Inviting competition: A bold step forward

In 1995, Tunisia embarked on a dramatic new phase of development. That year, Tunisia was the first country in the Middle East and North Africa (MENA) region to sign a European Union Association Agreement (EUAA). The main objective of the EUAA was to promote legislative, financial and social cooperation between the regions. Its cornerstone was the establishment of a manufacturing free trade zone. For the free trade zone, tariffs were phased out on non-agricultural imports from the European Union (EU) over a 12-year period (1996 to 2008).

Even taking into account the agreement’s gradual phase-in period, the opening of Tunisia’s economy to the highly competitive European market was a bold move. While the EUAA’s benefits promised to be considerable, so were its potential costs. Tunisia’s government was aware that some local enterprises would not stand up to competition from across the Mediterranean. With their days under a protectionist shelter numbered, Tunisia’s private enterprises were made to realize that survival would require increased efficiency.

Assistance along the way

Tunisia sought “purposeful progress” to gradually open its markets. Tunisian authorities frame it as a model of purposeful progress should dominate over speed, while maintaining social stability and security. On July 25, 1996, the World Bank approved a $75 million Economic Adjustment Competitiveness Loan (ECAL) for Tunisia to help support this goal. The EU and the African Development Bank (AfDB) provided coordinated, parallel financing. Two more ECALs from the World Bank followed in 1999 and 2001.

The aim of the loans was to build a sound macroeconomic and fiscal framework while adopting international good practices for trade and investment. In addition, the money from the ECALs went to increase the soundness, efficiency and competitiveness of Tunisia’s banking system. It also helped modernize Tunisia’s legislative and institutional framework for its private sector while providing opportunities through privatization. These objectives conformed to Tunisia’s development objectives—as outlined in its Ninth Development Plan (1997-2001) and Tenth Development Plan (2002-2006).

Targets for reform

The initial ECAL included a template for improving Tunisia’s legal system, which required substantial work. This first ECAL sought to improve the regulatory and administrative climate for enterprises, pointing out the need for stronger and sounder
legislation in these areas. New finance and information laws, along with amendments to Tunisia’s Civic and Commercial Procedures Code and insolvency law, were all deemed necessary.

To help with these large-scale reforms, the World Bank worked closely with Tunisia’s Center of Judicial and Legal Studies, a body that reports to the Ministry of Justice. As a result of consultations with the Center and the Ministry directly, the World Bank granted Tunisia $250,000 from its Institutional Development Fund in order to help modernize the Center and provide legal reform studies. The grant helped create a strategic action plan to introduce and pass needed legislation.

Thirteen consultants (mainly lawyers) were hired locally and internationally in order to study specific legal areas and report what worked and what didn’t to the World Bank and Tunisia’s Center of Judicial and Legal Studies. New computers were installed in the Center and connected to the Global Legal Information Network (GLIN), developed by the United States’ Law Library of Congress. GLIN allowed Tunisian professionals to access laws from countries around the world. Two judges from Tunisia’s Center of Judicial and Legal Studies visited Washington, D.C. for GLIN training.

What gets measured gets done

By the beginning of 1998, after the reform studies were completed, judges at the Center of Judicial and Legal Studies worked on a detailed strategic plan. The plan for reform was then submitted to the World Bank, which gave its approval for implementation. The plan also received resounding support from the EU and many of its member states.

One of the points discussed was Tunisia’s 1995 law regarding the recovery of businesses facing financial difficulties. As a result of Tunisia’s privatization of banks and enterprises, coupled with increased competition from the European market, this law needed to be amended. Indeed, the 1995 law was then amended twice; in 1999 and again in 2003. “There was a need for an efficient framework that safeguarded viable businesses and maintained employment,” says Jaouida Guiga, President of the First Instance Court and, at that time, head of the Center of Judicial and Legal Studies. The 1995 law was technically weak: the role of the judge had to be reinforced.

Changes introduced

The Center’s task force for amending the 1995 law included judges, lawyers, bankers and academics. This group studied France’s insolvency regime and wanted to design a similar system in Tunisia to better maintain jobs, pay debts, avoid bankruptcy and legally define the conditions under which a business could be considered “distressed.” Tunisia’s private sector, especially banks and small enterprises, were also encouraged to submit ideas. The Center then drafted the amendments to the law that were passed in 1999 and

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1 Law No. 95-34 of April 17, 1995.
After the amendments went into effect, the EU funded seminars and workshops to increase awareness of the changes and emphasize the importance of business reforms.

Embracing specifics: Early detection of financial difficulties

Tunisia’s 1995 law regarding the recovery of businesses facing financial difficulties was, in fact, the country’s first statute regulating the reorganization of businesses under financial strain. Prior to 1995, Tunisia’s Code of Commerce regulated insolvency, allowing for two options: liquidation (“procédures de faillite,”) or out-of-court composition with creditors (“concordat préventif”). The 1995 law repealed the articles in the Code of Commerce that regulated insolvency proceedings and established formal reorganization procedures. However, the 1995 law wasn’t without its flaws, especially in the eyes of the nation’s lending institutions. Guidelines for deciding if a business was in financial distress were broadly defined and insufficient for determining whether or not a business could actually pay its debts. This meant that the system was susceptible to abuse by businesses. Reorganizations are supposed to help distressed but viable firms survive only if they could remain solvent outside of a transient crisis. However, a number of unviable firms took advantage of the system’s vagaries and used reorganization proceeding as a delaying tactic.

In the absence of clear guidelines, judges began using their own definitions of “distressed,” and cases were settled ad hoc. On May 26, 1998, the Supreme Court of Cassation finally issued a ruling that provided a clear definition of a distressed business. The amendments in 1999 and 2003 also helped protect banking interests by closing the loophole that recalcitrant debtors used to forestall liquidation. The 2003 law states that a firm is considered insolvent when it is in a state of suspension of payments; that is unable to meet its liabilities with its cash and other assets in the short term (Figure 1.1).

Figure 1.1 Reform timeline

<table>
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<th>Time to reform</th>
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<td>Drafting of a detailed strategic plan for reforms by the Center of Judicial and Legal Studies</td>
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<td>The Supreme Court of Cassation issues a ruling that provided a clear definition of a distressed business</td>
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<td>Drafting and approval of first amendment to Law No. 95-34 of April 17, 1995 which reinforced the role of the judge</td>
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<td>Drafting and approval of 2nd amendment to Law No. 95-34 of April 17, 1995 promoting reorganization as an option to keep viable firms operating</td>
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The 2003 law also states that the Economic Enterprises Monitoring Committee, which was instituted by the Ministry of Industry in 1995, shall inform the president of the First Instance Court when any company’s losses have reached one-third of its capital as well as when any company’s ongoing operations are threatened. The application to be granted “distressed” status by the First Instance Court asked for specific data and documents—including, but not limited to:

- Reasons for the request for relief
- Nature and severity of the difficulties faced
- Operating forecasts for the next two years
- Balance sheets and annexes of the last three years
- Statement of wages and other debts not paid and the benefits accruing to each employee
- Statements of the debtor's assets and holdings
- Statements of assets and liabilities of the companies and securities justification indicating the identities of creditors and debtors and their homes and headquarters.

Failure to submit any of these documents obliged the president of the court to reject an application.

**Empowering the role of the judge: Ensuring protection of creditors**

The 2003 amendment not only maintained judges’ discretion but also strengthened their positions in the court. Specifically, Articles 8 and 4 of the law granted judges the discretion to seek outside input from parties like the Economic Enterprises Monitoring Committee, the National Social Security Fund, public accounting firms and financial institutions. Judges can also call on experts in diagnosis to ascertain the actual situation of a company. Under the older 1995 law, the president of the First Instance Court had to wait for all reports to be submitted and consult with the Economic Enterprises Monitoring Committee before going forward with reorganization. This caused delays, which often further eroded a business’s value.

The 1999 and 2003 amendments reinforced the importance of having a judge monitor reports issued by insolvency administrators and other experts. In amicable reorganizations, the judge was given the ultimate authority to commence the agreement process and then affirm or reject the agreement. Under the 1995 law, a judge had to accept an agreement even if the plan was perceived to be unviable.

**Speeding up the process**

The Center of Judicial and Legal Studies researched and confirmed the importance of speeding up insolvency procedures. Bankers and enterprises also embraced clear time limits to avoid unnecessary delays and consequently increase the odds of a business’s survival. Time limits apply to the opening of a judicial reorganization, to the submission of documents and to the filing of the administrator’s report. Specifically, in order to accelerate the process and safeguard businesses, the 2003 law eliminated a preliminary,
3-month renewable period (originally designed to ascertain the true economic situation of a company) and maintained an observation period during which an administrator (with the help of experts, if necessary) assessed a business’s chances of survival and then developed a reorganization plan.

Were the changes welcomed?

Tunisia’s private sector generally welcomed the overhaul of its legislative framework. Enterprises were enthusiastic about the benefits of the changes introduced. Law firms, banks, academics and businesses had helped the amendments succeed by providing their input and helping the reformers understand the costs incurred in the insolvency process.

The main challenge to the reforms came from the government. Tunisia’s political leaders were used to a state-led model of development. This created a gap between private sector interests and government policy. But by increasing competition and opening up to the EU, the government committed itself to a reform agenda. Nevertheless, Tunisian policymakers feared the social costs of privatization and opening markets. As a result, there was political disagreement about the pace of reform, and the government opted for a gradual transition. Patience was required. And it paid off. Tunisia’s experience demonstrates the need for development partners to show flexibility in their support over time.

Results and lessons learned

Reforming the Tunisian insolvency system helped pave the way for further reforms that eliminated barriers to new business start-ups and created job opportunities. At the macroeconomic level, Tunisia experienced a 5.2% boost to its real growth rate between 1997 and 2001 and it resumed again in 2003. With this sustained growth, the country’s poverty rate declined from 8% in 1995 to just 4% in 2000. Liberalization also led to productivity growth and market diversification. The export of manufactured products rose by 8% annually over this period.

In sum, reforms achieved many positive results. For a reorganization procedure to be successful over the long term, Tunisia recognized that it needed to be well-regulated. Greater power vested in the court helped protect creditors. The amendments to insolvency laws also aimed to ensure that proceedings moved rapidly—a benefit for both creditors and debtors. It also defined the parameters for payment suspensions, empowered judges, safeguarding viable firms and ensuring quick and binding resolutions—whether they be amicable settlements or judicial reorganizations.

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5 World Bank (2004)