors Trade (trd), which includes Hotels and Restaurants, and Recreation and other services (ros) are combined as an approximation for the tourism sector.

¹¹ Given the base year 2011, recent changes in trade pattern are not represented in all details, as tariff protection has already been changed in recent years (compare also Table 4 in section 6.1 and Table 5 here). However, a relatively adequate representation of trade and protection structures is still provided.

is simulated (“NTM”) separately, scenario 4 (“Full & NTM”) combines the bilateral elimination of tariffs and the liberalization of NTMs as intended by the DCFTA. Given that no detailed information on the scope of trade liberalization and the asymmetry in Tunisia’s market opening, as intended by the EC, is yet available, the simulation results based on the scenarios provide a range of potential effects based on different feasible negotiation outcomes.

Table 5: Sectoral Overview and Tariff Reductions EU-Tunisia

		TUN		EU	
		Import share (%)	Tariffs	Import share (%)	Tariffs
		(from EU)	Base year	(from TUN)	Base year
1	Cereals (cer)	2.1	50.2%	0.1	0.2%
2	VegOils (voil)	0.5	18.3%	1.3	41.1%
3	FruitVeg(v_f)	0.2	28.8%	1.4	5.6%
4	OthAgri (oag)	1.0	25.5%	0.4	0.9%
5	FoodsBev (f_b)	1.5	34.1%	1.6	1.8%
6	Meat (mea)	0.1	53.7%	0.1	1.9%
7	Dairy (dai)	0.3	31.2%	0.0	7.5%
8	Commodities (com)	8.7	0.1%	12.0	0.0%
9	Textiles (tex)	11.5	0.0%	6.3	0.0%
10	Apparel (app)	2.1	0.0%	17.2	0.0%
11	Footwear (lsh)	2.9	0.0%	5.0	0.0%
12	Chemicals (che)	12.6	0.0%	4.1	0.0%
13	Motorvehicles (mvh)	7.7	0.0%	2.6	0.0%
14	Machinery (mac)	19.9	0.0%	20.9	0.0%
15	Electronics (ele)	4.8	0.0%	7.0	0.0%
16	OthManu (oma)	17.2	0.0%	7.7	0.0%
17	Business (bus)	0.7		1.1	
18	Tourism (tou)	1.0		1.9	
19	OthServ (oser)	2.7		2.9	
20	Transportation (trans)	2.7		6.6	
SUM		100%		100%	
Average			12.9%		2.1%
Weighted Avg.			2.1%		0.7%

Source: GTAP

In order to simulate the reduction in NTM trade costs, we follow a scenario design applied in the EC’s Trade Sustainability Impact Assessment of the DCFTA, conducted by Ecorys in 2013. In this study, Ecorys (2013) assumes an asymmetric liberalization in the case of services. Trade cost equivalents (TCEs) of NTMs in services are “reduced by three per cent for Tunisian services entering the EU market, and eight per cent for EU services entering the Tunisian market” (Ecorys 2013: 15). For NTMs in goods, we assume a similar asymmetric structure with a reduction of TCEs of NTMs in goods from Tunisia entering the EU market by 2% and 4% for EU goods exported to Tunisia.¹² The asymmetry in NTM cost reductions is based on the assumption that Tunisia’s regulatory framework should be aligned to the one in place in the EU (as already intended in the Association Agreement of 1995). This would require no adjustment costs for EU companies exporting to Tunisia,

¹² Commodities are excluded from the reductions in NTMs.

while Tunisian exporters would face substantial adjustment costs before they can comply with EU standards, which lower their benefits from regulatory harmonization.

Possible longer-run effects of changes in FDI inflows and changes in investments induced by the agreement, as well as development cooperation efforts to improve trade-related capacities and capabilities and pressure on broader reforms in the Tunisian economy triggered by the agreement are not part of the simulation analysis. A further limitation of the simulations, as in most CGE models, is that effects of tariff reductions on products with low or no trade flows are underrepresented due to the use of past trade data. The simulation results should therefore be interpreted carefully.

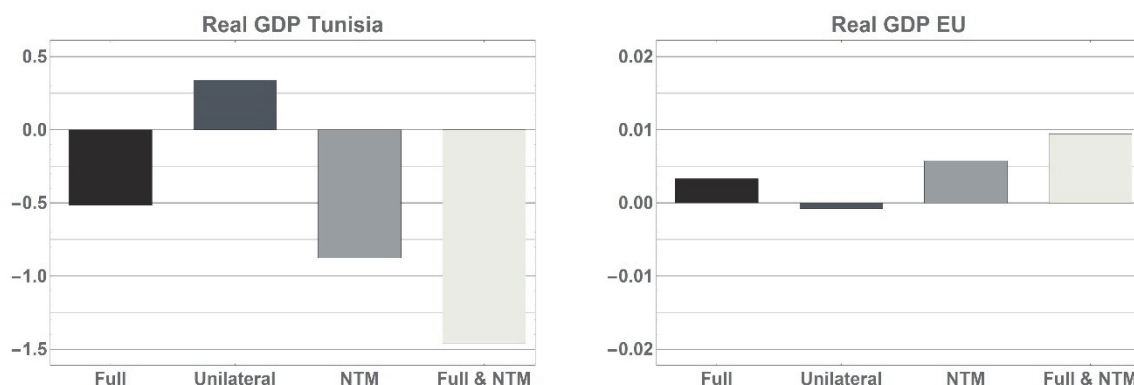
4.1.2. Macroeconomic results

The main macroeconomic results from the model simulations focus on the changes in real GDP and the contributions to these effects based on the income and the expenditure approach.

Growth of country real GDP

Figure 1 shows model output in the aggregate for Tunisia and for the EU for all scenarios, given that all other countries or regions are hardly affected by this bilateral agreement. Each bar represents the real GDP growth rate in Tunisia and the EU. Scenarios 1 and 2 (two left bars) represent the range of feasible options for tariff liberalization. All remaining tariffs are either fully eliminated (“Full”) or only the EU grants DFQF access for all imports from Tunisia. In the first case, bilateral reduction of tariffs depresses Tunisia’s real GDP by -0.52%, while the real GDP of the EU remains almost unchanged. In the case of an asymmetric opening of the EU market, Tunisia’s GDP increases by 0.34% due to positive effects from improved net exports to the EU.

Figure 1: Growth of country real GDP



Source: CGE calculations

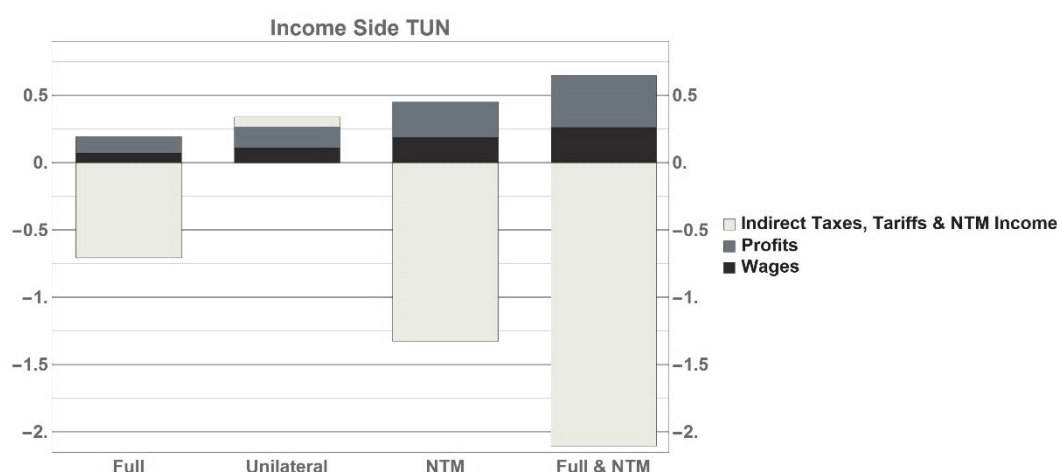
The reduction of trade cost equivalents of NTMs in goods and services affects Tunisia negatively in the aggregate (“NTM”). With a decline in real GDP of -0.88% the effect is more pronounced than in the case of full tariff liberalization, as NTMs are also part of trade costs in industrial goods and services. The simultaneous reduction of all tariffs and NTMs (as specified in the NTM scenario), causes a decline in Tunisia’s real GDP by -1.46% on the aggregate level. However, sectoral GDP changes in selected Tunisian sectors are still positive, for instance in the apparel and the tourism sector (see section 7.1.3. on sectoral details).

Growth contributions of incomes and expenditures

Figure 2 and Figure 3 contain the same information as Figure 1 but decompose the changes in GDP into variations in incomes – private and public – and expenditures – consumption, public expenditures, investment, and net exports specifically for Tunisia. Thus, the sum of all components in Figure 2 and Figure 3 are identical to the changes in real GDP shown in the left part of Figure 1. Most importantly, the breakdown of GDP changes allows for the identification of mechanisms, which lead to the aggregate GDP effects.

Figure 2 represents the income decomposition in income from wages and profits, public income from indirect taxes and tariffs as well as private income from NTMs, as NTMs are assumed to be fully income-generating. In the tariff scenarios (“Full” and “Unilateral”), the black and dark gray proportions of the bars in the top row represent the contribution of wages and profits to total growth and are positive in both cases. The outcomes of the two tariff scenarios differ with regard to changes in public income. While the loss of tariff revenues depresses Tunisia’s public income in the case of bilateral tariff liberalization (light gray proportion of the bar), public revenues increases in the case of unilateral tariff liberalization as tax and tariff revenues benefit from increased economic activities.

Figure 2: Growth of country real GDP (income side)



Notes: Decomposition of growth from the income side. Black represents growth contribution of total wages, dark gray profits, and light gray indirect taxes, tariffs and income from NTMs.

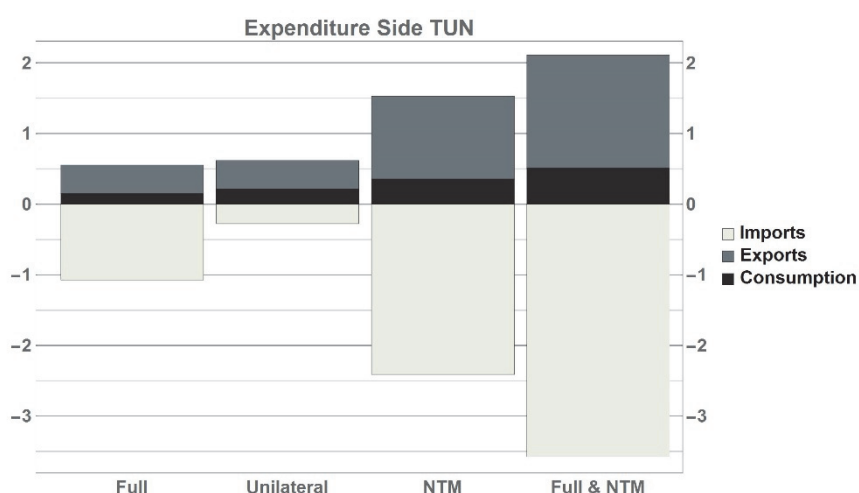
Source: CGE calculations

The reduction of NTMs has similar effects compared to the reductions of tariffs except that it accrues to households instead of the government as income. The light gray part of the bars in the scenario “NTM” in Figure 2 represents changes in private income from NTMs. These are clearly negative for the case of Tunisia (-1.33%), as rent-generating protection of importing firms declines significantly in the case of a harmonization of the regulatory framework towards the EU standard. In the fourth scenario (“Full and NTM”), losses in public income from foregone tariff revenues and private income from NTMs add up.

Analogously, Figure 3 shows the growth contributions of the endogenous components of demand. In all scenarios, consumption (black part of the bars) and exports (dark grey) add to aggregate demand in Tunisia, while increasing imports are a contractionary demand contribution. Only in the scenario of unilateral liberalization, the positive contributions of

exports consumption exceed changes in imports. Again, changes of the single components add up to the changes in GDP reported in Figure 1.

Figure 3: Growth of country real GDP (expenditure side)



Notes: Decomposition from the expenditure side. Black represents growth contribution of real consumption, dark gray real exports, and light gray real imports.

Source: CGE calculations

Effects on trade flows

As highlighted in Figure 3, changes in imports and exports are main drivers of changes in real GDP. Bilateral trade flows between the EU and Tunisia increase, while trade with other trading partners hardly changes.

Table 6 shows changes in trade flows for the combined scenario ("Full & NTM"). Exports from Tunisia to the EU increase by 4.4%. Due to the dominance of exports to the EU in total exports, this lifts total exports from Tunisia by 3.1%. Imports from the EU to Tunisia increase however by 10.6% causing a decline in net-exports for Tunisia. For the EU as a whole, changes in trade flows are marginal as the share of Tunisian trade in goods amounts to only 0.6% of total extra-EU trade.

Table 6: Changes in inter-regional trade flows, DCFTA

	EU	TUN	N.Africa and Turkey	all other regions	Total
EU	0.0%	10.6%	0.0%	0.0%	0.04%
TUN	4.4%		0.0%	0.0%	3.1%
N.Africa and Turkey	0.0%	0.1%	0.0%	0.0%	0.0%
all other regions	0.0%	0.2%	0.0%	0.0%	0.0%
Total	0.03%	6.4%	0.0%	0.0%	

Notes: Exporting countries/regions are in the first column and importing countries/regions in the following columns. Thus, exports from the EU to Tunisia increase by 10.6% or respectively imports by Tunisia from the EU increase by 10.6%.

Source: CGE calculations

Changes in macro balances

In contrast to standard CGE models, the ÖFSE Global Trade Model includes changes in macroeconomic balances, namely variations in net exports (foreign balance), private balance and public balance, all relative to GDP.

Figure 4 shows aggregate country results from a different perspective. Model equilibrium in the market for goods and services occurs when demand is equal to supply. An equivalent way of saying the same thing is that all demand injections equal leakages, or, more specifically, that the sum of the differences between injections and leakages of private, public and foreign 'institutional sectors' is equal to zero.

In other words, both before and after the application of the liberalization scenarios, the sum of net exports or the *foreign balance* (E-M, black), the *private balance* (I-S, dark gray) and the *public balance* (G-T, light gray) is zero. Note that the public balance is the negative of the public deficit. Following convention, the balances are defined as difference between injection and leakage, thus determining a *net borrowing flow* of the institutional sector.¹³

The *changes* in these balances, normalized by pre- and post-liberalization GDP are shown in Figure 4 for the case of Tunisia. Since the pre- and post-liberalization sum of the balances is zero, the sum of these changes will be zero as well. Important are differences in the scenario outcome. While the change in Tunisia's net exports relative to GDP in the first scenario with full tariff liberalization is negative (-0.78%), the change in public balance is positive (+0.85%). In terms of balances, this expresses an increase in the public deficit due to the foregone tariff revenues and constant government spending. Also, the private balance deteriorates slightly (-0.06%) and the increase in net borrowing is financed via foreign borrowing. In the second scenario ("Unilateral"), changes in the balances in Tunisia switch sides and the ratio of net exports to GDP increases while changes in the private and public sector are negative.

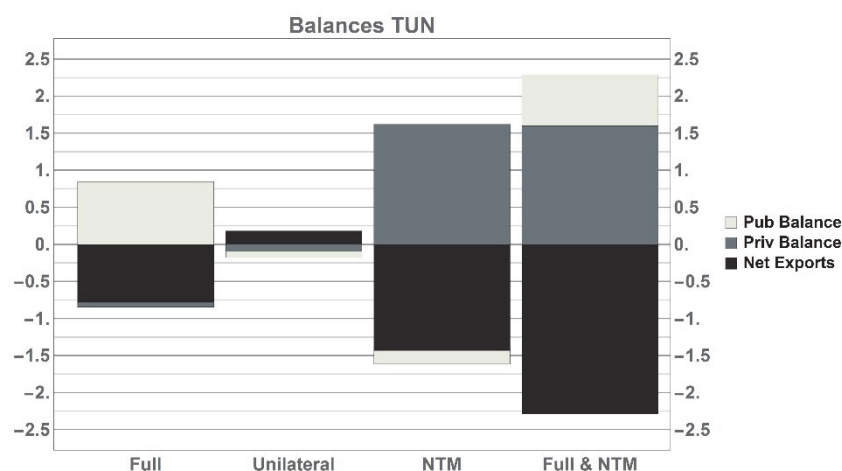
In the NTM scenario, the change in net exports to GDP deteriorates as imports increase more than exports in Tunisia. However, it is the private balance that changes positively, as the leakage in form of income from NTMs declines, given the private injection of constant investment. The fourth scenario shows that negative changes to net exports relative to GDP in Tunisia are compensated by positive changes (or higher net borrowing) in both private and public institutions.

In sum, the analysis shows that the public budget deficit will increase by slightly less than 1% of GDP in the case of full liberalization, both without and with NTM harmonization.¹⁴ Given the deteriorating fiscal situation of the country with public deficits of some 6% of GDP in 2016, an increase of macro-financial assistance from the EU and international organizations will be needed, if full liberalization were to be the outcome of negotiations.

¹³ In the case of a trade deficit, the foreign sector has negative net borrowing, which is equivalent to net lending from the rest of the world to the country under consideration. Note further that in the foreign balance both expenditure components are endogenous, but that in private and public balance only leakages are endogenous – public expenditure G and firm investment I are held constant.

¹⁴ Please note that the magnitude of this outcome is partially determined by the data provided in the GTAP database. More current data from alternative sources (IMF) indicate that trade taxes in Tunisia are less pronounced relative to GDP. However, the tendency of simulation changes is still shown adequately.

Figure 4: Change in sectoral balances relative to GDP



Notes: Black represents the change in net exports relative to GDP, dark gray the change in private balance relative to GDP, and light gray the public balance relative to GDP. Each balance is defined as a net borrowing flow, i.e. the difference between injections and leakages.

Source: CGE calculations

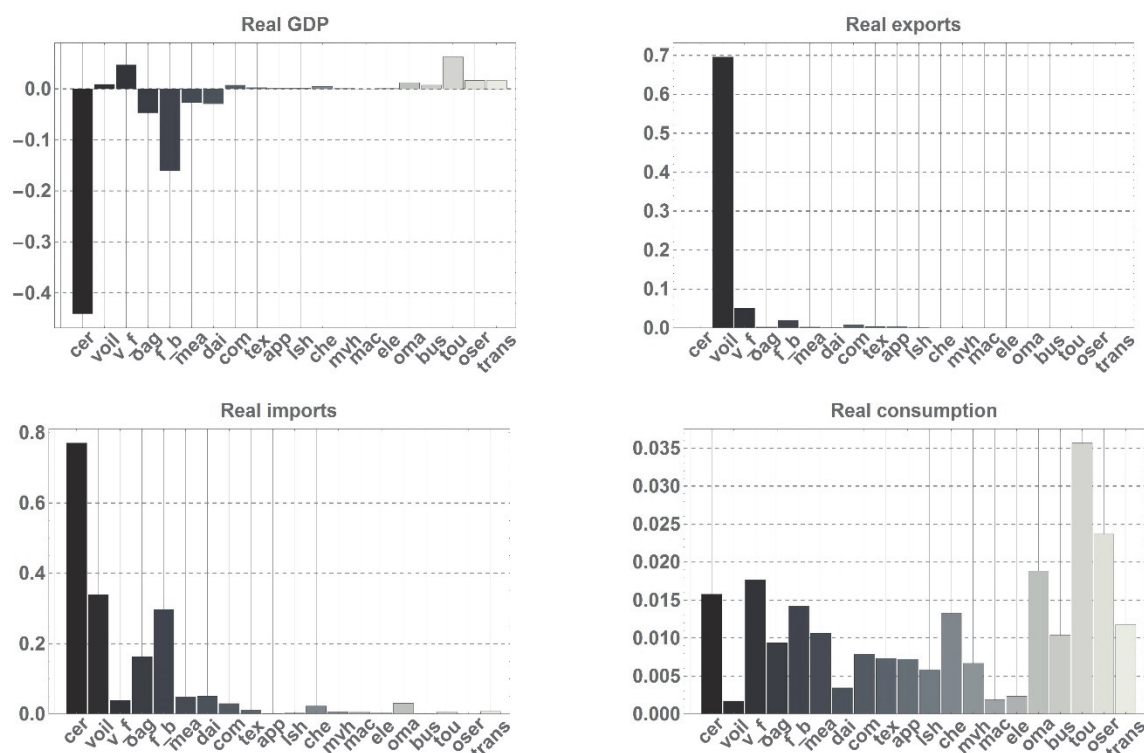
4.1.3. Sectoral results

Figure 5 and Figure 6 report sectoral results for Tunisia. In Figure 5, changes in real GDP, total exports and imports as well as consumption are presented as weighted changes. Thus, the sum of all bars in each single figure equals the changes reported above. In the case of GDP, the sum across the bars in the top left panel is the growth rate of GDP, namely -0.52% known from Figure 1 to Figure 3.

Changes in sectoral GDP in Tunisia are most pronounced in agricultural sectors, as tariffs in industrial goods are already liberalized. Negative changes to GDP appear mainly in the sectors cereals (cer) and foods/beverages (f_b). Both sectors still enjoy high tariff protection in Tunisia, while exports to the EU currently face low tariffs. Thus, trade liberalization triggers mainly imports into these sectors while exports hardly change. On the export side, only exports in vegetable oils benefit from the reduction of high EU import tariffs.¹⁵ Real GDP in the vegetable/fruits sector increases slightly despite small changes in exports. Consumption in Tunisia increases slightly in all sectors mainly due to higher real wages in the scenario of full tariff liberalization.

¹⁵ Tariff protection in vegetable oils (mainly olive oil) has already been lowered by the EU in recent years (see also case study IV for more details). Thus, the results reported here should be interpreted as a best case scenario for this sector.

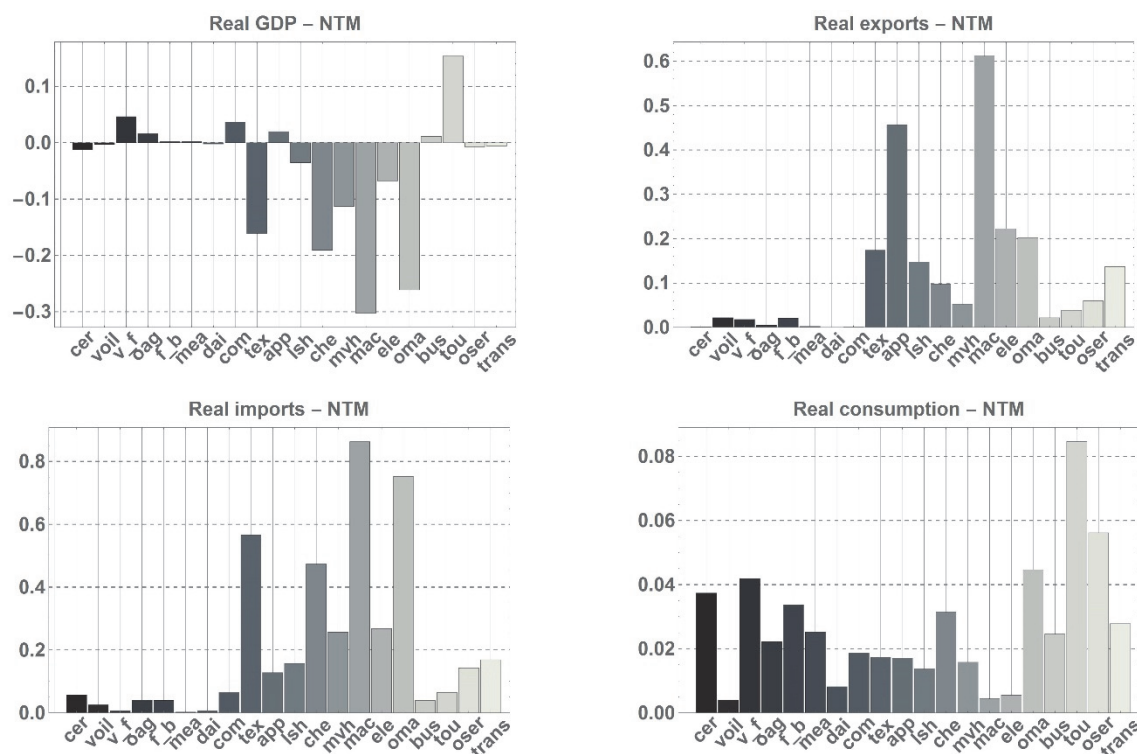
Figure 5: Sectoral contributions to growth in Tunisia (Scenario 1 “Full”)



Notes: Top left: Each bar represents the sectoral contribution to growth of real GDP. The sum across sectors amounts to -0.52%, see the bar for Tunisia in Figure 12 in the “Full” scenario. Top right: Each bar represents the sectoral contribution to growth of real exports. The sum across sectors is the aggregate growth rate of real exports (0.78%). Bottom left: Sectoral contributions to growth of real imports; aggregate 1.83%. Bottom right: Sectoral contributions to growth of real consumption (0.22%). Source: CGE calculations

The sectoral results of the tariff scenario with bilateral tariff reductions should be contrasted to sectoral outcomes in the case of NTM liberalization (scenario “NTM”). As reductions in trade costs due to changes in NTMs are assumed across all sectors (only exception is the sector commodities), trade and GDP effects appear in manufacturing and service as well as in agricultural sectors. As NTM trade cost reductions are smaller than changes in tariffs, the effects in the agricultural sector are limited. In contrast, trade and real GDP effects are most pronounced in manufacturing sectors. Given the asymmetric cost reduction favoring EU exports to Tunisia, the Tunisian net exports in most manufacturing sectors are negatively affected by NTM liberalization, causing real GDP to decline in these sectors. Only Tunisian sectors with a clear export surplus in trade with the EU in the base year (vegetable and fruits and apparel) can benefit in terms of GDP. In service sectors, the tourism sector can benefit from NTM liberalization due to an increase in trade. However, GDP growth in this sector is also caused by multiplier effects, as GTAP sector ‘trade’ includes also various domestic activities. Again, the sum of all changes in sectoral GDP is equal to the reported change in aggregate GDP in Figure 1 to Figure 3, namely -0.88%.

Figure 6: Sectoral contributions to growth in Tunisia (Scenario 3 “NTM”)



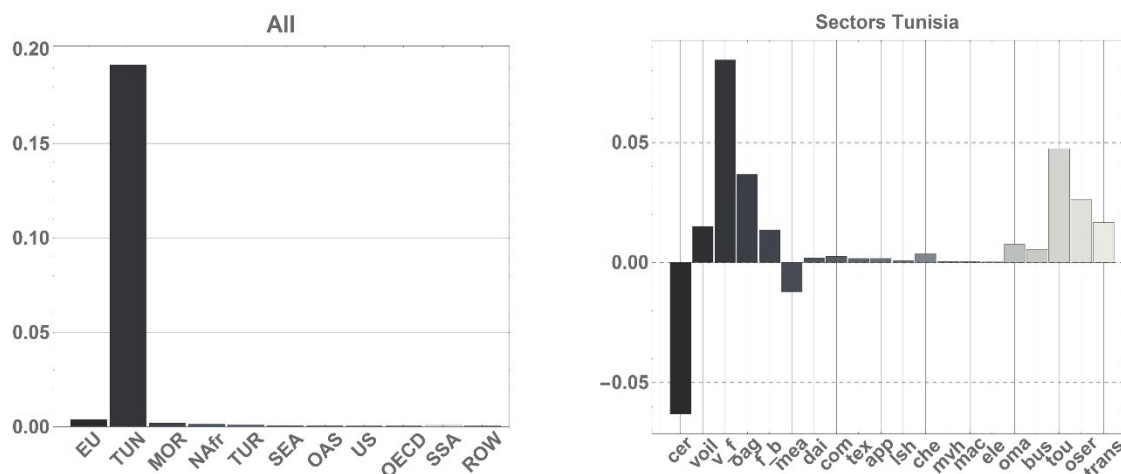
Notes: Top left: Each bar represents the sectoral contribution to growth of real GDP. The sum across sectors amounts to -0.88%, see the bar for Tunisia in Figure 12 in the “Full” scenario. Top right: Each bar represents the sectoral contribution to growth of real exports. The sum across sectors is the aggregate growth rate of real exports (2.29%). Bottom left: Sectoral contributions to growth of real imports; aggregate 4.13%. Bottom right: Sectoral contributions to growth of real consumption (0.53%). Source: CGE calculations

Despite potentially negative GDP effects in three of the four scenarios, the effects on employment are positive in aggregate due to positive output effects in labor-intensive agricultural and service sectors. Comparing the effects on employment in scenario 1 (“Full”) and 3 (“NTM”) in Figure 7 shows that employment in Tunisia increases by a relatively modest share of 0.19% and 0.53%, respectively. In the combined scenario 4 (“Full & NTM”), employment in Tunisia increases even by 0.68% due to the mentioned positive effects in the labor-intensive sectors.

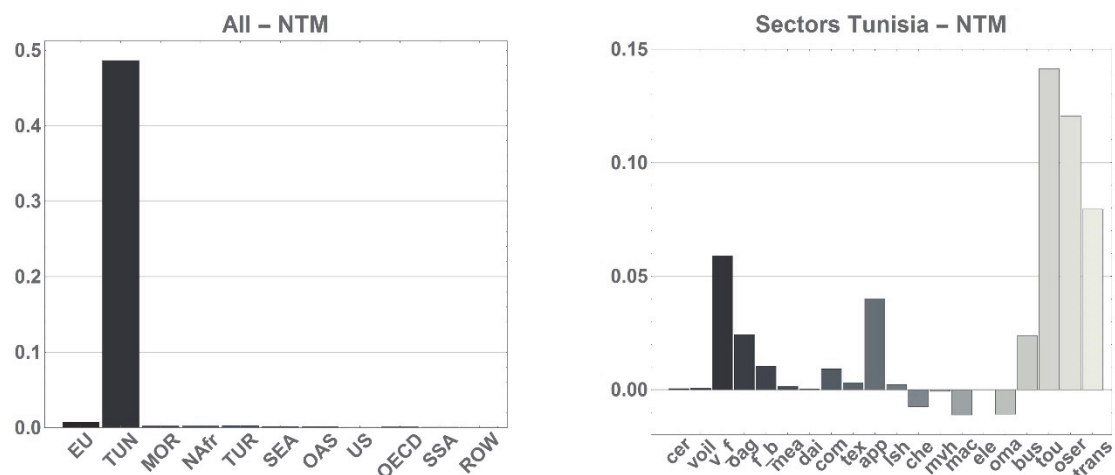
In particular, the sectors vegetables/fruits (v_f), apparel (app) and the service sectors can overcompensate any job losses in less labor-intensive sectors. In the case of NTM reductions, employment in selected manufacturing sectors is negatively affected.

Figure 7: Employment growth

Scenario 1 (“Full”)



Scenario 3 (“NTM”)



Notes: Left panel shows aggregate employment growth in all regions. Right panel shows sectoral contributions to aggregate employment growth in Tunisia. The sum across sectors at right is equal to Tunisia's bar in the left panel.

Source: CGE calculations

4.1.4. Sensitivity Analysis

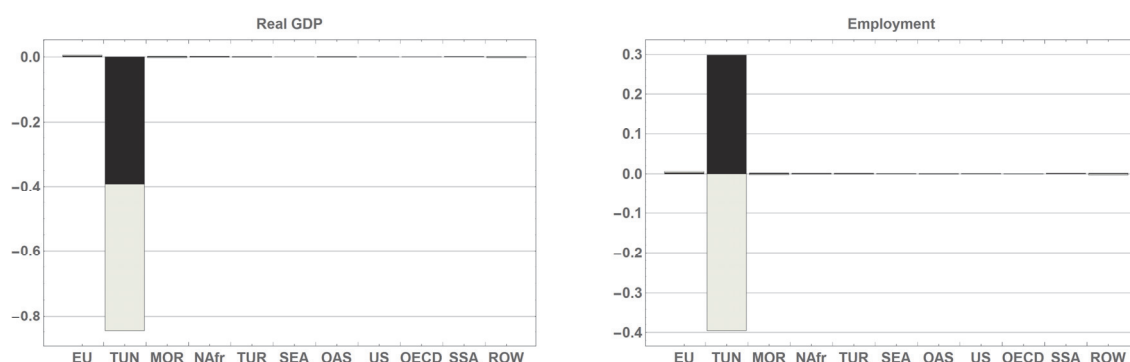
Figure 8 presents sensitivity analysis. The purpose of sensitivity analysis is to assess to what degree model results depend on parameter values, which are often subject to significant uncertainty. Here, we focus on import price elasticities: the elasticity that describes the percentage change in real imports corresponding to a percentage change in relative prices. Traditionally, but also in our model, these elasticities have a significant effect on the magnitude of the estimated effects. The elasticities applied in our model (as discussed above) are from the GTAP database, and are, following standard practice, uniform across countries but vary across sectors.

These so-called “Armington elasticities” are often viewed critically because they are unreasonably large. The unweighted average of the GTAP elasticities in our aggregation is 3.2, with elasticities around 4 in sectors such as *leather and footwear* and *machinery*. For our baseline calibration, which is used to produce model results previously discussed, we

therefore feed only half the GTAP value into the model, for an unweighted elasticity average of 1.6. In the case of Tunisia, the average elasticity vis-à-vis the EU, weighted by import shares, then amounts to 1.5.

Now, to conduct sensitivity analysis, we, first, further reduce the average elasticity values, and, second, increase them. Figure 8 presents these results for the first scenario of bilateral tariff liberalization. The low elasticities correspond to 1/3 of GTAP values, the high elasticities to full GTAP values. The black bar shows the growth rate of real GDP with low elasticities, and the gray bar shows the *additional change* with high elasticities. Thus, for Tunisia, the left panel records a real GDP contraction of 0.39% with low elasticities, and 0.85% with high elasticities. The right panel illustrates the concomitant growth rate of real employment, which ranges from 0.30% to -0.40%. The ranges represented in Figure 8 are indicative of the uncertainty surrounding estimates of the effect of liberalization. Thus, larger trade elasticities led to higher import competition in all sectors and overall employment effects in Tunisia turn out to be negative.

Figure 8: Sensitivity analysis DCFTA



Notes: The left chart shows model results for different trade price elasticities. The black (gray) bar corresponds to 1/3 (full) of GTAP trade price elasticities. The unweighted average of trade price elasticities across sectors is 1.01 (3.04); for our baseline scenario with half the value of GTAP elasticities the unweighted average is 1.60. The size of the gray bar is inclusive of the black. For example, Tunisia's real GDP declines by -0.39% with 1/3 of elasticities, but declines further by -0.85% with full elasticities. The right panel shows the corresponding results for aggregate employment.

Source: CGE calculations

4.1.5. Comparison and Conclusions

The scenario design for the DCFTA simulations with the ÖFSE Global Trade Model aims at assessing the macroeconomic implications of potential negotiation outcomes. With regard to tariff liberalization, the full reduction of import tariffs by both tariff partners is burdensome for Tunisia, given the applied high tariff rates in agriculture. In particular, the sectors cereals and foods/beverages will likely experience negative effects. As shown for the scenario with unilateral tariff reductions by the EU, a unilateral liberalization by the EU only is beneficial for the Tunisian economy. Hence, with respect to the intended asymmetry of the DCFTA, selected agricultural products or sectors in Tunisia might be excluded fully or partially from tariff reductions in order to prevent negative effects for the Tunisian agricultural sector on the import side, and give a stimulus to the export side.

With regard to trade cost reductions based on regulatory changes, the initial situation imposes a potential adjustment of NTM-related trade costs in favor of EU exports to Tunisia. Thus, only a limited number of sectors, such as vegetable and fruits and apparel benefit from simplified access to the EU market. Contrariwise, exports of Tunisian manufacturing sectors cannot compensate increasing imports from the EU. As cost-margins on imports due to NTMs are set as income generating in the importing country, the macroeconomic

effect is largely negative. However, though small, employment effects are generally positive in contrast to aggregate GDP changes, as selected labor-intensive sectors with initially large export surpluses might benefit from any trade liberalization granted by the EU.

The simulation results are in contrast to results of standard models applied to FTA trade liberalization scenarios. Generally, model results differ due to type of models (CGE, Partial Equilibrium), model causalities, datasets, time frames and liberalization scenarios and should therefore be compared with caution. For instance, EC's Sustainability Impact Assessment on the DCFTA conducted by ECORYS (2013) applies a standard CGE model for a short-run and long-run scenario (which includes labor and capital reallocation among sectors) and includes effects of NTM reductions and spillovers in their simulation. Trade liberalization would generate an increase in bilateral trade by more than 25% and a growth in Tunisian GDP by more than 7% in this set-up. Almost half of the growth in national income is derived from cost reductions in NTMs on goods due to the assumption of significant NTM liberalization effects for Tunisian goods exports to the EU. Tariff reductions are also beneficial for both trading partners. On a sectoral basis, positive changes in Tunisian value added appear mainly in the trade sector (75% of the total growth), vegetable oils and vegetable/fruit sectors. Even though more than half of Tunisia's sectors face declining exports and value addition (ECORYS 2009, tables 2.3 and 2.5) the overall macroeconomic effects are largely positive. Thus, the different modelling approaches generate distinct results with regard to tariff liberalization and diverging effects from NTM cost reduction in particular due to the different handling of income- and cost-generating NTMs.

4.2. General perception of the DCFTA in Tunisia

The debate on the DCFTA is only at an early phase in the Tunisian polity and the general public. This has to do both with the protracted and arguably deepening crisis of the political system since the entry into force of the new constitution in 2014, and to some extent also with a lack of capacities on the side of both government and civil society.

So far (i.e. as of June 2017), the government has not presented a systematic position on the DCFTA negotiations, but has remained silent on its negotiating priorities and red lines. As a first important step, it has initiated a public consultation with respect to 'ALECA' (ALECA being the widely used French acronym for DCFTA) and invited employers association, the trade union, NGOs and academia to participate.¹⁶ Particularly those civil society organizations with close affiliations to the EU, like e.g. Solidar Tunisie and the Euro-Mediterranean Human Rights Network, have started to work on the agreement and have published a number of studies and brochures on diverse aspects of the agreement.¹⁷

Our interviews, conducted with representatives of government agencies, business associations, the labor unions and other civil society organizations in late May 2017 suggest that, although political as well as economic relations with the EU are perceived by all stakeholders as being of pivotal importance for the future development of the country, the DCFTA negotiations are seen as a long-term project that needs a careful discussion and appraisal of its potential benefits and costs. The main reasons to suppose ALECA to become a protracted process have to do with the complex internal dynamics in the government and political system, respectively, severe macroeconomic problems, and the rather critical position, which large segments of civil society and in particular the influential trade union federation UGTT have adopted with respect to the negotiations.

As far as the internal dynamics are concerned, it has to be noted that since the first free democratic elections in October 2014 no stability of government has been achieved. Although the secular Nidaa Tunes party emerged as the largest political force and became designated to form the government all successive cabinets since then have been governments of national unity, i.e. coalition governments, including also the moderate Islamic Ennahdha party, in addition to other smaller political groups. Both big government parties have been plagued by internal divisions, which eventually led to the secession of minority political groupings with negative repercussions on the internal dynamics and power balance in the national assembly and the government. This has also affected the current government, which has been in office since August 2016 and is led by Prime Minister Youssef Chahed of Nidaa Tunes.

On top of this come difficult regional dynamics. The interior regions demand the implementation of the decentralization process foreseen in the new constitution. The implementation of decentralization presents a major political challenge in a situation of heightened social unrest due to the very high youth unemployment. Above all, the security situation in the Southern provinces bordering Libya and Algeria has continually deteriorated due to the activities of militant Islamist groups actively recruiting amongst the local population and forging an increasing number of surprise attacks on the Tunisian security forces.

Finally, on the macroeconomic economic front, the most urgent problems of the country have been the deep fiscal crisis, with the public deficit reaching 6% and the widening current account deficit standing at 9% in 2016 (World Bank 2017). Both phenomena have put

¹⁶ For more information see <http://www.aleca.tn/> (10.07.2017)

¹⁷ For more information see <http://solidar-tunisie.org/>; <http://www.euromedrights.org/> (10.07.2017)

pressure on the Tunisian Dinar, the nominal effective exchange rate of which has depreciated by 23% since the end of 2015 (IMF 2017). As a consequence, the government has received macro-financial assistance from the IMF under the Extended Fund Facility arrangement with Tunisia as well as from the EU, albeit on the condition of implementing politically sensitive public sector reforms and pushing forward with programs liberalizing the economy (IMF 2017). In combination with the critical position adopted by UGTT and civil society, this explains why DCFTA has so far not been a high priority for the government.

For their part, important segments of civil society, in particular UGTT and human rights organizations, have voiced their concerns over the potential negative social and economic effects of the DCFTA quite from the outset. In a public statement issued in February 2016, the organizations criticized the agreement for its lack of offering social development perspectives, the asymmetry of the proposed trade and investment liberalization in favor of EU businesses, and the proposed disciplines for the policy space with respect to key sectors of the Tunisian economy. Upon this basis, the organizations demand in particular: (i) an independent assessment of the economic effects of the Association Agreement of 1995; (ii) independent assessments of the effects of the DCFTA on economic and social rights; (iii) a fully transparent negotiation process that allows civil society organizations to effectively take part in the process; and (iv) provisions that ensure the free movement of persons in parallel to the free movement of goods, services and capital.¹⁸ These demands were reiterated both by subsequent public pronouncement of specific civil society organizations,¹⁹ and also by our interview partners in Tunis. UGTT representatives explicitly emphasized that negotiations on the DCFTA should only proceed after the results of the independent assessments of both the AA and the DCFTA were presented to the public, and upon that basis, a negotiating mandate for the government was defined in close consultation with civil society. Existing impact assessments, in particular the Trade Sustainability Impact Assessment of the EU (Ecorys 2013) as well as the impact study by the government-related *Institut Tunisien de la Compétitivité et des Etudes Quantitatives* on the DCFTA impact on the Tunisian service economy (ITCEQ 2016) were deemed insufficient, since the organization commissioned with the study was not considered independent. At the time of our field research, the government had reacted to these demands by opening a public tender for the commissioning of the assessment study on the AA. A decision was still pending.

With respect to the perception of the private sector, a survey conducted among entrepreneurs and managers in 2016 and 2017 showed that a majority of agricultural companies was against the adoption of the DCFTA, while service sector companies were undecided and manufacturing companies were in favor of the agreement. Amongst the priorities for the negotiations, companies highlighted the need to simplify administrative procedures, and the reform of RoO (IACE 2017). The latter was repeatedly highlighted by interview partners from the T&A sector as the most important expectation they held with respect to the negotiations. Public statements from various business federation representatives echo the reservations of the private sector with respect to the DCFTA. Officials from UTAP, the farmers' organization, have highlighted the need to exploit the flexibilities of DCFTA for granting exemptions for sensitive agricultural products, while also initiating in parallel a

¹⁸ For the full text of the statement see <http://www.aleca.tn/wp-content/uploads/2016/03/Déclaration%20de%20la%20société%20civile.pdf> (10.07.2017)

¹⁹ See e.g. the declaration of 18 September 2016 issued by Solidar Tunisie and the Global Progressive Forum: <http://www.aleca.tn/wp-content/uploads/2016/09/declaration%20solidarf.pdf> (10.07.2017)

program for the modernization of the traditional agricultural sector.²⁰ UTICA representatives have, besides stressing offensive demands for simplified RoO and the free circulation of persons, highlighted the need for upgrading programs both in manufacturing and service industries, so as to be able to compete with EU companies at a par.²¹

Given this panorama of perceptions with respect to the DCFTA, the Tunisian government will face a rather complicated task in trying to mediate the diverging interests. Nevertheless, a certain convergence of views seems to emerge on certain substantive issues. Specifically, upon the basis of a broadly shared understanding of the strengths and weaknesses of the Tunisian economy, (i) the view is broadly shared that offensive interests are particularly related to RoO, particular service industries such as ICT services and the freedom of movement for natural persons (Mode 4), and (ii) an ambitious liberalization of agriculture as well as of public procurement will be detrimental to the social and regional cohesion of the country. However, marked differences exist with respect to the process of negotiations. While the private sector demands to speed-up negotiations, the trade unions and civil society make their support conditional upon comprehensive impact assessment and a participatory approach to negotiations.

Ironically, the demand that enjoys the broadest societal support, that is the liberalization of the freedom of movement for natural persons (Mode 4), stands arguably the slightest chance of being conceded by the EU, given the strong anti-immigration bias currently visible in EU politics. According to our interview partners from the EU Delegation in Tunis, for the moment negotiations are de-facto on hold and the EC is in stand-by mode, waiting for the Tunisian side to make up its mind and set the next step in the negotiating process. It remains to be seen when and how that will happen.

²⁰ See e.g. interview with Omar Behi, UTAP Vice-President in *Breves d'Union - Lettre d'Information de la Delegation de l'Union Européenne en Tunisie, Supplement Thématique 2: 4*. http://eeas.europa.eu/archives/delegations/tunisia/documents/newsletters/supplement_thematique_2_aleca_fr.pdf

²¹ See statement of UTICA representative Mohsen Trabelsi, cited in the online magazine *African Manager*. https://africanmanager.com/51_laleca-fait-peur-aux-adherents-de-utica-trabelsi/ (12.07.2017); see also interview with UTICA representative Nafaa Ennaifer in *Breves d'Union - Lettre d'Information de la Delegation de l'Union Européenne en Tunisie, Supplement Thématique 2: 4*. http://eeas.europa.eu/archives/delegations/tunisia/documents/newsletters/supplement_thematique_2_aleca_fr.pdf

4.3. CASE STUDY III: Textile and Apparel Tunisia

The textile and apparel (T&A) sector is expected to be affected by the DCFTA particularly through the potential impact of changes to the RoO requirements. Changes in the RoO might affect EU-Tunisian, regional and global trade flows particularly in textile inputs depending on the specific agreed upon product rules and types of cumulation stipulations.

The sectorial case study of the T&A sector in Tunisia shows the importance of specific sector and value chain dynamics as well as local conditions in being able (or not) to use market access potentials provided through FTAs on the export side. To understand the development implications of the DCFTA on Tunisia's T&A sector, it is first crucial to analyze the potential regulatory changes the DCFTA might bring about. But the analysis of regulatory changes has, secondly, to be done in combination with assessing competitive business dynamics within the T&A GVC and particularly the sourcing and investment strategies of lead firms/buyers and foreign investors to understand potentials and limitations for export responses. Thirdly, local conditions clearly have a large impact on the possibilities to use the export potential of the DCFTA. In this regard, the importance of sector-specific support policies and the important role of development cooperation in capability building in production as well as in labor and environmental standards compliance is highlighted.

This section starts with an overview of the T&A sector in the European macro-region²² and the development of the T&A export sector in Tunisia, including the importance of different end markets and preferential market access, types of firms and upgrading processes in the sector. In the following, potential regulatory changes of the DCFTA specific for the T&A sector are discussed followed by an overview of potential impacts on Tunisia's sector discussing opportunities and challenges of the DCFTA. The last section concludes and provides policy recommendations.

4.3.1. The textile and apparel sector in the European macro-region²³

The apparel industry in Europe has experienced dramatic transformations, particularly since the 1990s, which involved the relocation of manufacturing capacities from Western European countries to Central and Eastern Europe (CEE) and North Africa. The deepening of these regional production networks has been propelled by changing industry dynamics and corporate strategies as well as the macro-regional integration process driven by regional trade agreements. The extension of these networks enabled Western European lead firms to access suppliers that offer lower costs as well as short lead times, responsiveness and flexibility. For supplier firms in CEE and North Africa, the integration into Western European production networks offered increased export and employment opportunities, but at the same time it often led to concentration in low-value and flexible production arrangements.

While labor cost is a main factor in sourcing decisions of lead firms in the apparel sector, other considerations have also become important. One of the most influential trends is the increasing importance of time. This is related to the shift to lean retailing and just-in-time delivery where buyers defray the inventory risks associated with supplying apparel to fast-changing, volatile and uncertain markets by replenishing items in short cycles and minimizing inventories (Abernathy et al. 1999, 2006). The increasing dominance of fast fashion – a business model that is based on increased variety and fashionability and permanently

²² An overview on the global textile and apparel sector is provided in Grumiller et al. (2018) Section 4.3.1.

²³ This section partly draws on Plank and Staritz (2014).

shrinking product life cycles – underlines these developments (Tokatli 2008). Shorter lead times, quick response and flexibility have however become important not only for genuine fast fashion retailers such as Inditex/Zara which has come to be known as the avant-garde in fast fashion (Plank et al. 2014). Also many traditional retailers follow fast fashion sourcing strategies at least for specific product lines. One consequence of this development is that geographic proximity to end-markets has increased in importance in sourcing decisions (Salmon 2013).²⁴

Organizational dynamics in apparel GVCs have to be assessed in the context of the changing regulatory landscape as production networks and developmental outcomes are also determined by “several layers of institutional environments” (Bair/Gereffi 2003: 165). In particular, the MFA quota system impacted on trade and employment patterns in the apparel sector and its phase out has increased global competition and consolidation. This liberalization process is, however, uneven as tariffs still remain relatively high compared to other manufacturing sectors and hence preferential market access continues to strongly impact on the articulation of apparel GVCs (Staritz 2011; Frederick/Staritz 2012a, b). Regional trade agreements have favored the emergence of regional production networks in Europe, North America and Asia and were part of a broader strategy to secure the competitiveness of the apparel and textile complex in the core countries of the Triad (Bair/Dussel Peters 2006).

In Europe, special trade agreements – referred to as outward-processing trade (OPT) – created favorable conditions for the offshoring and outsourcing of labor-intensive production steps to nearby countries to exploit low labor costs (Pellegrin 2001). This was achieved by allowing EU-based firms to temporarily export inputs for processing to an OPT-partner country and re-import products under preferential conditions, i.e., only paying duty on the minimal value-added (labor) taking place in the neighboring country (ibid.).²⁵ In the case of apparel, it generally involved the export of EC/EU inputs (fabric, cuttings or semi-finished apparel) to nearby lower-cost countries in CEE or North Africa, which made them up into ready-to-wear apparel for re-import into the EC/EU. These trade arrangements promoted a specific division of labor where low cost regional neighbors were largely responsible for labor-intensive assembly production – known as cut-make (CM)/cut-make-trim (CMT) in the apparel industry – whereas more capital-intensive and higher value activities remained based in the EC/EU. As integration deepened in the context of EU accession or the Euro-Mediterranean Partnership these specific RoO regulations were expanded but production structures remained sticky due to a deep-seated division of labor based on OPT relationships (Begg et al. 2003).

The OPT arrangements laid the ground for a flourishing intra-European and European-North African apparel trade in the 1980s and particularly after the collapse of state socialism in the 1990s. Western European apparel manufacturers and retailers increased their involvement in the region, but in different ways based on geographical location, cultural affinity, national industry pressures and existing structures and business contacts (Pincheson 1995; Textiles Intelligence 1997; Begg et al. 2003). German manufacturers started to outsource specific production processes already in the late 1960s to the European environs, including former Yugoslavia, Hungary and Romania (Schüßler 2009). In contrast, Italy was a relative latecomer, due to relatively low domestic wages, the outsourcing potential that was available domestically, the focus on up-market products, and the late date

²⁴ Location per se does however not constitute a major advantage or entry barrier on its own as distance can be compensated by other factors such as infrastructure and logistics, local availability of textiles and vertical integration, supply chain management and other firm-related capabilities and management practices.

²⁵ In the case of apparel these preferential conditions were either reduced tariff rates (tariff OPT) or expanded quota access (economic OPT) (Pellegrin 2001).

of initial capitalization of the Italian industry (Baden 2002; Sellar 2007). The restructuring process of UK's textile and apparel industries also started in the mid-1990s. Like German retailers, large UK retailers often used UK-based manufacturers as intermediaries to sub-contract production to CEE and North African countries (Begg et al. 2003). France was an early and prominent actor in apparel relocations focusing on North African countries, including Tunisia and Morocco, due to their colonial legacy in the region and the common language (Textiles Intelligence 1997).

In the context of regional trade agreements and fast fashion, regional supplier countries increased their market share in the EU-15 in the 1990s and early 2000s to the detriment of some higher cost East Asian countries and more importantly established European supplier countries, particularly Portugal, Spain, Greece and Italy (Baden 2002; Palpacuer et al. 2005) (Table 7). The boom in apparel exports from CEE and North Africa lost momentum in 2004 with the MFA phase-out, as orders shifted to China and other low-cost Asian apparel exporter countries (Gereffi/Frederick 2010; Staritz 2011; Frederick/Staritz 2012c). However, these reductions have not been as dramatic as expected by those foretelling the elimination of regional suppliers (Conway 2006). The global economic crisis had mixed effects – on the one hand, it reduced demand in EU-15 markets, which led to a dramatic export reduction in 2008 and 2009, but on the other hand, some retailers re-assessed their largely Asian-focused sourcing strategies in the context of global insecurities (Textilwirtschaft 2011). In this context, regional suppliers' market share continued to decline but at a relatively modest level, losing market share from 27.2% in 2004 to 21.3% in 2008 and 19.4% in 2013 and finally 17.6% in 2015. CEE-20 countries experienced a declining share from 44.8% in 2004 to 41.0% in 2008. In 2013, the share was 0.3% higher climbing to 43.8 in 2015. North Africa's share increased between 2004 and 2008 from 22.9% to 24.6%, but declined in 2013 to 20.6% and further to 19.6% in 2015 (Table 7).

Table 7: Top 15 apparel exporting countries to the EU-15

	in million EUR							in %						
	1995	2000	2004	2008	2011	2013	2015	'95	'00	'04	'08	'11	'13	'15
World	50.3	78.1	85.5	103.8	116.3	114.3	136,4							
EU-15 (In-	21,8	30,5	32,7	38,87	41,00	41,96	49,61	43.	39.	38.	37.	35.	36.	36.
China	3,54	7,45	11,0	24,33	29,44	25,71	28,77	7.0	9.5	12.	23.	25.	22.	21.
Bangla-	967	2,56	3,68	4,667	7,802	9,506	13,28	1.9	3.3	4.3	4.5	6.7	8.3	9.7
Turkey	3,18	5,32	7,52	7,612	8,241	8,364	8,868	6.3	6.8	8.8	7.3	7.1	7.3	6.5
India	1,58	2,00	2,43	3,826	4,651	4,058	4,986	3.2	2.6	2.8	3.7	4.0	3.5	3.7
Poland	1,60	1,82	1,15	1,421	1,976	2,117	2,922	3.2	2.3	1.3	1.4	1.7	1.8	2.1
Cambodia	43	282	517	554	1,075	1,747	2,903	0.1	0.4	0.6	0.5	0.9	1.5	2.1
Vietnam	271	732	610	1,201	1,660	1,772	2,745	0.5	0.9	0.7	1.2	1.4	1.5	2.0
Romania	972	2,55	3,67	2,349	2,292	2,192	2,330	1.9	3.3	4.3	2.3	2.0	1.9	1.7
Morocco	1,63	2,35	2,41	2,386	2,194	2,092	2,303	3.2	3.0	2.8	2.3	1.9	1.8	1.7
Pakistan	434	595	906	865	1,269	1,366	2,224	0.9	0.8	1.1	0.8	1.1	1.2	1.6
Tunisia	1,72	2,56	2,58	2,580	2,404	2,047	1,979	3.4	3.3	3.0	2.5	2.1	1.8	1.4
Sri Lanka	424	831	806	1,113	1,284	1,268	1,547	0.8	1.1	0.9	1.1	1.1	1.1	1.1
Indonesia	908	1,80	1,32	1,114	1,311	1,179	1,273	1.8	2.3	1.5	1.1	1.1	1.0	0.9
Bulgaria	252	772	1,04	1,132	1,127	1,086	1,115	0.5	1.0	1.2	1.1	1.0	0.9	0.8
Czech Re-	436	528	711	609	602	570	751	0.9	0.7	0.8	0.6	0.5	0.5	0.6
Reg. sup-	12,7	20,4	23,3	22,14	22,56	21,94	24,05	25.	26.	27.	21.	19.	19.	17.
CEE-20**	6,04	9,94	10,4	9,079	9,258	9,055	10,47	12.	12.	12.	8.7	8.0	7.9	7.7
MENA-4***	3,50	5,22	5,35	5,451	5,061	4,525	4,706	7.0	6.7	6.2	5.2	4.3	3.9	3.4

Notes: * Regional suppliers: MENA-4, CEE, and Turkey; ** CEE: Romania, Poland, Bulgaria, Czech Republic, Hungary, Slovakia, Slovenia, Estonia, Latvia, Lithuania, FYR Macedonia, Croatia, Serbia, Montenegro, Albania, Bosnia and Herzegovina, Moldova, Ukraine, Belarus, and Russia; *** MENA-4: Egypt, Jordan, Morocco, and Tunisia.

Source: Eurostat 2017: Comext – Apparel represents HS61+62; World value represents the sum of EU-15 intra and extra trade.

4.3.2. Overview of Tunisia's textile and apparel sector

The T&A sector is of central importance to Tunisia's economy. In the year 2015, 15% of Tunisia's exports accounted for apparel, which makes it the second largest export sector in the country (after the mechanical and electronic industries). The EU is by far the largest end market accounting for 83% of total apparel exports. For the EU, Tunisia is the 9th largest apparel exporter after China, Bangladesh, Turkey, India, Cambodia, Vietnam, Morocco and Pakistan (UN Comtrade 2017). The importance of the sector is also reflected in the number of employees. The T&A sector is Tunisia's largest manufacturing sector in terms of employment, providing jobs for more than 179.000 people or 34% of the total manufacturing workforce in 2013 (API 2014). This is equal to a share of 34 % of the workforce in the manufacturing industry. Up to 90% of the workforce is employed in the exporting sector (ibid.). The great majority of workers are women with a female share of the workforce of around 80 % (Fair Wear Foundation 2015).

Development of the apparel sector

Tunisia's T&A sector has experienced significant changes since the country's independence from France, which have to be seen in the context of shifting economic policies, enhanced economic integration with the EU as well as the GVC dynamics outlined above.

According to Ayadi and Mattousi (2016) the primary goal of the new government after independence in 1956 was to rebuild institutions and the civil service. It strived to advance import substitution and to break free of an economy depending on agriculture, food processing, and mining by adopting a corporatist structure. The failure of this strategy in 1969

led to an economic model combining import substitution, private sector development and export promotion. Heavy industry, transport, water and electricity continued to be dominated by SOEs, whereas private sector activities focused on the textiles and tourism sector. The so called ‘semi-liberal *infitâh* policy’ in the 1970s opened up trade and provided incentives aimed at encouraging the private sector to assume a more active role (ibid.). A number of investment laws were introduced granting next to other things tax concessions and duty-free import of capital equipment, raw materials and semi-processed goods. The laws were mainly directed towards foreign investors producing for export (Di Tommaso et al. 2001). This resulted in a significant expansion of the private sector and a rapid growth of manufacturing employment. Between 1972 and 1977 private investment exceeded public investment for the first time and between 1973 and 1978 85.800 new jobs were created in the light manufacturing industry: 54% of new investments and 87% of the employment generated was in the textile, apparel and leather goods industries. The later numbers depict the over-concentration of investment towards sectors, which are known for labor intensity and low labor skills requirements. However, the industrialization structure resulting from private capital investment was not only marked by sectoral over-concentration but also regional disparities between profiting Northeastern region and the rest of the country (ibid.).

The liberalizing period during the 1970s went hand in hand with the steady integration of the Tunisian economy into the European Economic Community (EEC) and the EU (Smith 2015). A customs and co-operation agreement was signed in 1976, which allowed for DFQF access of Tunisian industrial goods into the EU. However, ‘voluntary restraints’ on some of the Tunisian textile and apparel exports to the EC were accepted by the Tunisian authorities only two years later in 1978 (EEC 1982: 22).²⁶ Tunisian apparel exports to the EU accounted for 24% of total exports and 53% of manufactured goods exports by 1980 (ibid.). The trade relationship further intensified during the 1980s after European companies started to extensively outsource labor-intensive activities to Tunisia in the context of OPT arrangements. The capital-intensive production of textiles, however, remained in Europe. The Association Agreement signed in 1995 and entering into force of 1998 created a free trade area between the EU and Tunisia in the context of the newly established Euro-Mediterranean partnership (EUROMED). The Association Agreement provided duty free access to the EU market for a significant proportion of industrial products from Tunisia, including textiles and apparel. Trade liberalization was part of a general liberalization framework that encouraged foreign investment and privatization of SOEs during the 1990s (Di Tommaso et al. 2001). Propelled by these regulative measures, the EU accounted for roughly 70% of Tunisian imports, 80% of its exports and 90% of FDI in Tunisia by the late 1990s (Smith 2015: 444).

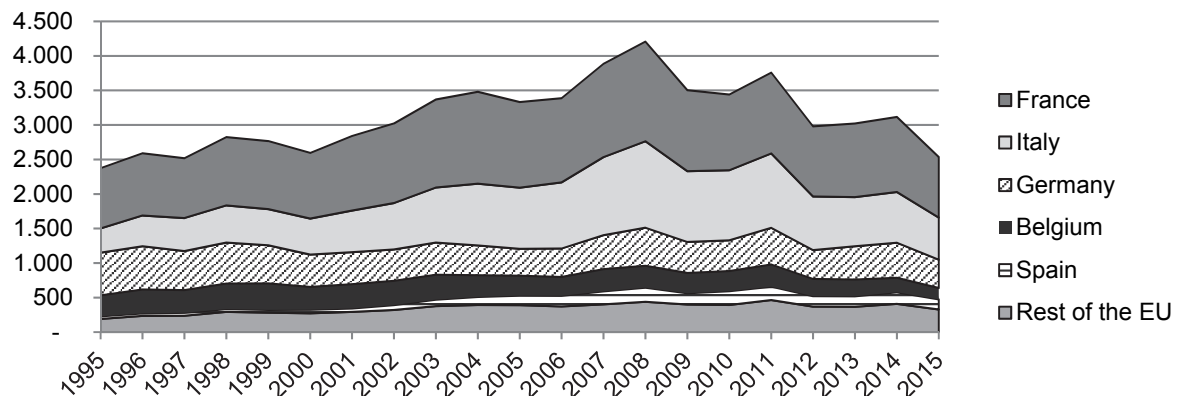
The competitive advantage of the economic integration process with the EU vis-à-vis key competitors that was based on DFQF market access – especially from Asia – deteriorated with the MFA quota phase-out in 2004. The struggle of the Tunisian T&A sector continued in the context of the worldwide economic crisis starting in 2007. Demand from European companies declined with corresponding consequences for Tunisian exports. EU household consumption of textiles and apparel fell for the first time in seven years, and demand has remained relatively stagnant ever since. Finally, the ‘Arab Spring’ revolution in 2011 transformed the Tunisian economic conditions fundamentally. The transition phase after the end of the Ben Ali dictatorship and the lack of a government until 2014 created a political vacuum. The resulting overall economic uncertainty was accompanied by stagnating

²⁶ In the light of the crisis in the EC’s T&A industry, export ceilings for woven cotton fabrics, T-shirts, trousers, shirts and blouses were specified. Additionally, overweigh restrictions regarding the French market for underpants, anoraks and dresses and the Benelux market for skirts were agreed on (EEC 1982: 22).

levels of FDI. Tunisian firms were furthermore confronted with increasing wage demands from workers due to heightened expectations after the liberalization from dictatorship (ibid.: 448ff.).

Today, the EU continues to be by far the biggest export market for Tunisian apparel products (

Figure 9: Tunisia's apparel exports to the EU-28 countries



Notes: Exports represented by imports reported by partner countries; Values in in million USD. Data retrieved 15/05/2017
Source: UN Comtrade 2017

Table 9). Exports elsewhere have increased in particular to Switzerland, the USA, China, Russia and Japan. The composition of final markets within the EU-28 strongly coincides with European ownership of firms in Tunisia (see below). France depicts the highest share followed by Italy, Germany, Belgium and Spain (**Fehler! Verweisquelle konnte nicht gefunden werden.**). Tunisian apparel exports have increased in absolute terms between 1995 and 2011 from USD 2,400 million to USD 4,184 million (Table 8). Exports declined to USD 3,491 million in 2012 in the context of the 'Arab Spring'. There has been a slight recovery during the years 2013 and 2014, however, exports have been on the lowest level since more than 10 years in 2015. Tunisia's share in global apparel exports continuously declined from 1.6% in 1995 to 0.8% in 2015. Woven exports are of particular importance for the Tunisian apparel sector. Even though its share in comparison to knit export declined throughout the late 1990s and 2000s, it has continued to account for around 70% of Tunisia's T&A exports since 2010 (Table 8).

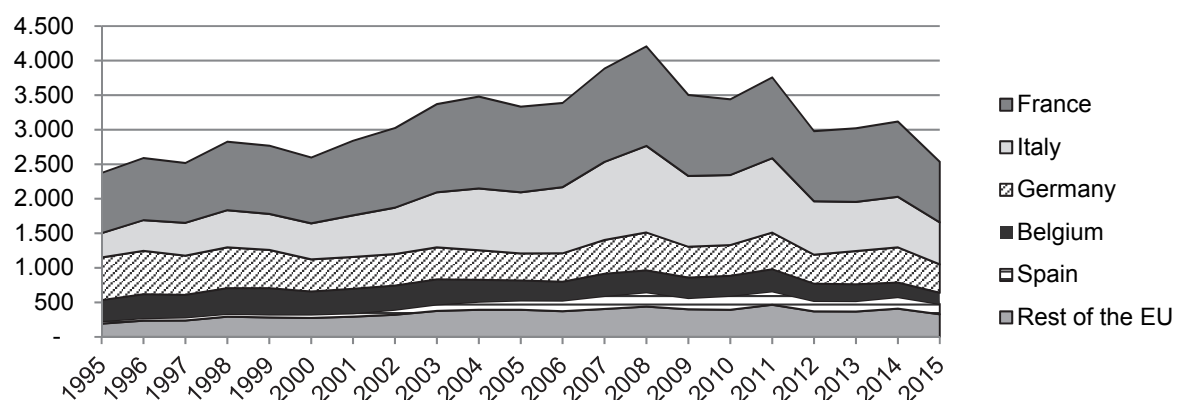
Table 8: Tunisia's apparel exports

	1995	2000	2005	2010	2011	2012	2013	2014	2015
Value (million USD)	2,400	2,654	3,497	3,778	4,184	3,491	3,594	3,700	3,036
Share of global exports	1.6%	1.4%	1.3%	1.1%	1.1%	1.0%	0.9%	0.9%	0.8%
<i>Woven and Knit Values (million USD)</i>									
Woven	1,977	2,055	2,569	2,663	2,948	2,434	2,574	2,622	2,171
Knit	423	600	928	1,115	1,237	1,057	1,020	1,077	865
<i>Woven and Knit Share (%)</i>									
Woven Share	82.4	77.4	73.5	70.5	70.4	69.7	71.6	70.9	71.5
Knit Share	17.6	22.6	26.5	29.5	29.6	30.3	28.4	29.1	28.5

Notes: Exports represent world imports from Tunisia; Apparel represented by HS1992: Woven: HS62; Knit: HS61; Data retrieved 15/05/2017.

Source: UN Comtrade 2017

Figure 9: Tunisia's apparel exports to the EU-28 countries



Notes: Exports represented by imports reported by partner countries; Values in in million USD. Data retrieved 15/05/2017

Source: UN Comtrade 2017

Table 9: Tunisia's Top Five Apparel Export Markets

Country/ Region	Value (million USD)					Share in exports (%)				
	1995	2000	2005	2010	2015	1995	2000	2005	2010	2015
World	2,400	2,654	3,497	3,778	3,036					
EU-28	2,375	2,595	3,333	3,440	2,534	99.0	97.8	95.3	91.1	83.4
Switzerland	5	3	—	—	89	0.2	0.1	—	—	2.9
United States	13	28	55	75	73	0.5	1.0	1.6	2.0	2.4
China	—	—	—	—	65	—	—	—	—	2.1
Russian Fed- eration	—	—	—	37	41	—	—	—	1.0	1.3
Japan	—	7	22	36	37	—	0.3	0.6	1.0	1.2
United Arab Emirates	—	—	—	—	24	—	—	—	—	0.8
Top 5	2,395	2,641	3,433	3,619	2,802	99.8	99.5	98.2	95.8	92.3

Notes: Apparel represented by HS1992 (61+62); Exports represented by partner country imports; (—): indicates country not in top 5 in given year. Data retrieved 15/05/2017.

Source: UN Comtrade 2017

Ownership and location of firms

According to recent data (June 2017) the Tunisian T&A sector includes 1,636 enterprises employing 10 or more workers, of which 459 are totally and 227 partly foreign owned (API 2017). Almost all FDI companies (664 out of 686) are exporting exclusively. The most important player is France with 265 firms (39%) followed by Italy (183; 27%), Belgium (80; 12%) and Germany (71; 10%) (API 2017). Overall, the number of foreign owned companies is on a decline. In 2013, 577 of 1.852 operational enterprises were 100% foreign and 279 partly foreign owned (API 2014).

The location of firms is regionally concentrated. The region with the highest share of T&A firms in Tunisia is Monastir (505 firms respectively 27% of all firms). Grand-Tunis is the second largest T&A region with 363 firms (20%). In addition, the other regions, which show a significant share of firms, are located at the eastern coast. More than three-quarters of all T&A firms are located in Monastir, Grand Tunis, Nabeul (212; 11%), Sousse (194; 10%) and Sfax (146, 8%) (API 2014).

Functions performed

In 2017, around 1240 firms (76% of all T&A firms) in the T&A sector engaged in apparel manufacturing and almost all (88%) produce for export markets only (Table 10 API 2017). Firms producing for the export market tend to be larger in size (API 2014). Based on interviews with the industry association FENATEX and sector experts, around 80% of apparel firms are engaged in CMT and only some larger local companies and FDI firms are engaged in FOB. The pronounced dominance of FDI companies in FOB is due to better access to finance and know-how. Prices are a key determinant in CMT and Tunisian CMT companies are particularly under competitive pressure from Asia. For FOB, prices paid by buyers are higher but supplier firms have to take over more functions and risks in which most firms have no experience and are therefore less competitive. For smaller local firms key problems include the difficult relationships with textile suppliers due to their demand of small quantities as well as the entertainment of a separate logistics department.

Table 10: Tunisian T&A firms by activity (2008 vs. 2017)

Activity	Totally Exporting (TE)		Other than TE		Total	
	2008	2017	2008	2017	2008	2017
Yarn	7	5	23	18	30	23
Fabric	9	11	32	15	41	26
Finishing	21	30	13	13	34	43
Hosiery	203	136	47	32	250	168
Apparel manufacturing	1406	1093	160	146	1566	1239
Other textiles industries	250	203	128	100	378	303

Notes: Enterprises may be counted more than once; TE = Totally exporting

Source: API 2010; API 2017

Since Tunisia's decreasing market share in the EU, many apparel manufacturers still succeeded to upgrade processes and products (Smith 2015: 450f.). Upgrading took place in the context of changing demands of EU buyers for higher quality products and lower lead times. Product upgrading generally did not lead to an increased economic security for firms, but at least they were able to sustain a status quo market share, even if it has not translated into widespread employment and productivity gains or enhanced economic security. The need for process upgrading has to be seen in the context of buyers' demands for decreased turnaround time, time to delivery as well as enhanced product quality and was particularly achieved by increased quality control mechanisms. Process upgrading enabled firms to retain production and employment levels despite increasing external pressures. Upgrading to FOB, however, has become increasingly constraint in the context of the 'Arab Spring' and decreasing FDI inflows as well as foreign ownership of companies (ibid.).

The textile sector in Tunisia is comparatively small and included 26 firms in 2017, only 11 of which were exclusively oriented towards the export market (Table 10). This is a significant decline compared to 41 companies in 2008, in particularly due to a decline in more domestically oriented textile firms. The largest companies²⁷ are integrated along the whole chain, including the production of yarn, fabric, finishing and apparel manufacturing. The upstream segment of the export oriented T&A value chain has been stable in recent years, which indicates to a certain degree the crisis resistance of large vertically integrated and often FDI owned companies.

Export products

In Tunisia, woven apparel items had a significantly larger export share to the EU (71%) compared to knitted items (29%) in 2015 (Table 8). This is also reflected in the top 10 apparel exports to the EU. Trousers made of cotton are by far the most important export item. Men's trousers at the top of the list account for 21.3% of total apparel exports to the EU and women's trousers for 11.0%. All the other items have a share below 4.3%. In total, the top 10 product categories account for 57.4%. Next to trousers the most important products are shirts and tracksuits and with secondary importance brassieres and women's swimwear. The comparison of the unit values of the top 10 exports products from Tunisia to the average unit values of EU imports reflects the comparatively high average value of Tunisian apparel exports for most products. The high value is particularly generated due to the exportation of high quality and fast fashion products (Table 11).

²⁷ These include Sitex (woven, Denim), VTL (knit), DEMCO (knit) and TFCE (knit).

Table 11: Top 10 EU-28 apparel imports from Tunisia in 2015

HS Code	Products	Value (million EUR)	Share (in %)	Unit values (EUR/kg)	Average UV (EUR/kg)*
	Total	1,995			
620342	Men's trousers, cotton, excl. knitted	424	21.3	29.1	19.7
620462	Women's trousers, cotton, excl. knitted	219	11.0	31.7	21.2
610910	T-Shirts, knitted	87	4.3	17.7	15.9
621210	Brassieres, incl. knitted	80	4.0	80.8	43.4
621132	Tracksuits of cotton, excl. knitted	65	3.3	16.1	17.7
621133	Tracksuits of man-made fibres, excl. knitted	65	3.2	18.9	18.7
610990	T-Shirts, knitted, excl. cotton	62	3.1	23.6	25.7
620520	Men's Shirts, cotton, excl. knitted	60	3.0	39.7	29.4
620343	Men's trousers, synthetic fibres, excl. knitted	42	2.1	28.2	21.3
611241	Women's Swimwear	41	2.0	51.9	40.2
Top 10		1,145	57.4		

Notes: * These are the average unit values of EU imports from the world of the top 10 export products of Tunisia.
Source: Eurostat 2017

4.3.3. Regulatory changes through the DCFTA

Tariffs and Rules of Origin on the export side

Today, the Association Agreement signed in 1995 between Tunisia and the EU grants DFQF access for apparel products (Table 12). The DCFTA thus yields no potential in terms of tariff reductions for the apparel sector. Instead, the Tunisian apparel sector is increasingly confronted with preference erosion due to the EU's expansion of free trade agreements, which also includes competitive apparel exporting countries such as Vietnam. The competitiveness of Tunisia's apparel sector thus increasingly needs to be based on shorter lead times as well as high productivity and quality production instead of tariff preferences.

Table 12: Tariffs on apparel

		MFN*	GSP	Euromed	DCFTA
HS 61	Knitted or crocheted	11.7	9.4	0	0
HS 62	Not knitted or crocheted	11.3	9.0	0	0

Notes: *Average of the HS codes.
Source: UN Comtrade 2017, WTO 2017.

Since the DCFTA will have no impact on tariffs, other regulations such as RoO play a more significant role in the negotiation process. RoO regulations are crucial as they determine if producers of T&A products can make use of preferential market access. For apparel, RoO are commonly differentiated in *single transformation*, where only the sewing stage has to take place in the beneficiary country (fabric to apparel), *double transformation* (fabric forward rule), where also one input production step has to be conducted such as knitting or weaving of fabric (yarn to fabric), and *triple transformation* (yarn forward rule), where in addition to knitting/weaving also the spinning of yarn has to take place in the beneficiary country (fiber to yarn). The specification of these manufacturing processes have a huge impact on possible sourcing practices and competitiveness, since they define whether or not firms can source intermediate inputs from abroad and continue to qualify for preferential access to the EU market.

Since textile production is more capital and scale intensive than apparel production, double and triple transformation act as a significant market barrier for countries or regions without a competitive textile sector as these characteristics make establishing a competitive textile sector challenging. Furthermore, even in the case of a developed textile sector, exporting firms might still need to source additional fabric and yarn from abroad. This is often a requirement to be part of certain GVCs as lead firms/buyers stipulate textile mills on a global basis that have to be used by their apparel suppliers. Hence, even though the motivation for more restrictive RoO might be to support backward integration, double and triple transformation RoO may hinder market access in GVCs. However, importing textile from abroad has also disadvantages in terms of lead times, flexibility and costs. Thus, developing competitive local or at least regional textiles sectors that can be used for the production of apparel exports will be crucial for competitiveness and value added reasons but imports will still be required as not all types of textile products can be produced locally.

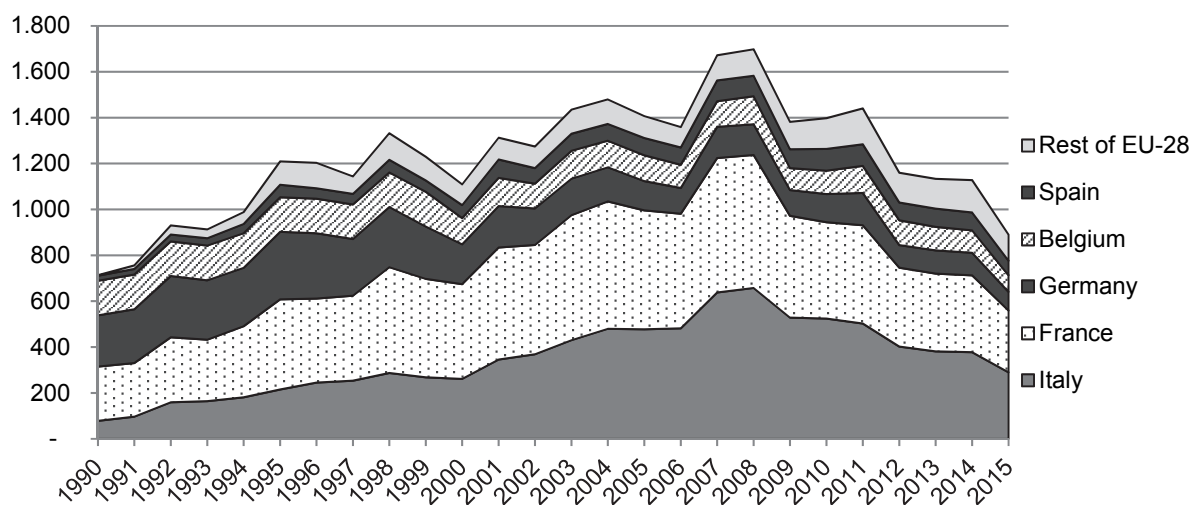
The RoO for Tunisian apparel exports to the EU currently require double transformation, but also allow for bilateral and diagonal cumulation with textile imports from the EU as well as members of the Pan-Euro-Mediterranean preferential rules of origin, which includes, most importantly, textile imports from Turkey. These RoO as well as buyers' requirements are the main reasons why Tunisia almost exclusively imported textiles from the EU until the mid-2000s (Table 13). The largest textile exporters to Tunisia are Italy, France, Germany, Belgium and Spain (Figure 10). The share of textile imports from the EU dropped from over 90% in the early-2000s to 62.8% in 2015. Today, the Tunisian apparel sector increasingly sources textiles from Turkey (15% of total textile imports in 2015) in particular due to more flexible cumulation rules (Table 13). Textile imports from China (8.1%), India (4.4%) and Pakistan (2.3%) are also of rising importance; however, textiles from these countries do not qualify for duty-free apparel exports to the EU.

Table 13: Tunisia's Top 5 Textile Import Countries

Country/ Region	Value (million USD)					Share (%)				
	1995	2000	2005	2010	2015	1995	2000	2005	2010	2015
World	1,289	1,207	1,614	1,845	1,418					
EU-28	1,203	1,109	1,407	1,397	890	93.3	91.9	87.2	75.8	62.8
Turkey	7	13	40	153	214	0.6	1.1	2.5	8.3	15.1
China	7	11	42	88	115	0.5	0.9	2.6	4.8	8.1
India	6	2	27	35	62	0.5	0.1	1.7	1.9	4.4
Pakistan	—	11	13	20	33	—	0.9	0.8	1.1	2.3
Egypt, Arab Rep.	—	—	—	7	21	—	—	—	0.4	1.5
Morocco	—	—	—	—	20	—	—	—	—	1.4
Korea, Rep.	—	—	10	12	14	—	—	0.6	0.7	1.0
Top 5	1,239	1,145	1,530	1,695	1,273	96.1	94.8	94.8	91.9	89.8

Notes: Textiles represented by SITC 65 Rev. 3. Imports represented by partner country exports to Tunisia. (—): indicates country not in the top five in given year.
Source: UN Comtrade 2017

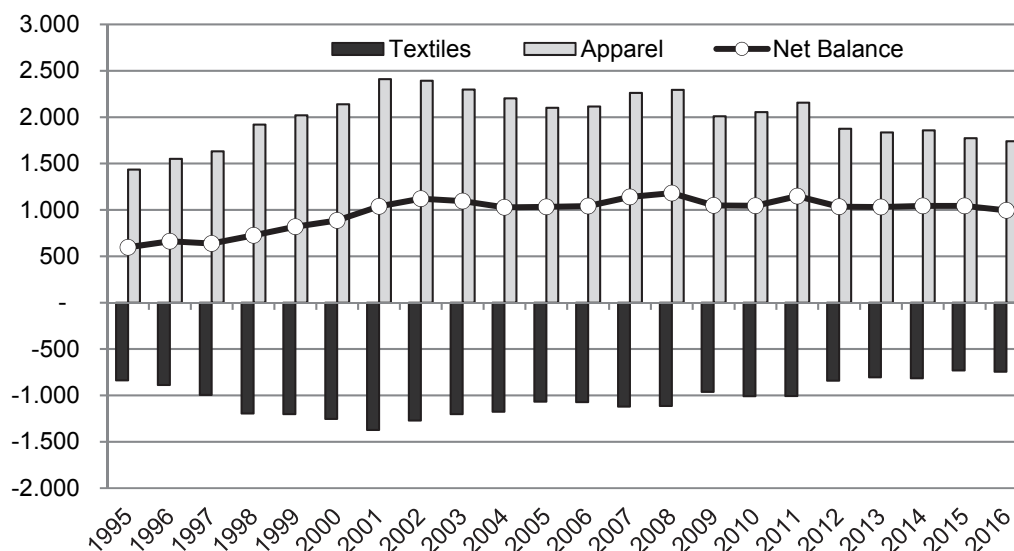
Figure 10: Tunisia's Textile Imports from EU-28 by Country (million USD)



Source: UN Comtrade 2017

Figure 11 depicts the trade balance in the T&A sector between Tunisia and the EU. Tunisia's trade surplus in the T&A sector amounted to almost EUR 1 billion in 2015 due to a trade surplus in apparel but a trade deficit in textiles. Tunisia was able to sustain the level of the trade surplus vis-à-vis the EU in recent years despite decreasing apparel exports due to the above mentioned decreasing share of textile imports from the EU. In this context, it must be mentioned that in addition to the textile imports from the EU, Tunisia also imported around USD 200 million apparel from EU (largely Italy and France) from a total of around USD 393 million apparel imports.

Figure 11: Tunisia-EU trade balance in textile and apparel (million EUR)



Notes: Textiles represented by SITC 65 Rev. 3., Apparel represented by HS 61 and 62.

Source: Eurostat 2017

During the field research, stakeholders of the Tunisian apparel sector strongly criticized the double transformation rule and its 'discriminatory effect' since under double transformation textiles have to be sourced from the EU or EuroMed partners, in particular Turkey.

This is perceived as leading to higher prices and thus as detrimental to the competitiveness of the Tunisian apparel sector since it limits apparel producers' flexibility to source competitive textiles from the cheapest suppliers. During the interviews, owners of Tunisian apparel companies furthermore claimed that they have repeatedly imported falsely labelled textiles from the EU at a higher price (e.g. Chinese textiles labelled as made in the EU). Apparel companies in Tunisia are therefore strongly in favor of introducing the single transformation rule for Tunisian apparel exports to the EU in the context of the DCFTA.

The DCFTA could potentially change the Tunisian T&A-RoO from double to single transformation.²⁸ The single transformation rule would benefit the Tunisian apparel sector since it would enhance its flexibility to source competitive textiles from around the world for DFQF apparel exports to the EU. The single transformation rule is therefore likely to improve the integration into GVCs as well as the competitiveness of the Tunisian apparel sector due to improved access to (price) competitive textiles for apparel exports to the EU. In case the DCFTA would grant single transformation, Tunisia should however not only rely on importing textiles from abroad since the expansion of the textile sector in Tunisia could yield significant benefits in terms of lead times, flexibility and costs as well as local value creation and linkages. However, it is unlikely that the EU will grant Tunisia single transformation RoO as they have only granted single transformation to selected countries such as LDCs in the context of EBA as well as ACP countries in the context of the EPAs.

Tariffs on the import side

As mentioned above, Tunisia is not only exporting, but also importing apparel in particular from Italy (22.7% of total imports in 2015), France (17.3%), China (10.3%), Portugal (6.5%) and others (Table 14). In 2015, Tunisia imported apparel worth USD 393 million which is significantly less compared to the 2000s. The traditional supplier countries (Italy, France and Germany) lost their market share to China, Portugal and Turkey. Tariff changes due to the DCFTA will not have an effect on T&A imports from the EU, since T&A products are currently already imported DFQF (WTO 2017).

Table 14: Tunisia Apparel Imports by Country

Country/ Region	Value (million USD)					Share (%)				
	1995	2000	2005	2010	2015	1995	2000	2005	2010	2015
World	421	432	560	518	393					
Italy	98	146	197	176	89	23.3	33.8	35.1	34.1	22.7
France	152	140	179	122	68	36.0	32.4	31.9	23.5	17.3
Unspecified	1	2	7	19	54	0.3	0.5	1.3	3.7	13.8
China	0	3	10	21	40	0.0	0.7	1.8	4.2	10.3
Portugal	0	1	22	26	26	0.1	0.2	3.9	5.0	6.5
Turkey	0	0	2	7	25	0.0	0.1	0.3	1.3	6.4
Germany	61	27	20	31	23	14.4	6.3	3.5	5.9	6.0
Belgium	40	28	30	41	20	0.0	6.4	5.3	7.9	5.1
Top 5	386	369	469	396	278	91.8	85.5	83.8	76.4	70.6

Notes: Apparel represented by HS 61 and 62.

Source: UN Comtrade 2017

²⁸ A change of the ROO would negatively affect diagonal cumulation possibilities allowed for in the Regional Convention on Pan-Euro-Mediterranean Preferential Rules of Origin since diagonal cumulation for exports to the EU would require identical ROO.

Investment side

Since the Tunisian revolution in 2011, the FDI inflows into the T&A sector have declined significantly. The annual FDI flows into the sector averaged TND 39.4 million between 2012 and 2015, compared to TND 94 million per year between 2001 and 2009 (FIPA 2016, UNCTAD 2012). This translates also in a deterioration in relative terms, as the share of the T&A FDI inflows compared to total FDI in all industrial sectors, declined to 7.7% between 2012 and 2015 compared to 11.7% in the period from 2006 to 2012 (FIPA 2016; World Bank 2014).

Regaining dynamics in FDI via the DCFTA depends on changing market access, RoO and investment security. The DCFTA will not improve market access to the EU in terms of reduced tariffs, since Tunisia already enjoys DFQF access to the EU market. The currently applied double transformation rule incentivizes investments in textiles, since textiles from third countries – with a few exceptions (see above) – do not qualify for DFQF access to the EU market. If anything, the introduction of the single transformation rule in the DCFTA could reduce investments into the textile sector. The benefits of the single transformation rule, however, could incentivize investments into the apparel sector. An ISDS mechanism alone is not likely to increase investments into the T&A sector, in particular since Tunisia already has bilateral investment treaties with all major EU member countries.²⁹

Sustainability chapter

The EC asserts in its new trade and investment strategy that economic growth and trade liberalization has to be aligned with “*social justice, respect for human rights, high labor and environmental standards, and health and safety protection*” (EC 2015: 22). Consequently, provisions relating to sustainable development have become the norm in recent EU FTAs. In how far this translates to the DCFTA with Tunisia will be up to negotiations. In any case, by the inclusion of social issues and labor rights as a key element in the EU approach to trade and sustainability the T&A sector is potentially affected.

Tunisia has already ratified all core conventions of the ILO. The Fair Wear Foundation (FWF) states in its 2015 country study, that Tunisia is, regarding the freedom of association, the right to collective bargaining and the right to strike, not amongst high-risk countries. Nevertheless, it reports of occasional problems within the sector, including limitations to workers’ right to collective bargaining. Even though a collective bargaining agreement (CBA) covering the T&A sector exists, CBA coverage applies to only roughly 20% of the workers. FWF adds that many of the articles in the CBA are not applied in practice and the degree of compliance is different from one company to another. The FWF further identifies the following sustainability issues in the Tunisian T&A sector: low union participation in company consultative committees; low wages in comparison to increasing costs of living; unannounced overtime and improper compensation and social contributions; issues concerning workplace safety and accident prevention; as well as short-termed contracts for workers (FWF 2015).

The current integration of the Tunisian T&A sector into GVCs and lead firms’ demand for more production flexibility has furthered short-term contracts for workers in the T&A sector. To cope with the demanded production flexibility the firm-level risk was transferred down the value chain to sub-contractors and again to employees (Smith 2015). It can be regarded as a direct outcome of the fast fashion model that among both CMT and FOB firms the majority used non-permanent staff, allowing them to manage short-term orders and to deal with the unpredictability and changing nature of contracts with lead firms by ensuring

²⁹ Tunisia currently has signed 19 bilateral investment treaties with EU countries (UNCTAD 2017).

production flexibility and reducing risk (Plank et al. 2012). Even though global buyers have taken compliance with labor standards central in their sourcing decisions and many global buyers have developed codes of conducts (CoC) that include labor standards and conduct regular audits, such corporate social responsibility (CSR) measures tend to be selective and may be in contradiction to the core sourcing requirements of buyers (see Plank et al. 2014).

Labor rights are formally guaranteed in Tunisia through the ratification of the ILO core conventions. However, the creation of institutional structures including the private sector, government and civil society actors – as envisaged in recent sustainability chapters – could provide important improvements to laws and regulations in traditional supplier country national, which often suffer from lack of enforcement as well as private sector driven CSR initiatives. As these mechanisms should involve EU and partner country actors, they could become particularly effective in comprehensively dealing with labor issues and related competitive dynamics along with sourcing requirements in apparel GVCs. However to ensure the effectiveness of these mechanisms and the implementation of labor clauses and of remedies for labor violations, a high level of involvement of civil society actors as well as Labour Ministries and Labour Inspectorates at the EU and partner country level is required.

4.3.4. Conclusions and policy recommendations

The T&A sector has significant importance for Tunisia's economy in terms of employment and export earnings. The T&A sector has grown impressively since the 1970s until the 1990s and early-2000s, but has come under pressure with the phase out of the MFA in 2004 and subsequently growing competition. The global and EU/Eurozone economic crisis since 2007 as well as the Arab Spring after 2011 exacerbated political and economic uncertainty, thus adding to the challenges of Tunisia's T&A sector, the important achievements inter terms of political freedom and democracy notwithstanding.

An important feature of the T&A sector is its high dependence on the EU market, which accounted for 83% of total apparel exports despite decreasing tendencies. The close links to the EU are also apparent in the strong EU-FDI presence in Tunisia's T&A sector as well as the high share of textiles imported from the EU due to bilateral cumulation rules. The geographic proximity of Tunisia's apparel production to the EU market is the T&A sector's biggest asset in light of EU buyers' demands for low lead times. The sector furthermore benefits from well-established capacities and capabilities, in particular in apparel manufacturing, which allowed for product and process upgrading in recent years (fast fashion and high quality products). The main challenges of the sector include the remaining dominance of CMT firms and the large dependency from imported textiles as a consequence of the lacking domestic textile industry.

The high dependence of the Tunisian T&A sector on the EU market makes the trade relationship and regulations even more important. Overall, the impact of the DCFTA on the T&A sector is difficult to assess due to existing trade agreements and the early stage of the negotiation process. The Association Agreement of 1995 between Tunisia and the EU already provides DFQF access for T&A products. Theoretically, the DCFTA could nonetheless significantly affect the T&A sector in case of a change of the RoO from double to single transformation.

Given the early stage of the DCFTA negotiation process, adaptations to the negotiating strategy of the EU are still possible, which would have a positive impact on the pro-developmental outcomes for the Tunisian economy and the T&A sector in particular. To this end, the following policy recommendations are particularly instrumental:

- a) **Grant single transformation to Tunisian apparel exports to the EU:** given the fact that the EC has so far offered single transformation only to selected countries (e.g. LDCs within the framework of EBA or ACP countries within the EPAs), it is unlikely that a likewise offer will be extended to Tunisia. The single transformation rule would benefit the Tunisian apparel sector in terms of increasing flexibility to source competitive textiles in particular from China, Pakistan, India and other producer countries. Given the difficult external and internal situation of the Tunisian apparel sector and the need for policies to increase its competitiveness, single transformation would be a useful short-term measure to support the apparel industry. The introduction of the single transformation rule could however constrain investments into the textile sector and thus supply chain upgrading. The development of a local textile sector is also beneficial with single transformation and required to increase lead times and flexibility particularly in the context of fast fashion as well as to increase local value addition and linkages (see next policy recommendation). Still, overall, the benefits of single transformation arguably outweigh its costs and hence the EU should accept such flexible RoO in the DCFTA from a developmental perspective.
- b) **Support investments for the build-up of a domestic textile sector:** The expansion of the textile sector should regain strategic importance in order to benefit from lower lead times, increased flexibility, lower input costs and an expansion of local value added activities. The reduction of lead times due to the availability of local fabrics could particularly benefit the fast fashion segment of Tunisia's apparel sector. Given limited state and industry capacities, developing the domestic textile sector will need to adopt a medium-term trajectory. In a first phase, the focus should lie on developing a domestic industry for finishing services, before projects for the development of the more technologically advanced textile production should be envisaged. Such a medium-term strategy should be supported by EU development cooperation, both in terms of providing technical advice and financial support via e.g. the provisioning of investment credits for local Tunisian as well as EU companies with an interest in setting up textile mills in Tunisia.
- c) **Provide affordable credit and capability building to the apparel sector for upgrading:** in the apparel sector, Tunisia is in the process of positioning itself as a more advanced apparel supplier extending its role from CMT production to FOB and partly ODM production, increasing local value added. In light of increasing competition and preference erosion to the EU market, the Tunisian apparel sector needs to intensify product, functional and process upgrading in order to expand the exportation of higher value-added products (e.g. high quality and fast fashion) and functions and decrease lead times. However, upgrading processes for the large majority of small and medium-sized local firms are expensive and hampered by the very limited access to credit from domestic banks. The establishment of affordable credit facilities to build up robust working capital endowments in apparel firms for FOB production and other productive investments should thus be supported by EU development cooperation. Further, capability-building measures particularly for small and medium-sized firms are necessary to extend capabilities required for upgrading which could be also supported by EU development cooperation. Linking larger local or FDI firms with smaller firms through subcontracting arrangements can be a potentially important channel for learning and upgrading of smaller firms and hence should be supported by policy incentives.

4.4. CASE STUDY IV: Olive Oil Tunisia

The sectorial case study of the olive oil sector in Tunisia shows the importance of specific sector and value chain dynamics as well as local and, more importantly, international constraints in being able to use and profit from potentially enhanced market access on the export side. To understand the potential development implications of the DCFTA for Tunisia it is crucial to analyze the current market access regulations as well as discuss potential changes due to the DCFTA. This has to be done in combination with assessing competitive business dynamics within olive oil GVCs and particularly the sourcing and business strategies of lead firms to understand the potentials and limitations for Tunisian olive oil exports. Local conditions, of course, also crucially affect the possibilities to use potential market access improvements of the DCFTA.

From a development perspective, it is not only important to improve conditions for and outcomes in production for agricultural sectors but also to assess and support opportunities for upgrading to higher value added activities. The olive oil value chain is an example of an agricultural value chain in which lead firms in the traditional producer countries (mainly Italy, Spain, Greece and Portugal) continue to retain higher-value added activities of the chain (branding and bottling). Non-EU exporters of olive oil thus struggle to upgrade from bulk exports. The case study will show which conditions are necessary for non-EU exporters to utilize upgrading opportunities due to changes in demand patterns for olive oil, most importantly increasing demand in non-traditional markets³⁰ and niche markets for high quality products.

The case study of the Tunisian olive oil sector highlights local constraints in the olive oil value chain and the struggle of non-EU exporters for product and functional upgrading in the context of increasing demand in non-traditional markets as well as restricted market access and high competition in the EU. Furthermore, it shows the potential of the DCFTA to promote higher-value added olive oil exports to the EU. The next section starts out with an overview of the global olive oil value chain and highlights its dynamics as well as governance structures. Thereafter, we describe the olive oil sector in Tunisia by focusing on the role and key challenges of olive as well as olive oil producers and exporters. Based on this analysis, we discuss the potential impact of the DCFTA on the sector in general and upgrading opportunities in particular.

4.4.1. The Global Olive Oil Value Chain

The production of olive oil is geographically concentrated in Mediterranean countries. EU countries are the most important producers with a global market share of more than 70% (IOC 2016). All EU countries are also the major consumers of olive oil taking up more than 55% of total output in 2015/16. However, non-EU markets have become more important over the last two decades, especially the US. The olive oil GVC is a buyer-driven bi-polar value chain, with lead firms in the manufacturing of bottled and branded olive oils as well as in the retailing segment (distributor brands) (cf. Coq-Huelva et al. 2011). Lead firms in the core EU producer countries focus on high-value added activities, in particular bottling and branding and/or retailing, for which they combine olive oils from various producers and origins³¹. Thus, they exert strong control over the value chain, which makes it difficult for

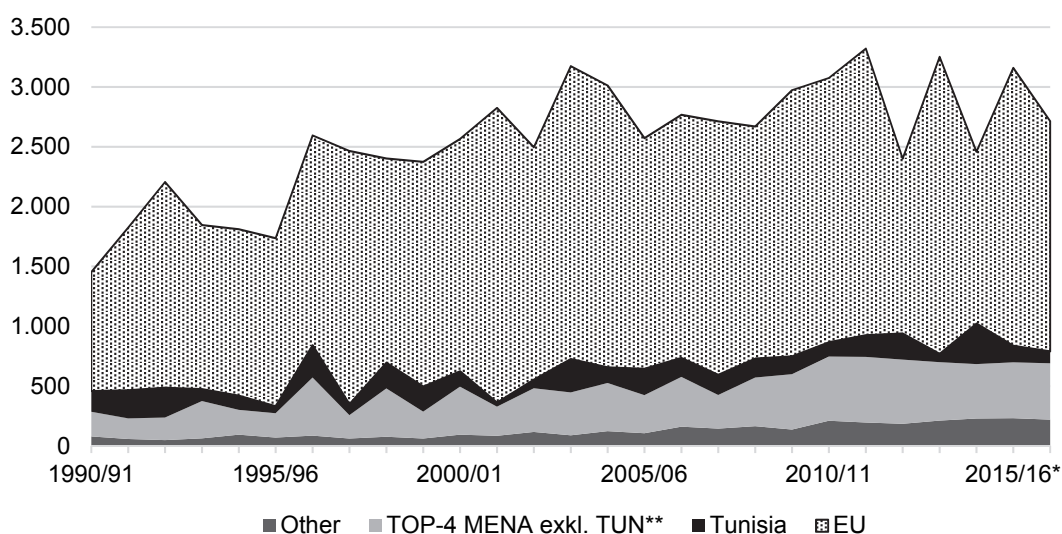
³⁰ Traditional markets are markets with major and historically grown olive oil production and consumption (Spain, Italy, Greece, etc.). Traditional olive oil markets also tend to be the largest importers of olive oil since they are closely connected with well-established olive oil processors and brands.

³¹ Lead firms do not necessarily produce olive oil themselves.

producing countries and exporting companies outside the EU to achieve product upgrading and promote higher value activities. With increasing demand for olive oil in non-traditional markets, however, exporting companies and brands outside the EU increasingly gain opportunities to increase the share of higher-value added product exports. However, the opportunities for product and functional upgrading have to be seen in the context of changes in the global olive oil value chain.

The development of the international olive oil market during the last three decades can be roughly divided into three phases (Lybbert/Elabed 2013). In the first phase until the early 1990s, the expansion of supply and demand was relatively balanced due to increasing production in the major EU producing countries and increasing demand in non-traditional markets (in particular Northern Europe) at the same time. In a second phase, starting in the mid-1990s, there has been significant production growth (Figure 12). Total output of olive oil expanded from 1.7 million tons in 1995/96 to 3 million tons in 2003/4 (IOC 2016). During the third phase, the spread of the Mediterranean diet to health conscious consumers worldwide has not only broadened olive oil markets and stimulated increasing market segmentation by price and quality. In particular, markets for high-value extra virgin oil and top-quality, single origin oils with unique flavor profiles emerged (Lybbert/Elabed 2013). The combination of increasing demand in non-traditional markets as well as the increasing importance of niche markets has created opportunities for non-EU exporting companies to increase production and diversify exports by destinations and grades.

Figure 12: Olive oil production volume over time (thousand tons)



Notes: * Provisional data; ** Algeria, Morocco, Syria, Turkey.

Source: IOC 2016

The processing of olives to olive oil and further processing of oils largely determines the final quality of olive oil. Thus, the exact arrangement of the olive oil value chain depends on the defined olive oil grades³². The olive oil value chain can roughly be divided into five stages: (i) the supply of inputs for olive tree extension; (ii) the production of olives, including

³² The International Olive Council (IOC) differentiates virgin olive oils fit for consumption (extra virgin olive oil, virgin olive oil, ordinary virgin olive oil), virgin olive oil not fit for consumption (lampante virgin olive oil), refined olive oil, olive oil, olive pomace oil, crude olive pomace oil and refined olive pomace oil (IOC n.d.b). (Extra) Virgin olive oils comprise the highest quality. Refined olive oil is obtained by refining virgin olive oil. Olive oil – next to virgin oils usually found in supermarkets – consists of a blend of refined olive oils and virgin olive oils (ibid.).

growing of the tree and harvesting of the fruit; (iii.a) the processing of the olives by mills and, (iii.b) depending on the grade, refineries; (iv) the branding and packaging (and potentially blending); and (v) the distribution of olive oil, e.g. by large or niche retailers. The value chain might include various other actors, such as traders and other intermediaries, for example between olive oil producers and packagers or exporters.

As indicated above, the production of olive oil is regionally highly concentrated. The top six producers are located in the Mediterranean region and were accountable for 92.6 % of the production in the crop year 2015/16 (Table 15). The EU, in particular Spain, Italy, Greece and Portugal represents by far the largest share of global production (73.5%). The EU is also the largest exporting group of countries (73.5 % of global exports, excl. intra EU trade). MENA-countries export only a small share of their production Tunisia is the exception. The country exported around 100,000 tons out of 140,000 tons produced in 2015/16. Tunisia thus exported 71.4% of its production, which represents a global export share of 12.1% in 2015/16 (Table 15).

Table 15: Global olive oil production (crop year 2015/16) and exports (2015/16)

		Production volume (thousand tons)	Share of global production (%)	Export volume (thousand tons)	Share of global exports (%)
1 (1)	EU-28	2,322	73.5	610*	73.5
	<i>Spain</i>	1,401.6	44.0	326.1	39.3
	<i>Italy</i>	474.6	15.0	219.5	26.5
	<i>Greece</i>	320	10.0	10.2	1.2
	<i>Portugal</i>	109.1	3.0	47	5.7
2 (4)	Turkey	143	4.5	20	2.4
3 (2)	Tunisia	140	4.4	100	12.1
4 (5)	Morocco	130	4.1	16.5	2.0
5 (9)	Syria	110	3.5	5	0.6
6 (-)	Algeria	83.5	2.6	0	0
12 (3)	Argentina	19	0.6	30.5	3.7
	Other	212	6.7	47.5	5.7
	Total	3,159.5	100	829.5	100

Notes: Provisional data; Sums may differ due to rounding; * Extra-EU trade only, including inward processing traffic

Source: IOC 2016

The EU is by far the largest consumer of olive oil and meets its demand mainly via domestic production (Table 16). The EU is nonetheless still the second largest importer of olive oil following the US. The large majority of EU imports consist of bulk ware which is processed further by EU buyers (blending, branding, bottling, etc). Depending on the country of origin, these imports are imported duty free or take place either under certain quota criteria or within inward-processing arrangements. The latter allow for duty-free imports from third countries under the condition that the equivalent oil quantity is exported outside the EU after processing. These arrangements strengthen the EU's position as major exporter of olive oil. The US and other non-traditional markets such as Japan, Brazil, Canada and China, meet consumer demand mainly by imports and tend to have a large share of bottled and branded imports. The relatively high domestic consumption in the traditional producing countries of the MENA region is met by domestic production.

Quality standards and grades are of major importance in the olive oil sector. The International Olive Council (IOC) as an intergovernmental organization of stakeholders in producing and consuming countries in the olive oil and table olive sectors plays an important role in setting global standards, in particular concerning guidelines on quality and grading (IOC n.d.a). Its members comprise the leading international producers and exporters of olive oil

with the EU holding 77% of voting rights. The IOC has no enforcement body. Therefore, standards still fall within the competence of the individual member countries. However, national olive oil standards are closely aligned to IOC's standards in order to be able to participate in international trade.

Table 16: Global olive oil consumption (crop year 2015/16) and imports (2015/16)

		Consumption volume (thousand tons)	Share of global consumption (%)	Import volume (thousand tons)	Share of global import (%)
1 (2)	EU-28	1,618.5	54.9	119*	14.5
	<i>Italy</i>	583.1	19.8	66	8.0
	<i>Spain</i>	502.5	17.1	45.8	5.6
	<i>Greece</i>	140	4.8	0	0
	<i>France</i>	102	3.5	4	0.4
2 (1)	USA	310	10.5	314	38.2
3 (-)	Turkey	124	4.2	0	0
4 (-)	Morocco	120	4.1	6.5	0.8
5 (-)	Syria	105	3.6	0	0
6 (-)	Algeria	81.5	2.8	0	0
7 (3)	Japan	53.5	1.8	53.5	6.5
8 (4)	Brazil	50	1.7	50	6.1
9 (5)	Canada	41	1.4	41	5
10 (6)	China	39	1.3	34	4.1
12 (-)	Tunisia	35	1.2	0	0
	Other	368	12.5	210.5	25.6
	Total	2,945.5	100	822.5	100

Notes: Provisional data; Sums may differ due to rounding; * Extra-EU trade only, including inward processing traffic

Source: IOC 2016

The production of high quality products, such as high quality extra-virgin olive oil or organic products is not a major challenge for non-EU producer countries given the long experience in production and processing and the existence of well-established milling and exporting companies. In the context of a buyer-driven value chain, the obstacle, however, is to upgrade to high value added activities such as bottling and branding in which producers and buyers in the EU – Tunisia's core end market – see their competitive advantage and have dominant market positions.

4.4.2. The olive oil sector in Tunisia

The olive oil sector plays an important role for the Tunisian economy. Olive cultivation represents around 40% of total agricultural production by area cultivated (around two million hectares) and olive oil is by far the most important agricultural export product, amounting to an average of 36% agricultural exports by value between 2006 and 2016 (CEPEX 2017). Italy (37% of total olive oil exports in 2016 by value), Spain (18%), the US (17%), France (11%) and Canada (4%) are the main export markets of Tunisian olive oil (UN Comtrade 2017).

Tunisia's olive oil sector has experienced significant changes since the country's independence from France. Elfkhi (2014) differentiates four periods: The first period – lasting from 1956 to 1962 – was marked by the absence of government interventions, free prices and a local market consuming almost half of the domestically produced olive oil. Contrarily, in the second period (1962 to 1994) was characterized by state interventionism in order to promote exports and regulate power imbalances between exporters and producers. The Tunisian Olive Oil Board (Office National de l'Huile, ONH) was the key governmental agency in the olive oil sector. ONH engaged in the production of olive oil, had a monopoly

in olive oil exports and regulated the national prices in the sector. Its strategy included the import of seed oils and the export of olive oil in order to improve the foreign exchange balance. The third period was initiated by the abolishment of the monopoly of ONH in 1994 that started in 2002. The partial deregulation of the Tunisian olive oil sector was accompanied by increasing importance of private exporters. Export destinations (e.g. USA, Japan and France) were diversified, while demand of traditional markets (Italy and Spain) was still met. During this period, ONH fixed purchasing prices of olive oil at the beginning of the harvesting period (launching prices) and in this way still influenced prices and income for olive growers (ibid.). Further deregulation took place in the fourth period from 2002 onwards. The system of launching prices was eliminated by ONH, however, an intervention price system was reintroduced in 2012 in order to influence prices by purchasing olive oil for exports during times of low domestic prices (ibid.).

In the following, we describe the current structure as well as opportunities and challenges for upgrading in the olive oil sector in Tunisia. The analysis will reveal that Tunisian exporters currently struggle to increase the share of higher-value added products relative to bulk exports. The process of product and functional upgrading has been particularly challenging considering the most important market for Tunisian olive oil: the EU. Hence, the negotiation and outcome of the DCFTA will be of particular importance for upgrading opportunities in the Tunisian olive oil sector.

In order to be able to assess the potential impact of the DCFTA, we will first assess the structure of the olive oil sector in Tunisia. The **main segments of the olive value chain in Tunisia** include (i) input suppliers; (ii) olive producers; (iii) intermediaries; (iv) olive oil producers; (v) and exporters as well as packagers.

Olive production in Tunisia provides a livelihood to around 310,000 farmers (CEPEX 2017). Around 72% of farmers are smallholders with less than 10 hectares of cultivated land (Jackson et al. 2015: 7ff.). This group represents 33% of Tunisia's olive acreage and 72% of the workforce employed in the olive sector (ibid.). Roughly two-thirds of smallholders have a diversified agricultural production portfolio and thus do not only rely on producing and selling olives (GIZ 2017). Olives, however, are estimated to yield the highest share of income for smallholders compared to other crops and livestock in Tunisia.³³ Smallholders and workers in the agricultural sector can be identified as the main vulnerable group in the olive and olive oil sector. The large majority of short-term wage workers in the olive oil sector in Tunisia are mainly women.

Olive production by smallholders is extensive and only few larger farms invested in intensive production. Many olive-mills and exporters are also integrated in olive production. Olives are cultivated in nearly the whole country and the olive season runs from November to February. The large majority of olives is used for olive-oil production (around 80-90%). Various olive varieties exist in Tunisia, however, Chemlali and Chétoui (roughly 80% respectively 20% (Jackson et al. 2015)) are the by far most important cultivated olive varieties. Table olive cultivation plays only a negligible role in Tunisia.

The biggest challenges for olive farmers include price volatility, low productivity rates and large fluctuations in production volumes. The price volatility of olives heavily depends on the global market price of olive oil. Productivity remains on a low level³⁴ since smallholders often lack equipment and capabilities to employ good agricultural practices (such as soil

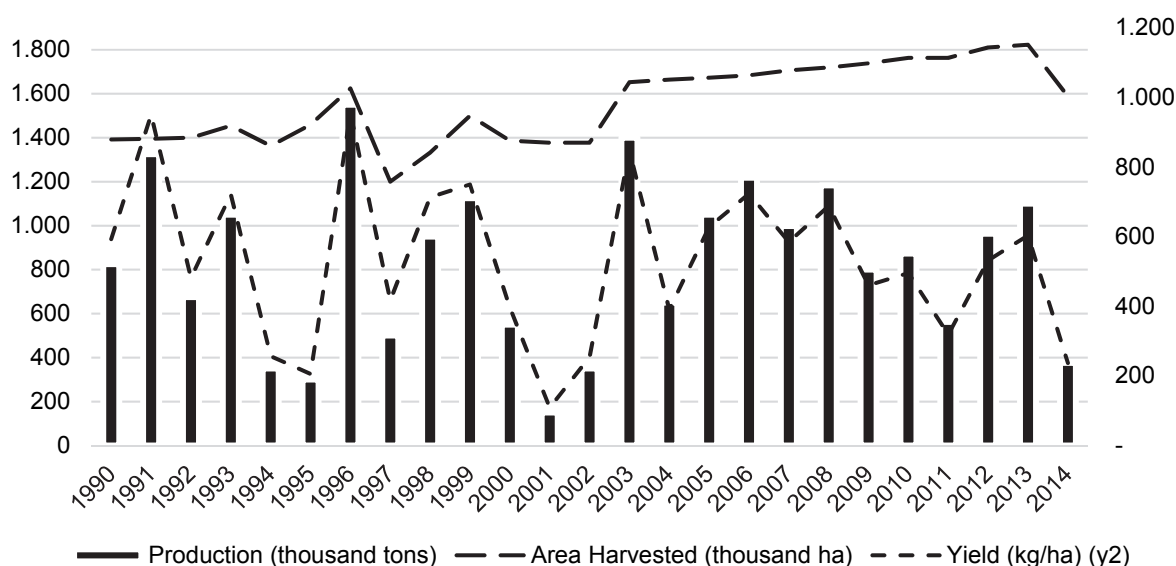
³³ GIZ (2017) estimates that smallholders with a diversified production portfolio receive on average around half of their yearly income from selling olives.

³⁴ According to the FAO (2017), average yields in Tunisia between the years 2000 and 2014 were only 20% of productivity levels achieved in Spain.

management as well as harvesting- and post-harvesting methods). The volatility of production is furthered effects by climatic changes and water scarcity (Figure 13), with adverse effects on the livelihood of farmers and workers in the sector.

Improving the organization of farmers yields great potential since only very few smallholders are organized in cooperatives³⁵ so far. Existing cooperatives are mainly engaging in providing services (e.g. provision of seeds and lending of machinery) to members. In order to increase the livelihood of smallholders, productivity levels must be increased and product upgrading (e.g. market organic products, specific regions, taste, etc.) should be attempted. Opportunities for product upgrading of farmers directly depend on the capacities, capabilities and market access of exporters to sell higher-value added olive-oil products to the global and particularly the European market (see below). Since the 2000s, Tunisia successfully increased the output of high-value niche products such as organic olive oil. Organic olive growing in Tunisia increased from 0.5% in 2000 to 6.7% in 2010 of the total area harvested (Jackson et al. 2015). Tunisia is the third largest producer of organic olive oil, after Spain and Italy (UNECA 2013).

Figure 13: Production of olives in Tunisia (1990-2014)



Source: FAO (2017)

Intermediaries play an important role in buying and transporting olives from farms to olive-mills. This segment of the Tunisian olive oil chain lacks organization and is highly informal. Intermediaries play a crucial role in linking small-scale producers and processors. During the field research, several stakeholders identified the extensive inclusion of intermediaries in the value chain as well as their practices as a risk factor for the quality of olives and olive oil especially due to prolonged delivery times after harvest. Larger and vertically integrated farms sell or transport directly to olive-mills and do not rely on intermediaries.

There are around 1,720 **olive mills** with a crushing capacity of around 44 thousand tons per day (Ayadi/Fourati/Triki 2014: 61). Around 1,100 of the mills are modern (super presses and continuous system mills) and 620 are traditional. Tunisia almost exclusively produces virgin and extra virgin olive oil. There are six extraction facilities for pomace oil and four refineries (ibid.). The operation and output of mills heavily depends on the volatile

³⁵ It is estimated that only around 4% of farmers in Tunisia are organized in cooperatives (GIZ 2017).

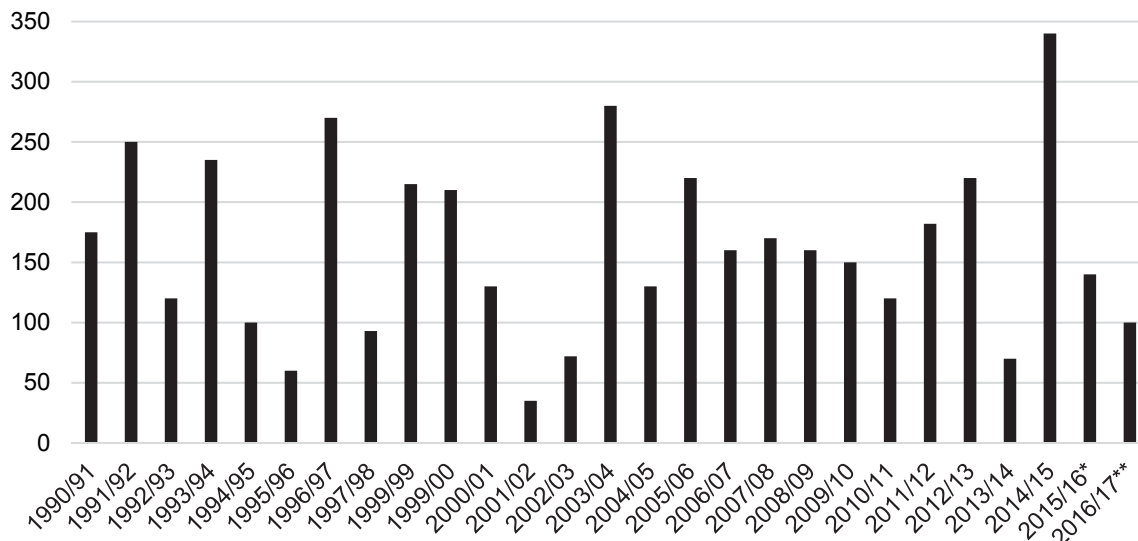
production of olives (Figure 14). Extreme volatility due to effects from climatic changes can be observed in recent years, in which output varied between 70 thousand tons in 2013/14 and 340 thousand tons in 2014/15 (IOC 2016). Tunisia also suffered from low output during the seasons 2015/16 (140 thousand tons) and 2016/17 (estimated to be 100 thousand tons) (ibid.).

The olive mill segment is highly competitive since there are little obstacles to enter the market. Sfax is the most important olive oil production area (around one third of all mills are located in Sfax) (IOC 2012: 7). Many olive mills are vertically integrated and own olive farms. Olive mills generally do not export their produce directly to global buyers, but sell their olive oil to exporters in Tunisia. The olive mills also sell olive oil in bulk to the domestic market (directly to households or distributors) as there is little to no demand for bottled and branded olive oil on the domestic market.

The biggest challenges for olive-mills include the volatile supply of olives, the price volatility of olive oil, limited or no access to credit, their relative subordination vis-à-vis exporters and the high competition in the sector. The limited access to finance has increasingly led to (informal) contract farming arrangements with exporters who advance finance to mills for buying olives.

Olive oil production in Tunisia has adverse environmental impacts (in particular on superficial and underground waters), since the olive mill wastewater is often not treated and disposed accordingly (see Gargouri et al. 2013). It is estimated that Tunisia generates more than 700,000 tons a year of olive mill waste and 450,000 tons of olive husk. The husk is utilized as animal feed or for energy production after residual oil extraction (ibid.).

Figure 14: Production of olive oil in Tunisia (1990-2016, thousand tons)



Notes: * Provisional data, ** Estimate

Source: IOC 2016

The **exporting companies** in Tunisia buy olive oil from mills and market the olive oil as bulk or bottled and branded olive oil to global buyers. There are around 80 exporting companies in Tunisia, around 50 of which engage in the exportation of bottled and branded olive oil (MIC 2016). Three companies – CHO (Tunisian), Borges (Spanish) and Sovena (Portuguese) – dominate the exportation of olive oil in Tunisia. Larger exporting companies tend to be vertically integrated along the whole chain (including olive production, olive mills

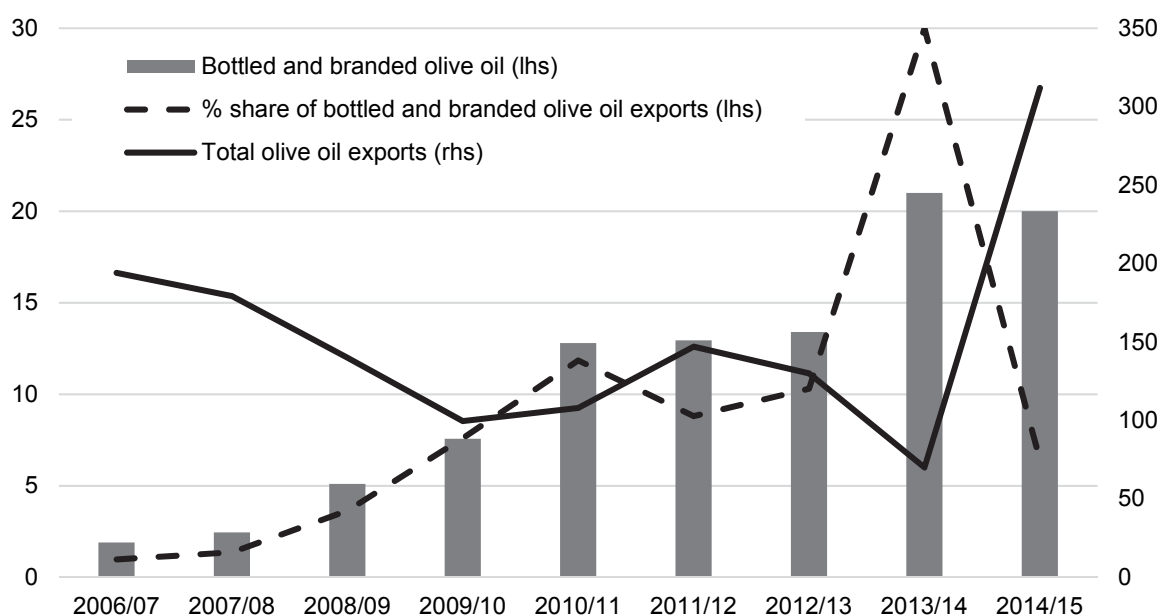
and bottling facilities), but also heavily rely on buying olive oil from other mills. Bottles are produced locally by the Tunisian company Sotuver and are imported from abroad, especially from Italy, due to the need for different varieties and qualities. CHO also owns a refinery and a laboratory as well as manufacturing facilities for side products such as soap and olive cake (bricks to burn). The larger FDI companies only entertain manufacturing facilities since higher value added functions and decision-making competences are located in EU headquarters. (Larger) Exporting companies are the dominant players in the Tunisian olive oil sector, since they have access to finance, exporting infrastructure and international buyers. Additionally, they are often vertically integrated along the whole chain. There are significant economies of scale in the exporting sector due to the transporting costs for olive oil, in particular bottled and branded olive oil.

The biggest challenges of exporting companies include the low share of value-added product exports, the diversification of export markets, the volatile supply of olive oil and the high cost of finance (in case of Tunisian companies). The large majority of Tunisian olive oil, around 90% in recent years, is exported in bulk (Figure 15). Value-added activities, such as bottling, labelling and in particular branding are only to a very limited extent conducted in Tunisia and were almost absent during the early 2000s. In recent years, however, many bulk olive oil exporters have tried to upgrade and raise their share of bottled and branded olive oil exports despite various obstacles. During the 2013/14 and 2014/15 periods, exports of various varieties of bottled and branded olive oil have increased to more than 20 thousand tons (MIC 2016). It is estimated however that around half of the bottled exports were not 'Tunisian brands', but distributor brands (esp. companies from the EU), limiting value addition taking place in Tunisia to bottling, excluding branding. A further challenge is that packaging costs are high which is also due to the dependence on imported bottles. In 2014/15, the most important markets for bottled and branded olive oil exports were the EU (40% of total bottled and branded olive oil exports by volume), especially France (38%) and the US (35%) (ibid.). Tunisia currently exports bottled and branded olive oil to 50 different markets (PACKTEC 2017).

The main challenges to increase exports of bottled and branded products include limited consumer awareness of Tunisian olive oil and their brands, buyers who prefer to buy in bulk due to their own business model, the difficulty to diversify markets and high packaging costs. Market access for bottled and branded olive oil has been particularly troublesome in the EU, in which the acceptance of Tunisian olive oil has been comparatively weak and buyers have a strong preference towards bulk imports. In 2014/15, the share of bottled and branded olive oil exports by volume to the EU (40%) is thus comparatively low compared to the total exports of olive oil (73%) to the EU (ibid.). The promotion of bottled and branded olive oil exports to non-traditional markets, such as the USA, Canada and East Asian countries, has received comparatively less resistance.

Consumer awareness for Tunisian olive oil tends to be comparatively low due to the current practice of international, and in particular, EU importers of Tunisian bulk olive oil not to declare the Tunisian origin of their products, but mix, bottle and sell Tunisian olive oil under their brand at a higher price. This practice results in a lack of value attributed to Tunisian olive oil and brands and limits the possibilities towards an increased consumer awareness concerning Tunisian olive oil. As long as most EU buyers prefer to buy in bulk, market diversification (e.g. North America and East Asia) plays an important role in boosting bottled and branded olive oil exports from Tunisia. In 2015, Tunisia exported olive oil to more than 61 countries (UN Comtrade 2017), 50 of which also imported bottled and branded olive oil from Tunisia (PACKTEC 2017).

Figure 15: Exports of olive oil and bottled and branded olive oil (thousand tons)



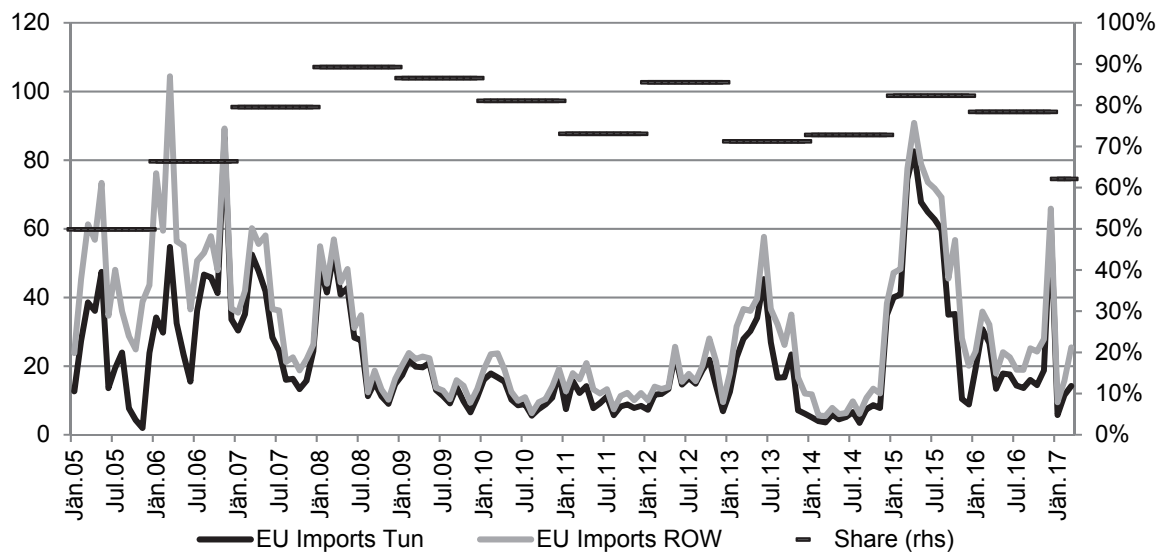
Source: MIC 2016

Various government institutions, funds and development cooperation actively promote the development of the Tunisian olive oil sector. The key state agencies promoting the exportation of bottled and branded olive oil include the Center for the Promotion of Exports (CEPEX) and the Technical Center for Packaging and Conditioning (PACKTEC) (Belgaïed 2014; Elfkih 2014). The most important project, which is actively promoting the olive oil sector is FOPROHOC (Fonds de promotion de l'huile d'olive conditionnée). FOPROHOC is a fund particularly aiming at the promotion of bottled and branded olive oil exports and is financed by a 0.5% exportation tax on bulk olive oil exports. FOPROHOC aims to facilitate the financing of various companies' investment activities as well as international marketing efforts. Activities funded by FOPROHOC include participation in fairs and exhibitions, marketing, adapting packaging for specific market requirements, creation of quality labels, publicity campaigns and others. FAMEX and FOPRODEX are broader funds promoting exports and market access in various sectors. The funds are managed by CEPEX and financed by the Ministry of Industry. FAMEX is co-financed by the World Bank. Another important currently adopted measure to support the sector is the plantation of new trees and thereby raising output and productivity. The goal in addition to replacing old orchards all over the country is to expand the number of trees in areas with extended rainfall, e.g. in the north of the country.

4.4.3. Impact of the DCFTA

The DCFTA might have important implications for the future development of the Tunisian olive oil sector. The EU is currently by far the largest importer of Tunisian olive oil and Tunisia is the most important supplier of olive oil outside the EU. The trade relations are extremely volatile (Figure 16), since the crop of olives and thus the output of olive oil in the EU as well as in Tunisia vary dramatically due to climatic changes. Tunisia nonetheless has supplied between 60% and 90% of total EU imports of olive oil by value in the last decade and total EU olive oil imports vary with imports from Tunisia (Eurostat 2017). Tunisia, on the other hand, exported between 60% and 70% of their total olive oil exports by value to the EU in most years since 2010 (Un Comtrade 2017).

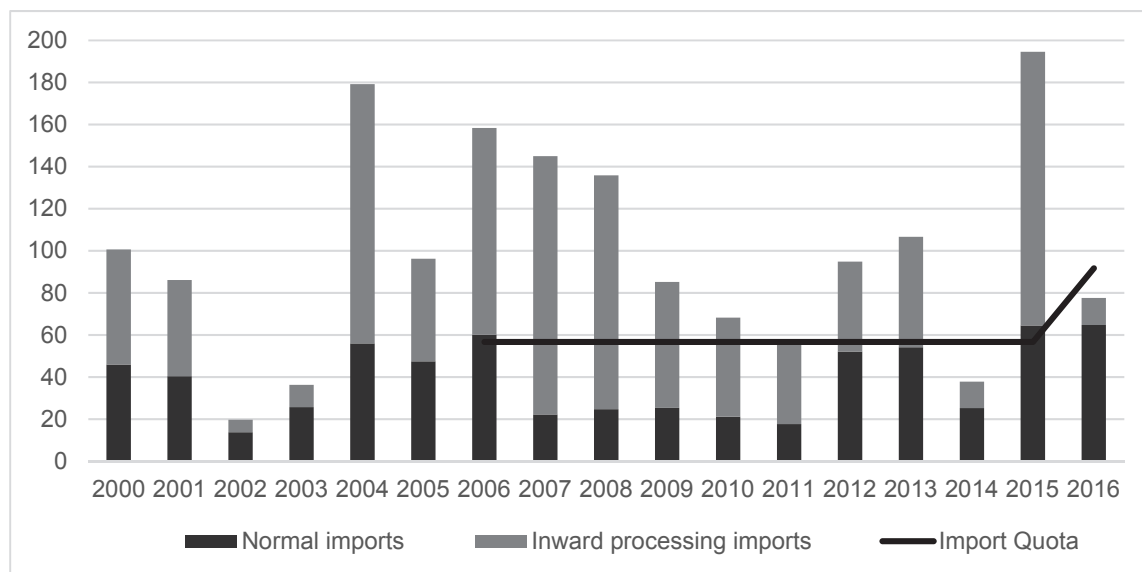
Figure 16: EU imports of olive oil by value (2005-2016, million EUR (lhs))



Notes: Monthly import data; Share indicates EU imports from Tunisia relative to total extra-EU imports of olive oil as annual average

Source: Eurostat 2017

Figure 17: EU imports of olive oil by volume (2000-2016, thousand tons)



Notes: EU-Tunisia import volumes includes quota and out-of-quota imports as well as imports via inward-processing arrangements. Quota-volume are not necessary fulfilled in years in which imports exceed the quota limit.

Source: Eurostat 2017

Tunisian olive oil imports to the EU are subject to a preferential tariff quota at a zero rate of duty or to inward-processing arrangements (TARIC 2017). Inward-processing arrangements allow for duty-free imports from third countries under the condition to export the equivalent oil quantity outside the EU after processing. The annual permanent duty free tariff quota for olive oil has been 56.7 thousand tons since 2006.³⁶ In April 2016, however,

³⁶ Regulation (EC) 1918/2006

the EU temporary expanded the yearly quota by 35 thousand tons until the end of 2017 in order to assist the Tunisian economy.³⁷ Most importantly, the specific application of the import quotas by monthly limits until 2016 has led to underutilization of quota volumes in all years between 2013 and 2016, even though total imports exceeded the quota volumes in two out of these four years (Figure 17; OTE 2017). Since 2016, the import quota has been applied on a yearly basis aiming to reduce the administrative burden. Flexibility for importers increased insofar as the issued import licenses are now valid from the day of their issuance until the end of the corresponding year.³⁸ In 2016, the total quota of 56.7 thousand tons was allocated in the first week of the year. Additionally, 10.4 thousand tons of the expanded quota were allocated throughout the year (EC 2016). Tunisia utilized nearly 100% of the standard quota in 2017, but did not utilize the additional quota as of mid-December 2017 (EC 2017b). Tunisia already utilized 100% of the standard quota in the first week of 2018, however, the EU did not grant an extension of the additional quota for 2018 (EC 2018).

Exports to the EU outside the quota or the inward-processing arrangements are subject to a tariff between EUR 1.226 and 1.346 per kg (TARIC 2017). The tariff quota system thus significantly limits the potential of Tunisia to export olive oil at a competitive price outside the quota to the EU. The US as the second biggest import market also taxes olive oil imports per kg, but at a very low level (USD 0.034 to 0.05). Canada and Japan – as potentially growing markets – do not apply any tariffs (WTO 2017). Main competitors, such as Morocco, have DFQF access to the EU market for olive oil. Minor competitors such as Turkey, Syria, Argentina or Australia do not have DFQF access to the EU market.

Inward processing arrangements and the quota impede the promotion of bottled and branded olive oil exports to the EU. While inward processing arrangements per se do not allow other imports than bulk, the difficulty regarding the quota is to find EU importers with access to the quota and a business strategy that involves the importation of bottled and branded olive oil from Tunisia. EU importers with access to the quota generally prefer to import Tunisian olive oil in bulk in order to add value by bottling and branding. CHO, for example, decided to build up a European subsidiary in order to get access to the quota and import bottled and branded olive oil from their mother company in Tunisia, significantly prolonging the time and increasing the cost of market entry to the EU for higher value added products.³⁹ The quota is thus one of the key reasons why exports of bottled and branded olive oil to the EU remain on a comparatively low level. Another issue is that the quota impedes the signing of long-term contracts between Tunisian exporters and European buyers (esp. retailers), since it is unclear if the Tunisian products will fall under the quota in the future (the quota might be fully utilized at the time of agreed delivery). The recent revision of the quota from a monthly to an annual issue of licenses slightly limited this insecurity in planning. DFQF access to the EU market via the DCFTA would nonetheless likely increase the exports of Tunisian olive oil to the EU in general and the exports of bottled and branded olive oil in particular.

Various other obstacles also hamper the increase of bottled and branded olive oil exports to the EU as we have already pointed out above. The existence of well-established companies and brands from the EU limit the room for new market entries from Tunisia. The biggest difficulty, however, lies in the lack of consumer awareness concerning Tunisian olive oil, in part due to the practice of European importers to mix Tunisian olive oil with

³⁷ Regulation (EU) 2016/605

³⁸ Regulation (EC) 2015/2031; before – according to Regulation (EC) 1345/2005 – import licenses were valid 60 days; a security of EUR 20 per 100 kg has to be deposited.

³⁹ In the case of CHO the market entry to the EU for bottled and branded olive oil was prolonged to five years: the decision to enter the EU market via subsidiaries was made in 2008, the process started in 2010 and the first bottles were sold in 2013.

other olive oils without being obliged to declare its Tunisian origin (EU Regulation No 29/2012, Article 4(2b)). Regarding the DCFTA negotiations, Tunisia should thus not only try to abolish the tariff rate quota, but also push for changes in labelling provisions that require the declaration of olive oil originating in Tunisia also on blended olive oils. The DCFTA can also be utilized to protect geographical indications that are planned to be developed and marketed in the future.

The biggest challenge in negotiating the DCFTA with regard to olive oil is the political resistance in the EU. Olive oil producers in the EU, especially from Italy and Spain, are actively lobbying against the improvement of EU regulations in favor of Tunisian exporters (Selby 2015; Granitto 2016). The campaign against Tunisian olive oil has been mostly visible in an Italian media campaign in early 2016, in which the Tunisian olive oil quality was called into question (Ngonga-Gicquel 2016).

4.4.4. Conclusions and Policy Recommendations

The case study of the Tunisian olive oil sector highlights the opportunities for and challenges of product and functional upgrading in the context of a buyer-driven bi-polar value chain in which lead firms in the EU focus on high value added activities such as bottling and branding and thus tend to buy and import olive oil in bulk. The potential for product and functional upgrading in Tunisia has improved with increasing demand in non-traditional markets as well as for high-quality niche products. In this context, many Tunisian exporters of bulk olive oil successfully increased their share of bottled and branded exports to non-traditional markets and the EU. The state has been particularly supportive of market diversification and product and functional upgrading strategies of exporting companies.

The EU nonetheless remains the most important market for Tunisian olive oil and exports of bulk as well as bottled and branded olive oil to the EU are hampered due to restricted market access. The quota system increases market access costs as well as complicates Tunisian exporters' relationship with EU buyers and thus limits export growth of high value products. In case Tunisia is able to accomplish the abolishment of the olive oil quota, the DCFTA is likely to simplify Tunisian exports of olive oil to the EU during years in which the Tunisian production of olive oil surpasses the current quota level and improve price competitiveness of Tunisia olive oils. The abolishment of the quota furthermore yields the potential to increase Tunisian exports of bottled and branded products to the EU due to reduced market access costs.

Tunisia could furthermore push for more detailed labelling requirements during DCFTA negotiations in order to improve consumer awareness for Tunisian olive oil. EU companies currently import and mix Tunisian olive oil and other olive oils without declaring the Tunisian origin. The limited consumer awareness for Tunisian olive oil in the EU due to this practice is another key obstacle in promoting bottled and branded olive oil from Tunisia in the EU.

The Tunisian olive oil sector and thus export development also face various local constraints. The volatility of supply of olives due to climatic changes will remain a major challenge. Supply increases could be particularly supported via the promotion of productivity growth in olive production. The returns of production of olives are below international standards, in particular in the Southern region of the country. In the context inadequate use of inputs (e.g. fertilizer and pesticides) and new technologies as well as the lack of sufficient amounts of water, measures should be taken to improve agricultural practices (e.g. pre- and post-harvest handling) and infrastructure (e.g. irrigation systems in areas with sufficient amount of water).

In order to tackle the challenges of the olive oil sector in Tunisia, the needs and interests of different actors and social groups in the Tunisian olive oil sector have to be taken into account. A strategy that largely focuses on product and functional upgrading of exporters (bottling/branding) will likely have only few benefits for olive producers and mills. Strengthening the role of farmer-based organizations, increasing productivity gains via educational measures, product upgrading (e.g. organic olives) as well as enhancing income diversification (e.g. via the diversification of crops) and stability (e.g. via price- or income stabilization funds) are only a few examples on how to improve the livelihood of marginalized social groups within the olive oil sector.

5. CONCLUSIONS AND POLICY RECOMMENDATIONS

In the concluding section, we summarize the detailed analysis and case studies for the DCFTA between the EU and Tunisia in order to upon that basis draw conclusions and policy recommendations as well as formulate key take away messages and policy recommendations. In the following, the section (i) provides a summary analysis of the key economic impacts, (ii) discusses opportunities and challenges of the FTAs in the textile and apparel sectors as well as of productive development in export-oriented agricultural value chains in Tunisia, and, finally, (iii) identifies the need for a differentiation in the sustainability chapters by EU trading partners. The section concludes with key messages and take-aways.

5.1. Expected Economic Impacts

A scenario of full tariff liberalization between the EU and Tunisia shows negative effects for Tunisia. While tariffs in manufacturing sectors have been already liberalized, lowering the overall tariff protection of the Tunisian economy to only about 2% of import volume, the impact of the DCFTA will be mainly determined by changes in the agricultural sector, where imports are still subject to significant tariffs and quotas. Thus, the sectors cereals and foods & beverages will likely be negatively affected by higher import competition from EU products, while only selected sectors in Tunisia (vegetable oils and vegetables/fruits) benefit slightly on the export side. Overall, real GDP in Tunisia will decline by 0.52% in the case of full tariff liberalization in both DCFTA partners (see section 4.1. for details). As the negative impact on GDP is concentrated on a few specific sectors, exemptions from tariff reductions on selected products and sectors should be taken into account during the negotiation process. Further, sectors that are negatively affected by trade liberalization and particularly if they concern such important sectors for the livelihood of farmers and consumers as cereals and foods & beverages would require adjustment assistance to cushion any negative effects. Most importantly, sectoral differences in the labor intensity are crucial, as shown by simulation results on employment.

For the case of Tunisia, the effects of trade cost reduction by changes in non-tariff measures (NTMs) are also simulated, given the stronger emphasis of the DCFTA on regulatory harmonization and the relevance of NTMs in manufacturing and service sectors in the bilateral trade relations. Assuming an asymmetric reduction in NTM trade costs due to regulatory harmonization towards EU standards, the effects for the Tunisian economy are potentially negative, since the burden of adjustment has to be borne by Tunisia (see section 4.1. for details). This should not be interpreted as a principal objection to regulatory harmonization, but it must be emphasized that regulatory harmonization confers costs upon economic and public agents, which need to be taken into account and cushioned through policy support.

In the case of Tunisia, also the effects of tariff liberalization on the public budget need to be carefully considered. An increase of the public budget deficit of up to 1% of GDP will not be easily absorbed in a situation where the country already needs macro-financial assistance in order to control the size of the deficit. The latter reached 6% of GDP in 2016 and is not likely to return to balance in the near future. In the short to medium term, trade liberalization should be complemented by additional budget support. In the long term, the fiscal base of the country needs to be broadened.

5.2. Implications of the FTAs on export sectors in Tunisia

Improvements in market access in agriculture-based value chains depend of quota regime

The analysis of the buyer-driven export sector of olive oil in Tunisia revealed a particularly important lesson with regard to market access and upgrading opportunities. As things stand, the sector would only profit from improved market access in the context of the DCFTA in the case the currently existing tariff rate quota for imports into the EU will be abolished or at least significantly expanded. The quota regime thus of fundamental importance for any upgrading strategies.

Upgrading to higher value added products and processing is of strategic importance in agriculture based value chains

Assuming that the DCFTA will result in improved market access, in agriculture based value chains, it is of strategic importance to increase not only exports but to increase the share of higher value and processed export products. The extent to which this will materialize will not only depend on market access but also on GVC dynamics and lead firm strategies as well as local opportunities and constraints for increased exports and upgrading.

The Tunisian olive oil sector struggles with supply constraints due to climatic changes and low productivity levels. Although olive oil is primarily exported to the EU, the main challenge is that importers in the EU primarily buy in bulk and mix Tunisian olive oil with oil from the EU, which significantly limits value creation possibilities in Tunisia. The export of bottled and branded products to the EU is furthermore limited by the lack of consumer awareness of Tunisian olive oil, partly because the Tunisian origin in mixed products must not be labelled. In addition, the specific application of the quota system creates barriers for exporters. The abolishment of the quota would not only increase bulk exports to the EU, particularly in years with excess production, but could also significantly enhance exports of bottled and branded products to the EU, as market entry costs would fall and the relationship of Tunisian exporters to EU buyers would be simplified.

Though already enjoying DFQF access, Tunisia faces preference erosion in the apparel sector

Tunisia already enjoys DFQF access to the EU market under the AA. The DCFTA thus has no potential to improve the competitiveness of the Tunisian apparel sector due to tariff liberalization. Instead, the Tunisian apparel sector suffers from preference erosion due to the EU's expansion of FTAs with other countries (such as Vietnam) and lost market shares in the EU. In order to benefit from DFQF access, the Tunisian apparel sector currently has to source fabrics mainly from the EU and Turkey, due to double transformation cumulation rules of the PEM Convention on RoO. Single transformation granted under the DCFTA would thus enhance the competitiveness of the Tunisian apparel sector, since the industry would then be able to source competitive fabrics globally. However, it is very unlikely that the EU will grant single transformation to Tunisia's apparel sector, even though it is the main interest of apparel exporters in Tunisia related to the DCFTA, according to firm interviews.

Upgrading and expansion of the textile sector are of strategic importance to the apparel sector in Tunisia

In Tunisia, the currently applied double transformation rule in theory should have also incentivized investments into the textile and particularly fabric sector. However, apparel exporters relied instead on importing fabric from the EU and increasingly Turkey to fulfill

double transformation, given cumulation with Turkey. In a situation of a stagnating apparel sector, there are limited incentives for textile investments, which are only likely if the private sector, the government and international donors join forces. The case for the expansion of the Tunisian textile sector rests in particular on the reduction of lead times due to the availability of local fabrics and related products, which could particularly benefit the fast fashion segment of Tunisia's apparel sector and thus help exploit the geographic proximity of the Tunisian apparel sector to the EU market. Further, it would increase local value added and linkages.

More generally, the apparel and textile industries should be considered a strategic export sector, to be used for learning and upgrading within the sector as well as beyond. Relying primarily on low-cost labor does not ensure sustained competitiveness. Tunisia should thus increase efforts to position itself as a more developed apparel supplier, extending its role from CMT production and lower value products to increasing local value added and linkages. In particular, an important part of Tunisia's apparel sector has successfully upgraded to higher quality and fast fashion products and to FOB production with selectively including design elements as well as has intensified efforts towards process upgrading in order to reduce lead times and increase production flexibility.

5.3. Trade and sustainable development

The concept of sustainable development is usually defined as economic development that is socially inclusive and respects ecological boundaries. With the UN Sustainable Development Agenda, also a fourth, political dimension was introduced, which focusses on fostering peace, democracy and the rule of law, as well as cooperation amongst states and societies.

While our estimations have shown that small, but negative growth outcomes may well be expected for the case of Tunisia, this result depends on the specific form of trade liberalization implemented. As a minimum, asymmetrical trade liberalization needs to safeguard particularly sensitive sectors such as e.g. agriculture. While consumer welfare might profit from lower prices for imported goods, of particular importance for developing economies is the balance between import competition and export revenues. As the pioneering work of Thirlwall has shown, growth in developing countries is constrained by the balance of payments (Thirlwall and Pacheco-Lopez, 2008, Thirlwall 2013). With a structural dependence on imports of in particular manufactured products, export increases are of particular relevance for most developing countries in order to earn the foreign exchange necessary to pay for imports. However, export growth is not only dependent on market access, but needs active policy support in order to diversify the basket of export products and upgrade into higher-value added goods and services. Our assessment of export potentials has shown that in the case of Tunisia the competitiveness of its main export sectors has recently suffered and strong industrial policy measures are necessary to reinvigorate export growth.

Needless to say that growth alone is not sufficient. The extent to which growth is socially inclusive depends on a multitude of factors, both domestic and international. With the current trade agenda, the EU has focused on an approach that aims at promoting human rights and labor standards, and at an instrumental level privileges dialogue over hard conditionalities. As we have argued in the study, for this approach to become effective, it is, first, necessary to breathe life into the monitoring structures built into the agreements. Second, a more context-specific approach is advisable, which takes due account of the specific problems in a country and adapts both the substantive provisions and consultation process to local circumstances. Our analysis with respect to the T&A sector and agriculture

and food sector in Tunisia has shown that particularly apparel and agricultural workers, who are also to a high degree women, represent vulnerable groups, whose rights need particular attention. A full realization of the potential of the sustainability chapter of EU FTAs thus will need a higher dose of ownership on the side of EU institutions, and much more support for cooperation between EU and partner country civil societies under EU development cooperation Aid for Trade programs.

In addition to dialogue, a second important aspect of social inclusiveness relates to the potential of trade agreements for promoting employment and decent work, i.e. employment that pays living wages and fosters good working conditions. Our analysis suggests that on balance the FTA will produce some employment gains depending on the liberalization scenarios, though not in all sectors of the economy. As trade liberalization typically has an impact on the structural production patterns in an economy, it is important to ease the social adjustment costs concomitant to that process. The latter is conditional upon the existence of basic social and employment policies in partner countries. In the case of developing countries, such policies often do not exist or lack from adequate funding. Adequate policy responses are often hampered by the fact that tariff liberalization reduces public income precisely at a time, when additional funds are required. In this respect, it is important for trade policy-makers to assess the impact of trade liberalization on public budgets, and if necessary, provide for temporary budget support as well as promote domestic resource mobilization. We have pointed out that for the case of Tunisia this issue needs to be remedied.

Further, although export sectors may gain employment due to better market access, this quantitative impact says nothing about the qualitative aspects of the jobs created. The case study sectors are particularly prone to problematic working conditions in terms of low wages or prices, long working hours, problematic OHS standard compliance and restricted representation and collective bargaining. These labor issues are related to dynamics in the GVCs, where competition is high and costs, quality, lead times and flexibility requirements of global buyers stringent. But they are also related to country specific contexts where Tunisia through its strong labor movement has generally a longer tradition in labor compliance compared other countries in the Global South, though arguably room for improvement does still exist. In both sectors, in addition to producer country regulations, private buyer-driven CSR initiatives are important. To have a sustained effect they need to be independently monitored and aligned with sourcing requirements of buyers. Further cooperation with local labor inspectorates and labor ministries as well as trade unions is of crucial importance, which could be developed in the context of the Sustainability Chapters of the DCFTA.

With regard to the environmental impact of trade liberalization, a systematic and comprehensive analysis has been beyond the scope of this study. Existing assessments on the DCFTA however suggest that on balance negative environmental effects in particular with respect to emissions will likely prevail, though this depends on a number of developments, in particular the sectoral specialization patterns, and is thus difficult to estimate for the long run (ECORYS 2009, 2013). With respect to the case studies covered in our report, we have argued that instead of an increase of unprocessed exports of olive oil in the case of Tunisia, which clearly would have negative environmental repercussions, the challenge consists in extracting more value-added from the export-oriented production of the commodity. If managed properly, this would arguably also promote more sustainable production models, as consumers in Europe increasingly demand organically grown and sustainably harvested food products. EU development cooperation should support the ecological orientation of agricultural value chains in Tunisia and facilitate branding and marketing activities for the establishment of high quality products in buyer-driven value chains such

as olive oil, where lead firms are mostly residing in the EU. For the T&A sectors, particularly water pollution related to the disposal of chemicals and washing water is a crucial concern. Particularly in the context of the development of a local textile sector, that is strategic in both countries, environmental issues have to be taken seriously.

Finally, the political dimension of sustainable development is also important. Due to the geopolitical importance of the Tunisia in the MENA region, major threats to security due to militant Islamism both for the region as well as the EU, and the all-pervasive migration crisis in the EU, the latter has every interest in supporting the consolidation of democracy in Tunisia, which at the moment is living through a critical phase. We have argued that this requires an approach to the DCFTA negotiations that avoids any measure, which would potentially weaken the already fragile social and territorial cohesion of the country. The strict implementation of the principle of policy coherence for sustainable development is thus particularly pertinent and must prevail over both vested commercial interests of EU businesses and adherence to the standard EU negotiating template. This would in particular call for a more nuanced EU negotiating position with respect to trade liberalization in agriculture, public procurement as well as competition and state aid. On the other hand, the EU should target areas that deliver short-term benefits for the Tunisian economy and thus ameliorate the economic situation in the country. In this respect, (i) simplified RoO for the T&A industry, (ii) improved market access for agricultural export products such as olive oil, and (iii) a more liberal regime with respect to freedom of movement for Tunisian service providers would appear as the most appropriate starting points, as well as (iv) supporting upgrading to higher value added products and functions through EU Development Cooperation and Aid for Trade programs.

5.4. Key take-away messages

The **main findings and key policy recommendations** of the study can be summarized as follows:

1. Estimated economic effects of trade liberalization for Tunisia are negative:

Since tariffs on manufacturing products between the EU and Tunisia have been already liberalized in the existing Association Agreement, lowering the overall tariff protection of the Tunisian economy to only about 2% of trade volume, the impact of the DCFTA will be mainly determined by changes in the agricultural sector, where imports are still subject to significant tariffs and quotas. In the case of full tariff liberalization by the EU and Tunisia, the Tunisian sectors cereals and foods & beverages will be negatively affected by higher import competition from EU products, while only selected sectors in Tunisia (vegetable oils and vegetables/fruits) benefit slightly. Overall, real GDP in Tunisia will decline by 0.52% in the case of full tariff liberalization in both FTA partners. Thus, if the EU is serious about striving for an asymmetrical agreement with Tunisia, it should apply a differentiated approach with respect to specific agricultural sectors in order to mitigate potential negative effects. In these cases, exemptions from tariff reductions on selected products and sectors should be considered during the negotiation process. Further, sectors that are negatively affected by trade liberalization and particularly if they concern such important sectors for the livelihood of farmers and consumers as cereals and foods & beverages would require adjustment assistance to cushion any negative effects. Because of strong differences with respect to the sectoral labor intensity of production, overall employment levels will remain roughly unchanged.

Given the stronger emphasis of the DCFTA on regulatory harmonization, the effects of trade cost reductions triggered by alignment of non-tariff measures (NTMs) are also simulated. Though resulting in long-term cost savings for Tunisian exporters, NTM alignment will mainly be based on regulatory harmonization of Tunisian standards towards EU standards. This will involve adjustment costs for the Tunisian economy. Regulatory harmonization towards EU standards should thus be supported by EU Aid for Trade programs.

2. Public revenue losses will negatively affect Tunisia and need an EU policy response:

In the case of Tunisia, the effects of tariff liberalization on the public budget need to be carefully considered. An increase of the public budget deficit of up to 1% of GDP in the case of full liberalization of tariffs on imports from the EU, will not be easily compensated in a situation, where the country already gets macro-financial assistance from the IMF and the EU in order to control the size of the deficit. The latter reached 6% of GDP in 2016 and is not likely to return to balance in the near future. In the short to medium term, trade liberalization should thus be accompanied by additional budget support. With respect to the long-term, EU Aid for Trade should support reforms to broaden the fiscal basis.

3. Promotion of export sectors needs pro-active policies for upgrading:

Given that trade liberalization should positively contribute to growth and employment creation, a careful consideration of the potentials for increasing exports in selected sectors is important. Based on a detailed analysis of the leading export agriculture sector of olive oil as well as the textiles & apparel sector, our analysis points to the need for policy interventions in two priority areas:

- c) *Export potentials for food products depend on investment in processing and branding activities and in quality infrastructure:* given that most GVCs for agricultural and food products are buyer-driven, increases in export revenues need an approach that aims at extracting more value-added from each unit exported. This is particularly the case, where further increases in export volume are constraint by production conditions, e.g. water scarcity, and/or lead to negative environmental externalities. Export-oriented upgrading activities, in particular production of bottled olive oil for final consumers, do not only need investment in processing facilities, but in particular marketing and branding strategies in order to gain access to retailers and become attractive to final consumers. Trade policy can support upgrading both by improving market access, e.g. by eliminating remaining tariffs and quotas, and furthermore, by supporting to meet standards, both public SPS and private standards of lead firm in GVCs, in particular quality standards and certifications for organic products.
- d) *Promotion of upgrading and of the textile sector is of strategic importance in the apparel sector:* against the background of continuing preference erosion in the apparel sector as more countries are receiving preferential market access due to the proliferation of FTAs, reduced lead-times and the trend to fast fashion, the sustained competitiveness of the apparel sector in the future will not primarily rest on the availability of cheap labor and DFQF market access, but on the availability of a flexible and high-quality production system that extends from the production of yarns and fabrics, the availability of accessories and finishing services to modern logistics and transport services. Apparel producers in Tunisia should thus increase their efforts to position themselves as more developed apparel suppliers, extending their role from CMT production and lower value products to increasing local value-added and linkages. This will involve investments in the build-up of a domestic textile sector, but also

extend to other supporting services, e.g. increasing the availability of working capital for FOB production and productive investment credits as well as improving the technical skills of T&A workers.

4. Trade policy should foster policy coherence for sustainable development and be context-specific

Sustainable development as defined by the UN Agenda 2030 and adopted by the European Consensus on Development, calls for the promotion of sustainable economic growth that is socially inclusive, respects ecological boundaries and promotes peace and democracy. Trade liberalization should thus be considered as a means to achieve the objective of sustainable development. Due to different geographical conditions, economic structures, political and institutional systems, trade liberalization outcomes for individual countries are however variegated, and it cannot be taken for granted that effects are exclusively beneficial, neither at the aggregate nor sectoral level. Thus, any approach to trade policy in compliance with the principle of policy coherence for sustainable development must take the specificities of a partner country systematically into account and adapt trade policy measures accordingly. The Sustainability Chapters are an important step forward in this regard but they need to be mainstreamed throughout the chapters of the core agreement. Further, where these chapters already exist such as in the case of the EU-Vietnam FTA, their formulation is rather weak and the political interest to implement them and fund the necessary dialogue processes has been weak on both sides.

Given the exceptional characteristics of contemporary Tunisia, which is in the difficult and protracted process of consolidating its democratic transition in a complex regional environment, the report suggests a significantly modified negotiating approach that prioritizes the safeguarding of socio-territorial cohesion and a focus on short-term benefits for its struggling economy.

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APPENDIX

Table 1A: Sectoral Details DCFTA Model

	Sector	GTAP 9 Sectors (short)
1	Cereals (cer)	PDR, WHT, GRO, PCR
2	VegOils (voil)	VOL
3	FruitVeg(v_f)	V_F
4	OthAgri (oag)	OSD, C_B, PFD, OCR, CTL, OAP, RMK, WOL, FRS, SGR
5	FoodsBev (f_b)	OFD, B_T
6	Meat (mea)	CMT OMT
7	Dairy (dai)	MIL
8	Commodities (com)	COA, OIL, GAS, OMN
9	Textiles (tex)	TEX
10	Apparel (app)	WAP
11	Footwear (lsh)	LEA
12	Chemicals (che)	CRP
13	Motorvehicles (mvh)	MVH
14	Machinery (mac)	OME
15	Electronics (ele)	ELE
16	OthManu (oma)	LUM, PPP, NMM, I_S, NFM, FMP, OTN, OMF, ELY, GDT, WTR
17	Business (bus)	OBS
18	Tourism (tou)	TRD, ROS
19	OthServ (oser)	CNS, CMN, OFI, ISR, OSG, DWE
20	Transportation (trans)	OTP WTP ATP

List of conducted interviews

Interviews were conducted in person or telephone and supplemented by inquiries via email.

Institution/Organization/Business	Date
Centre for Export Promotion (CEPEX)	22.05.2017
Delegation of the European Union to Tunisia	22.05.2017
Friedrich-Ebert-Stiftung (FES)	23.05.2017
Federation Nationale du Textile (FENATEX) TFCE Group	23.05.2017
Friedrich-Ebert-Stiftung (FES) – Conference on ALECA	24.05.2017
Gesellschaft für Internationale Zusammenarbeit (GIZ)	24.05.2017
Consulting Services Assistance (CSA)	24.05.2017
Centre Technique de l'Emballage et du Conditionnement	25.05.2017
Union Générale Tunisienne du Travail (UGTT)	25.05.2017
Institut Tunisien de la Compétitivité et des Etudes Quantitatives (ITCEQ)	25.05.2017
EuroMed Rights	26.05.2017
Faculté des Sciences Economiques et de Gestion de Tunis	26.05.2017
Rosa Luxemburg Foundation	26.05.2017
Agence de Promotion de l'Industrie et de l'Innovation (APII)	26.05.2017
van Laack	26.05.2017
UGTT	27.05.2017
Sfax Chamber of Commerce and Industry	29.05.2017
Olive oil sector expert	29.05.2017
C.H.O. Group	29.05.2017
L'Institute de l'Olivier	30.05.2017
Sfax Huile Export	30.05.2017
GIZ	01.06.2017