

## REVIEW

# The Impact of Democratization on “FDI” in Tunisia-A Comparison of Pre and Post Revolution Periods

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### ABSTRACT

The study examined the impact of democratization on foreign direct investment in Tunisia and has done a comparison of the pre and post revolution periods. The paper has used secondary data for the variables GDP per capita, FDI, Gross Fixed Capital Formation (GFCF), Current health expenditure (% of GDP) for the period 2001-2018. The study aims to provide arguments of the favorable political conditions for FDI, the purpose is to understand; whether, democracy and autocracy attract FDI in the Pre and Post-event of revolution in Tunisia. In addition, this investigation discusses the key elements for path dependency in democratic transitions from autocracy to democracy. The study found that there is a correlation between the adoption of a democratic regime and the FDI evolution. A democratic regime creates the right political circumstances to improve macroeconomic performance. It can stimulate growth if it is conducted in a stable political environment.

## 1. Introduction

Political environment in a country has great impact on its economy. Some countries have democratic form of government and some have nondemocratic. In a democratic form of government people have authority to choose their ruler. The rulers are accountable to the people. People have right to vote and have freedom of expression. On the contrary in nondemocratic form of government, people have no such right. Power lies in the hands of government. Government takes decisions for the people. Monarchy, oligarchy, aristocracy, anarchy, feudalism and theocracy are the different forms of nondemocratic government<sup>[1]</sup>

## 2. Transition in the Tunisian Economy

The political environment in Tunisia has transformed from the non democratic to democratic government system. Below is the detailed discussion on the political environment in Tunisia.

### 2.1 Political Climate: Introductory Background

Tunisia is one of the successful uprisings of “Arab Spring” (2011) especially that other states plunged into disintegration, war and political upheaval. There are many factors that contributed in the revolution due to structural advantages,

(1) Homogenous Population

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- (2) Politically weak Military cadre
- (3) A mature Civil Society
- (4) Balance of power between Islamists and Secularists <sup>[2]</sup>.

These are key points for which Tunisia has become an essential case study for the democratization and the birthplace of “Arab Spring” <sup>[3]</sup>, which allowed masses to break the chains of dictatorship and directed them to attain autonomy. The initial objectives of the revolution were mainly employment, freedom and restoration of democracy <sup>[4]</sup>. The Ben Ali regime fell on January 14, 2011 and has raised questions about the objectives of the revolution, and the government oppression in the making of Tunisian uprisings <sup>[5]</sup>. The progress can be indicated by the democratic transition, as:

- (1) The first three reform commissions (2011).
- (2) First free elections (October 2011).
- (3) National Constituent Assembly (NCA) formation (November 2012).
- (4) The promulgation of the new constitution (February 2014).
- (5) First free legislative elections (October 2014).
- (6) Presidential elections (November, December 2014) <sup>[6]</sup>.

These factors have revamped the democratic process, and adding substantial support to continue the transition.

## 2.2 The Democratic Transition Process

The country in “transition-phase” experienced a policy change of authoritarian regime to a democracy. T. L. Karl and P. (1991) Schmitter made a statement of the determination of such as transition <sup>[7]</sup>:

- (1) The transition can be possible when elites abandon authoritarianism after mutual consensus.
- (2) When the opposition is created the elites.
- (3) Reforms made the transition when masses are mobilized by peaceful means.
- (4) The revolution is the harbinger of transition when masses hold weapons to revolt government.

The adoption of the new Constitution on 27 January 2014 was an essential component of Tunisian transition.

The transition of Tunisian political system has a significant impact on its economy. The Government of Tunisia has opened most of the sectors of economy to foreign capital participation and trying to improve the business climate to attract FDI. The Tunisian Parliament passed an investment law (#2016-71) in Sep 2016 to encourage the responsible regulation of investments. Under this law three institutions were launched in 2017- The High Investment Council, The Tunisian Investment Authority and The Tunisian Investment Fund. The foreign investors have the same rights and obligations as Tunisian investors under this law. But the Foreign Investment

Promotion Agency (FIPA) is the principle agency to promote foreign investment in Tunisia. It provides investment related information and communicate with investors through FIPA offices throughout the country <sup>[8]</sup>

Foreign direct investment plays a crucial role in the development of a country. Therefore the contribution of FDI in an economy cannot be ignored. The study investigated the impact of democratization on foreign direct investment in Tunisia and made a comparison of pre and post revolution period. For this purpose the analysis has been divided into two parts- pre revolution period (2000-2010) and post revolution period (2011-2018). The data has been taken from the World Bank for the variables GDP per capita, FDI, Gross Fixed Capital Formation (GFCF), Current health expenditure (% of GDP).

The main objective of this study is to demonstrate the impact of the governments democratic / undemocratic system does attract the FDI. In this case, the extensive empirical study gives us contradictory arguments for both of the political and economic policies related to FDI. This has been debated after the revolution, in the Tunisian conference while directing to European investors, as, “We have no more dictators”. This is argued due to the conception that democracy may be the path to more FDI inflows.

## 3. Review of the Literature

At the dawn of 2011, Tunisia reached to become a democratic republic after “Jasmine Revolution”, which is explained by (Laurel E. Miller, 2012) as a distinct case of successful democratization in the Arab World <sup>[9]</sup>. The revolution has led to spark the process of the democratic revolution in other countries like Libya, Egypt, and other Middle Eastern countries. Hence, The Tunisian democratization has long been considered an exception in the Arab world for a democratic transition. The successful transition is witnessed due to a large middle class; educated population and ethnically homogenous population <sup>[10]</sup>. Rachdi, H., & Saidi (2015) are in support of the democratic process for investments that foster economic growth <sup>[11]</sup>. The inflow of investment from a donor country to the host country is the determinant of economic growth known as Foreign Direct Investment (FDI) (Siddique, H. M. A., Ansar, R., et al. 2017), which is considered a milestone in regulating economic constraints; establishing a well-ordered inclusive structure with high-income economies <sup>[12]</sup>, Bass, H. H. (2015) views Tunisia in the limelight while giving the fact as “African Lions’ ‘ due to financial deepening and emerging industry <sup>[10]</sup>.

This shows the significance of the impact of FDI (Hassen, S., & Anis, O. 2012) which evolves in the

context of “free trade”, and “free flow of goods and services”<sup>[13]</sup>. Over the past decade, FDI was considered to be integrated into socio-economic policy and adopted the strategy for gaining development<sup>[14]</sup>. This is the rationale that the impact of FDI on economic growth is considered in theoretical and economic studies (Bass, H. H. 2015) and offers a number of economic advantages, for instance, Tunisia since the 1990s has liberalized the capital market while attracting direct investment by a variety of incentives<sup>[10]</sup>.

Also, (Mekki R., 2005) FDI is vital in increasing industrialization and prospects of high economic growth by benefiting the host country by technological inflow, increasing employment and stimulating competitiveness. Thus, the considerations of economic reforms in developing countries place the FDI as an integral component of their policy. Tunisia, being a developing country, is not an exception<sup>[14]</sup>.

It is a widely argued notion that democracy attracts more FDI as it provides an enabling environment for investors in establishing businesses. Otherwise, it is also believed that autocratic regimes are more favorable for multinational corporations and foreign investors that deal with them easier as FDI can be used for their personal benefits. The major determinants of FDI are the policies, rules, rights and duties adopted by the government, other than this debate of democracy versus autocracy for attracting more FDI in the country<sup>[15]</sup>.

Tunisian economic reforms in the autocratic regime were considered as the model since it gave impressive economic growth. However, serious problems have been hidden under this economic endeavor as the unemployment rate among educated youth skyrocketed. Also a regional disparity related-to socio-economic standards vis a vis individual debt among the middle class prevailed<sup>[9]</sup>.

### **3.1 The Impact of Democracy and Autocracy on FDI**

There is a debate whether democracy has more impact or autocracy on FDI, yet the scope of the subject is never challenged by any school of thought. Countries have introduced reforms for a successful democratic process (Prezworski and Limongi, cited in Rachdi, H., & Saidi 2015) “we have no idea to suggest whether democracy stems economic growth or not”<sup>[16]</sup>. The rationale is that FDI becomes an essential component of the global economy and is one of the factors that drives development strategies of both the developed and developing countries. Jensen, N. (2003) finds different perspective in two-way approach (Cross-sectional and Time Series cross-sectional

tests) of 100 countries to analyze the determinants of FDI as follows in two type of governments<sup>[17]</sup>:

(1) Democratic structures flexible to drive FDI inflows into a country.

(2) Democratic countries attract (70%) more than their counter autocratic regimes<sup>[17]</sup>.

The extensive study of literature review suggests that democracy and autocracy have ambiguous courses of actions on FDI. These are the rights, obligations, and approaches which set risky ground for democracy and autocracy in case of foreign investment. Li and Resnick (2003) argue further this difference between the effects of democracy and its interaction with respect to risk for foreign investors. They argue for the influence of democracy with respect to rights, commitments and approaches contrasting to autocracy that pledges a series of explicitly deferential general rights and of work rights<sup>[18]</sup>.

Harms and Ursprung (2002) implies that the democratic government attracts less FDI than autocracy. The former gives greater ability to workers and thus deter foreign investors. In line with this argument, as observed by Rodrik (1999), by giving more weight to workers, democracy may drive pay scale-up, thus diverting those foreign investors, who are searching for labor on cheap wages. Additionally, democratic governments may in like manner differentiate from autocratic governments in their approaches towards FDI<sup>[19,20]</sup>.

O'Donnell (1999) contemplated that, forcing investors, like multinational firms, misuse a customary fondness for autocrats while taking personal benefits from foreign investments<sup>[21]</sup>.

As Li and Resnick (2003) argue that dictators possibly counter less limitation than democrats, they prioritize their own interests and also offer liberal, enabling and inspiring incentives to foreign investors. For instance, exemptions in tax and subsidies in investments and allotments.

On the other hand, democratic systems offer a voice to a greater segment of the masses, including experts who may not be able to bring FDI if it poses threat or challenge to local economic firms. Thus, it is suggested that the demand for protection from FDI is practically more accepted in democracies since losers from FDI have more ways to deal with the policymakers. Therefore, an open system or public policy becomes less conceivable for FDI in democratic governments. The argument ought to be qualified, considering the way that the interests of the losers from FDI must be weighed against those of the victors from FDI<sup>[18]</sup>.

In many countries, the median voter is contributing to more work than capital. The median voter thus gets more benefits by capital inflows. According to the Stolper-

Samuelson speculation, and should subsequently reinforce FDI enabling policies. As Pandya (2014) argued that by allocating decision power towards the median voter and away from a conventionally elite with more capital than the median voter, the democratic government ought to achieve continuously FDI-pleasing policies. As per her argument, Pandya (2014) sees that democratic countries have less restriction with respect to FDI <sup>[22]</sup>. The third estimation along which democratic governments varied from authoritarianism is industrial policy.

On the other hand, considering the way that democratic governments offer a voice to a greater segment of the people, they are less disposed to recognize monopolies, whose interest is to provide profits to a smaller subset of people however, their cost is borne by a larger set of people. Additionally, in line with the argument of Grosjean and Senik's (2011), democratic governments ensure income redistribution, while providing an insurance against the adversative outcomes of capital inflows for some groups of people <sup>[23]</sup>.

Therefore, they provide the citizens with incentives to enhance market liberalization. The arguments deduce that democratic governments should opt for more market-friendly approaches. This has been acknowledged by Rode and Gwartney (2012), Giuliano et al. (2013), and Bjornskov and Rode (2014) <sup>[24-26]</sup>.

Generally, democratic governments have been found to execute approaches that indirectly pull in FDI, for instance by empowering the education sector, and openness to trade <sup>[27]</sup>. The effect of democracies with respect to risk to property rights, firms that put their assets into another country or invest there, face a threat of seizure. Though, complete seizure of assets is not common, however, firms may lose some part of their benefits or revenue because of taxation, rules on foreign ownership, capital controls, downsizing, thievery of authorized advancement rights, or even more generally taking into account policy changes that decline the revenue streams made by their favorable assets <sup>[17,18,28]</sup>.

Therefore, the favorability of democracies or autocracies with respect to FDI will depend on the capacity of these two systems of government to safeguard property rights. Regarding the impact of democracies on property rights, Przeworski and Limongi (1993) recounted that classical theorist, for instance, David Ricardo and Karl Marx, considered universal suffrage would emasculate property rights, by virtue of the incentives for poorer voters to seize the rich <sup>[29]</sup> Alesina and Rodrik (1994), Persson and Tabellini (1994), and Acemoglu and Robinson (2001) give modern forms of the argument in models where democratic policies redistribute income

towards the median voter. <sup>[30-32]</sup>

Rather than those arguments, North (1990) and North and Weingast (1989) argued that a larger democratic government guarantees increasingly secure property rights since it construes adjusted administration that constrains the actions of policymakers <sup>[20,31,32]</sup>. As Henisz (2004) point out, in a democratic framework, changing laws requires the agreement of a couple of veto players. As their number goes higher, the probability of policy-change that may affect property rights becomes lessened <sup>[28]</sup>.

Dutt and Mobarak (2016) argued that the inconsistency in policies will be more diminutive in a democratic framework, considering the way that decision making power is shared across people who can add up to more information in a manner like that of a Condorcet jury <sup>[33]</sup>. Contrary to it, the power of decision making in an autocratic framework is concentrated in one or few hands. As per these arguments, and the empirical evidence, provided by Adserà et al. (2003) or Besley and Ghatak (2010), generally indicate that there is a positive relationship between democratic policies and safeguarding of property rights, which ultimately attract FDI <sup>[34,35]</sup>. In the case of Tunisia, the democratic transition is going to complete a decade, thus the previous two decades, one with autocracy and second with democracy, provide a rich opportunity for comparison of FDI in these two decades.

### **3.2 Evolution of FDI in Tunisia: Pre and Post revolution (2000-18)**

The Tunisian economy has given vital significance to FDI as a way to advance financial and economic development; it has persuaded the significance of their role in advancing the country's economic performance in growing GDP. Attracting FDI and providing easy ways to foreign investors for a long time, also, it has been the subject of major national policy to gain economic development.

The Tunisian government has proclaimed a progression of monetary and administrative measures to inspire foreign investors to situate in the country by setting up a great venture and favorable circumstances for investment.

In this research, we have found, that, there is fluctuation in both of the periods, while doing in-depth content analysis into the subject matter, Grosjean and Senik's (2011) Rode and Gwartney (2012), went in favor of democracy, as, democracy ensures income redistribution, and provides capital inflows as an incentive for market liberalization <sup>[23][24]</sup>. Supporting to it, Giuliano et al. (2013), and Bjornskov and Rode (2014) argues approaches of government that brings FDI to country, for instance, while investing to the education sector, (Aidt and Gassebner, 2010) forward this while discussing factors of FDI,



“openness to trade” attracts to a country<sup>[25-27]</sup>.

Dutt and Mobarak (2016) critically observe the democratic framework, as the ill-political policies have always been disastrous for creating a viable political milieu, as the power is concentrated in few elite hands, who exploit it for personal benefits<sup>[33]</sup>. Harms and Ursprung (2002), Rodrik (1999), As Li and Resnick (2003) have found the elements of democracy that enable to bring the FDI<sup>[19][207][18]</sup>. Due to various reasons, for instance, if the foreign investors find the labour market too expensive, then they start to look for the cheapest one, in order to manufacture cheaper products for high sales and profits in return. Yet, it has been found in pre-revolution period that Tunisia’s economic policy underwent abrupt changes, for the sole rationale of attracting FDI, yet, the challenges

arose from the state actors and non-state actors, which operates from unprecedented reasons. However, a flexible economic policy is designed on the base of the consensus, and the cooperation of different actors.

#### 4. Result and Discussion

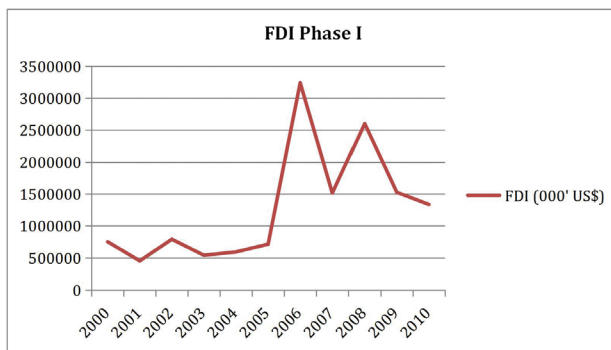
The study investigated the democratic transition with the given variables, the interpretation is explained through the table and its graph.

Table 1 shows that there was a significant increase in FDI in 2006, but there was decreasing trend in FDI after 2008. GDP per capita, Gross fixed capital formation and Current health expenditure (% of GDP) had increased persistently over the pre revolution period.

**Table 1.** The variables relative to the evolution of FDI (Pre Revolution)

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
FDI (000' US\$)	750720	451515	790303	539482	592148	712715	3239909	1515345	2600675	1525245	1334498
GDPPC (US\$)	2212	2253	2344	2760	3111	3193	3370	3776	4307	4128	4142
GFCF(000' US\$)	5404100	5588239	5730886	6286845	6900442	6883999	7763636	8967067	10600114	10574095	10830376
Current health expenditure (% of GDP)	5.0	5.1	5.4	5.5	5.5	5.4	5.4	5.4	5.4	5.7	5.9

Source: WorldBank



**Graph 1.** Foreign Direct Investment in Tunisia (2000-2010)

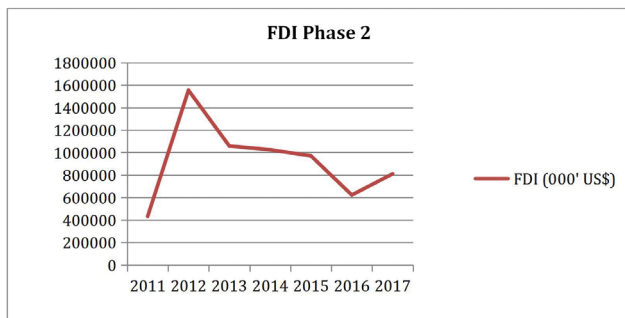
The statistics of the World Bank give a valuable rise of 152% increase, that is 402.9 million in 1997 to 1015.7 million in 2005. Tunisia is facing economic as well as other successive crises before the revolution. The first crisis known as the “subprime crisis” is the external financial crisis which began after the global 2008 global financial crisis.

Table 2 shows that FDI had decreased till 2016 but it has been increasing afterwards. GDP per capita and Gross fixed capital formation had declined post revolution. But current health expenditure (%GDP) has been increasing post revolution.

**Table 2.** The variables relative to the evolution of FDI (Post Revolution)

Year	2011	2012	2013	2014	2015	2016	2017	2018
FDI (000' US\$)	432666	1554269	1058623	1024754	970522	622569	810936	988943
GDPPC (US\$)	4265	4153	4223	4305	3862	3698	3482	3448
GFCF(000' US\$)	10012797	10131378	10134609	9680862	8570351	8070950	7497189	7392044
Current health expenditure (% of GDP)	6.4	6.6	6.9	6.8	7.0	7.0	7.2	

Source: WorldBank



**Graph 2.** Foreign Direct Investment in Tunisia (2011-2017)

The feasible and viable environment of Tunisia attracts investors across the world. It's the strength of economic policy that has been adding milestones to Tunisian epoch. Tunisia needs an economic strategy to foster the milieu in which FDI could prosper. The struggling economy can be revamped by overcoming key challenges, such as, unemployment, unequal distribution of income, and regional disparities or unequal distribution of wealth (Achy, L. 2011). For this, the government should design a shaping public policy to take all the sectors on the road to progress. In a similar manner, (Achy, L. 2011) cites, the impressive performance is attained at the end of 2010 reaching \$3720 per capita income, as compared to \$2713 in 2005<sup>[36]</sup>.

When Tunisia retains the integrity that is promised, then foreign investors entrust their funds with real change. This trust in investing on projects can be effective, particularly, the masses.

## 5. Conclusion

The objective of this case study is to answer the following question: In what extent the democratic political regime adaptation impact the Pre/Post revolution FDI evolution?

Using indicators and variables relating to FDI, Pre and Post revolution. We conclude that there is a correlation between the adoption of a democratic regime and the FDI evolution.

A democratic regime, which involves the existence and exercise of fundamental civil liberties and political rights, creates the right political circumstances to improve macroeconomic performance. Democracy tends to encourage and prepare actors to exercise economic freedom and to encourage the private initiative of entrepreneurs.

This article does not provide a definitive conclusion as to the nature of the relationship between democracy and FDI. In order to find an explanation for this case, our attempt was to verify that the political weather stability could affect the nature of this relationship.

We have found that democracy can stimulate growth if it is conducted in a stable political environment.

This study is part of a long-term research project. In this sense, to improve the academic understanding of this subject, this research can be supplemented or further developed by developing it through a pre-selected countries, an introduction of other determinants of democracy, other variables of the FDI and the application of more robust econometric methods.

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