

DISCUSSION PAPER No. 315

## Morocco, Tunisia and the politics of the EU's list of non-cooperative tax jurisdictions

FINANCE

By **Riccardo Fabiani** and **Chloe Teevan**

December 2021

Morocco and Tunisia were both included on the EU's list of non-cooperative tax jurisdictions in 2017. This listing process was set up to fight global tax avoidance and evasion in non-EU countries and aspired to be entirely technical. However, drawing on the cases of Morocco and Tunisia, the paper shows that the process touched on these countries' core fiscal and industrial policy tools, and was in fact highly political. These cases also lend weight to claims that the list fails to truly tackle global tax avoidance and evasion, as neither country contributed significantly to global tax loss due to corporate tax abuse.

This paper explores the reasons for Morocco's grey-listing and Tunisia's black-listing and subsequent grey-listing. It further examines the process by which the two countries finally managed to remove themselves from the list, eliminating long-standing tax incentives for export-oriented and service industries. The differences between the two were illuminating. They demonstrated the two countries' very different levels of negotiating capacity and how important domestic political economy considerations were in integrating the required changes into wider fiscal reforms or not. In turn, this had an impact on the process' credibility and the EU's reputation and diplomatic relations in the region.

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## Acknowledgements

The authors would like to thank all interviewees who made time to speak and to share their perspectives and experiences. Thanks also to San Bilal for his comments and inputs, and to Inna Perova for layout. Riccardo Fabiani is the North Africa project director at the International Crisis Group.

The views expressed in this brief are those of the authors and any errors or omissions remain the responsibility of the authors. Comments and feedback regarding this brief or suggestions regarding future work can be sent to [cte@ecdpm.org](mailto:cte@ecdpm.org) and [rfabiani@crisisgroup.org](mailto:rfabiani@crisisgroup.org).

## Acronyms

BEPS	Base erosion and profit shifting
CoEU	Council of the European Union
CSO	Civil society organisation
DG TaxUD	Directorate-General for Taxation and Customs Union
EC	European Commission
ECDPM	European Centre for Development Policy Management
Ecofin	Economic and Financial Affairs Council
ECON	Committee on Economic and Monetary Affairs (European Parliament)
EP	European Parliament
EU	European Union
FDI	Foreign direct investment
GDP	Gross domestic product
NCJ	Non-cooperative jurisdictions
OECD	Organisation for Economic Co-operation and Development
OXFAM	Oxford Committee for Famine Relief
PSA (Group)	Groupe PSA (Peugeot Société Anonyme)
SDC	Swiss Agency for Development and Cooperation
SME	Small and medium-sized enterprise
US	United States
VAT	Value-added tax

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## 1. Introduction

The inclusion of Morocco and Tunisia on the EU's list of non-cooperative jurisdictions forced those countries to make changes to their fiscal policy, removing long standing incentives for exporting industries that were central to their industrial policy models. This demonstrated the EU's power to force changes in the domestic economic policy choices of its neighbours, but the process by which this happened in the two countries also demonstrated the differing room to manoeuvre of those countries based on domestic politics and macroeconomic factors.

While EU officials largely insisted on the technical nature of the process, officials and civil society representatives in Morocco and Tunisia largely did not accept that the process was technical. Indeed, the EU's perceived unwillingness to compromise, together with perceived communication failures caused issues for bilateral relations. The manner of the EU listing and the power dynamics that the listing revealed demonstrated the imbalance in the EU's relations with its neighbours. It was perceived by many in Morocco and Tunisia as unjust and biased given that some EU member states are objectively much more important sources of global tax loss due to corporate tax abuse. While the listing of Morocco and Tunisia may have triggered fiscal changes in these countries, it did little to further the fight against global tax evasion.

The impact of the listing on the two countries appears to have led to quite different outcomes, which at the same time supports the claim that the process was not quite so technical as the EU had outlined, and also that periphery countries have a certain leeway to push back when implementing EU policies. Morocco, with its centralised politics and solid macroeconomic fundamentals, was better able to negotiate a gradual policy adjustment, and to locate that change in wider policy shifts as it attempts to redefine its development model. Thus, while it was forced to make fundamental policy changes, it made an effort to locate these changes in a wider narrative of policy change. Tunisia, which faces much deeper fiscal constraints and political instability, proved less able to negotiate and did little to locate these changes in a wider narrative. This failure highlighted some of the problems in both its decision-making system and its relationship with the EU. It was those domestic failures that later contributed to the 25 July 2021 decision by President Kais Saied to declare an emergency state and suspend parliament.

Drawing on the examples of Morocco and Tunisia, this paper ultimately questions whether the EU's list of non-cooperative tax jurisdictions can be construed as a purely technical process, disconnected from political and diplomatic considerations. Our research found that it is ultimately impossible for the EU to disconnect the apparently technical listing process from political and diplomatic considerations. We argue that as with other efforts to push for reform in these strategically important EU Neighbourhood countries, these measures should be considered within the wider political economy of these countries and approached in the spirit of partnership. The risk is that, by ignoring political constraints and sensitivities, this apparently technical but actually political issue could undermine some of the European Neighbourhood Policy's objectives. The paper also argues that by focusing on countries like Morocco and Tunisia, whilst not including EU member states in the same process and delisting important hubs for tax evasion, the current approach fails to tackle the real sources of global tax evasion and suffers from a credibility deficit.

The policy brief will start by briefly explaining the EU list of non-cooperative tax jurisdictions, although this will be covered in more detail in another ECDPM brief. It will then look at what the EU list considered to be "harmful tax regimes" in the cases of Morocco and Tunisia, before looking into how the listing played out in Morocco and Tunisia respectively, and what some of the common responses to the listing were in the two countries. Finally it will reflect on lessons learned from these two case studies and make some recommendations regarding what the EU might do differently in future.

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## 2. The EU non-cooperative tax jurisdictions policy explained

The EU list of non-cooperative tax jurisdictions aims to tackle external risks of tax abuse and unfair tax competition, thereby improving international tax governance. The process is led by the Code of Conduct Group of the Council of the European Union, with the support of the European Commission's Directorate-General for Taxation and Customs Union (DG TaxUD). The three criteria by which countries are judged include tax transparency aimed at ensuring that jurisdictions comply with international standards on information exchange; fair-taxation that aims to assess if a country has harmful tax practices or regimes (judged by EU's own and OECD standards); and anti-domestic tax base erosion and profit shifting (anti-BEPS), which aims to assess if a country applies anti-BEPS measures (EC n.d.).

EU and EU member state officials interviewed for the study repeatedly insisted that the process was purely technical and that political considerations did not play a role in the listing process.<sup>1</sup> Yet, this has been called into question by the failure to move Turkey from the grey list to the black list despite its failure to meet an agreed deadline to comply with the first criteria on information exchange, for example. Reports suggest that member states' positions on whether to blacklist Turkey were explicitly tied to their political and diplomatic positions vis-a-vis Turkey (Valero 2021, Smith-Meyer 2021). Few of the officials, experts or civil society organisation (CSO) representatives we interviewed in Tunisia and Morocco accepted the suggestion that the process was purely technical. Indeed, a couple of interviewees suggested that this was rather the result of shifts in the economic policies of the countries of the Global North, that were beginning to favour reigning in the era of hyper-globalisation, and in turn forcing countries in the periphery to shift policies, having previously pushed the agenda of economic liberalism.<sup>2</sup>

The interests of and role played by specific member states in this process remains unclear, but several interviewees did point to the growing French rhetoric on reshoring key industries.<sup>3</sup> Indeed France had been losing jobs in the automotive sector to Morocco for years, and in December 2019 French Economy Minister Bruno Le Maire explicitly criticised PSA and Renault for offshoring car production in Morocco, Slovakia, and Turkey (Murati 2019). However, an official from another member state, who was involved in the initial listing process, denied that there was a hidden agenda pushed forward by member states.<sup>4</sup>

European and global civil society organisations such as the Tax Justice Network and Oxfam have been scathing in their criticism of the process, which they note does not necessarily target the worst offenders in terms of global tax losses due to corporate tax abuse, while EU member states are not included in the process, and the process as a whole lacks transparency and appears to actually include political motivations (Oxfam International 2019a).<sup>5</sup> The fact that the process delisted the worst offenders was highlighted by the delisting of the Cayman Islands in February 2020 "it adopted new reforms to its framework on Collective Investment Funds in September 2020" (CoEU 2020c), even though the jurisdiction has a zero percent tax rate. Cayman Islands is considered by the Tax Justice Network to be the second worst Corporate Tax Haven, based on the level of complicity in helping multinational corporations underpay corporate income tax, as well as the worst jurisdiction for financial secrecy (Tax Justice Network 2021, Tax Justice Network 2020a). EU member states are currently included in a separate process, which has been critiqued for its lack of transparency and its inability to actually tackle global tax evasion. Indeed, the EU process has been critiqued for driving harmful tax competition between EU states rather than tackling corporate tax evasion (Nouwen 2021, Becker et al. 2021). This is despite the fact that an estimated 30% of global profit shifting operated via EU

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<sup>1</sup> Interviews, European officials, 20 November, 1 & 4(a) December 2020, 15 March 2021.

<sup>2</sup> Interviews, Civil society, 9 December 2020, Moroccan economist, 16 March 2021.

<sup>3</sup> Interviews, European official, 27 November 2020, Former Tunisian minister, 4(b) December 2020, Moroccan economist, 16 March 2021.

<sup>4</sup> Interview, European official, 4(a) December 2020.

<sup>5</sup> Interview, Civil society, 20 November 2021.

member states such as Ireland, the Netherlands and Luxembourg in 2015 (Oxfam International 2019a, p. 18). The failure to include EU member states in the same listing process undermines the legitimacy of that process.

### 3. Morocco and Tunisia’s “harmful tax regimes”

In 2017 the Code of Conduct Group identified Morocco and Tunisia as “non-cooperative jurisdictions” on fiscal matters on the basis of their “harmful tax regimes” (criteria 2) , while the EU also requested that the two countries enhance their exchange of information framework. In particular, several tax incentives and free zones, mainly aimed at foreign companies, were highlighted as an undue advantage for them and a discrimination against domestic firms. The group demanded that Rabat and Tunis tackle these issues by eliminating or at least significantly reducing the taxation gap between national and international businesses.

**Table 1: EU listing of harmful tax regimes in Morocco and Tunisia**

	Tax regime	Original arrangement	Post-NCJ amendments	Identified	Modified
Morocco	Coordination centres	International companies’ branches performing management, coordination, or control activities in Morocco benefited from a reduced tax base, equivalent to the income of non-operating activities, plus 10% of their operating costs	Abolished	2017	2019
	Export enterprises	Export-oriented companies’ foreign currency income was exempted from the corporate tax for 5 years, after which the rate became 17,5% for an unlimited period (while the normal tax rate was progressive and ranged from 10% to 31%)	Amended with a de facto “grandfathering” period of 5 years, after which all export-oriented companies will be subject to a 20% rate. Meanwhile, the corporate tax rate for domestic-oriented firms has been reduced from 31% to 28% and will have to converge with the standard rate by end-2023.	2017	2020
	Free trade zones	Export-oriented firms based in any of Morocco’s free trade zones were allowed a 5-year corporate tax holiday, followed by a 8,75% rate for 20 years. In addition, dividends to non-residents were exempt from taxation	Amended to raise the tax from 8,75% to 15% (still below the 28% rate valid in the rest of the country) and extended to all types of income (not just from exports). It enjoys a 20 years-long “grandfathering” period, in addition to whatever remains of the 5-year holiday originally given to companies established before this amendment	2017	2020
	Offshore banks	Offshore financial institutions were defined as receiving funds in foreign convertible currency from non-residents and transacting, offering assistance, and investing on behalf of non-residents. They benefited from either a fixed	Only one business benefited from this regime before the authorities agreed to cancel it	2017	2019

		corporate tax of US\$25,000 or 10% for 15 years			
	Offshore holding companies	Firms with foreign shareholders, managing portfolios of non-residents, with capital in foreign convertible currency, and transacting exclusively in foreign convertible currency were allowed to pay a fixed corporate tax of US\$500 during the first 15 years of operation	Closed to new entrants on 1 January 2019 and currently subject to a grandfathering period that will remain in place until 31 December 2021	2017	2019
	Casablanca finance city	Service companies enjoyed a 5-year corporate tax holiday, and a rate of 8,75% afterwards applicable to exports and foreign source capital gains, in addition to a 0% rate on dividends	The authorities confirmed the 5-year exemption, but raised the rate that is applicable afterwards to 15% and abolished the distinction between local and export revenues. They also confirmed the decision to have no taxation on dividends	2018	2020
Tunisia	Export promotion incentives	Firms could benefit from a 10% corporate tax rate on their incomes generated by exports. These incentives had been reviewed in 2017, when the authorities decided to abolish the previous full exemption from corporate tax, customs duties, social security contributions, and other income taxes	De facto abolished	2017	2019
	Offshore financial services	Offshore investment vehicles (banks, portfolio management companies etc.) exclusively dedicated to non-resident investors were subject to a 10% corporate tax rate and a fiscal exemption on interest received on hard currency deposits and on withholding tax on interest payment on loans	Abolished	2017	2019

Source: Authors' own based on CoEU 2019a, b, c, d & e, CoEU 2020a & b, CoEU 2021

The Code of Conduct highlighted six issues for Morocco, which was put on the grey list in December 2017. As for Tunisia, the Code of Conduct Group highlighted two problematic regimes and decided to initially blacklist Tunisia in December 2017, before moving it to the grey list in 2018 and finally removing it entirely in March 2019. Both countries had introduced these enticements at various times over the previous 50 years. As import-substitution and state-led development strategies began to flounder in the 1970s under the weight of growing external debt and worsening terms of trade, Morocco and Tunisia gradually adopted trade and capital liberalisation and export-promoting policies. International financial institutions encouraged them to attract foreign companies through special free trade zones, tax holidays, and special labour laws (Azmeah and Elshennawy 2020). For example, Tunisia

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established what it called an “offshore regime” as early as 1972, providing fiscal exemptions and lower tariffs to export-oriented foreign businesses (Ayadi and Mattoussi n.d.).

These setups enabled Morocco and Tunisia to integrate into some of Europe’s increasingly flexible manufacturing value chains. As European firms started to outsource low-value, labour-intensive processes, these countries developed manufacturing capabilities ranging from textiles to chemicals, automotive parts, and aerospace. This relative success, however, has not been enough to sustain the two countries’ long-term development. Indeed, Azmeh and Elshennawy argue that most export-oriented firms relied on European technology, designs, capital and inputs, giving these firms a limited capacity in terms of value-addition. Further, few linkages were created between foreign direct investment (FDI) and domestic and regional markets and supply chains (Azmeh and Elshennawy 2020). Local civil society groups and economists also criticised these arrangements’ fairness and cost-benefit effectiveness. An independent organisation pointed out that Morocco and Tunisia’s fiscal regimes were unfair and ineffective from a cost-benefit analysis perspective, as they incentivised tax avoidance and evasion and created low-wage jobs.<sup>6</sup> Oxfam Maroc looked into Rabat’s tax incentives for foreign investors and concluded that they did not produce sufficient jobs and wealth to be justified and there was a lack of transparency and information. In a report on tax fairness, they argued that the case of Renault, which opened a major factory in Morocco in return for a 25-year-long tax holiday and other enticements, might have benefited the country’s trade balance but had much less benefit for citizens and other local businesses (Oxfam International 2019b). A Moroccan economist also supported this viewpoint and said that the socio-economic costs of these tax incentives outweighed the benefits of the (relatively modest) FDIs.<sup>7</sup>

Likewise, Al Bawsala’s Sahar Mechmech argues that in Tunisia the cost of these tax incentives was on average equivalent to 1.6% of GDP, similar to government spending on education and almost twenty times larger than the budget for the health ministry. She points out that the incentives mainly benefited the mining and energy sectors (collectively 27.73%), the textile sector (6.08%), and banking (5.28%). Yet she argues that incentives are unnecessary for the mining and energy sectors, where investments tend to go where the raw materials are located, while the textile sector is a relatively low-skilled and low-wage sector, which offers little by way of technology transfer. In conclusion, she argues: “These types of investments are not the ones that Tunisia should aim to attract and not the ones which will offer us substantial positive externalities” (Mechmech 2020).

Morocco and Tunisia’s tax enticements have inflicted considerable losses to the state budget, even though they play a very marginal role in global tax avoidance and evasion arrangements. According to the Tax Justice Network, in recent years Tunisia has lost US\$257,400,000 to corporate tax abuse, but inflicted US\$0 of tax losses on other countries, and was responsible for 0% of global tax lost to corporate tax abuse. Likewise, Morocco has lost US\$451,611,585 to corporate tax abuse, inflicted US\$0 of tax losses on other countries, and been responsible for 0% of global tax lost to corporate tax abuse. By way of comparison, Panama arguably inflicted US\$326,541,993 of global tax losses, while Jersey inflicted US\$4,465,999,479 of global tax losses (Tax Justice Network 2020b).

There was thus a strong domestic case for revising many of the tax incentives that were being used to attract industry in Morocco and Tunisia. However, as laid out in the previous paragraph, the losses were largely at the national level, and the fact that neither country was imposing apparent tax losses on EU economies, nor indeed on the rest of the world, poses important questions about their inclusion in the EU’s non-cooperative tax jurisdictions listing. In the next two sections, we will look at how each of the countries responded to its inclusion in the list and how the differing political and economic constraints in the two countries led to quite different consequences in terms of how the countries negotiated with the EU and how they incorporated the changes into their domestic political economy.

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<sup>6</sup> Interview, Civil society, 20 November 2020.

<sup>7</sup> Interview, Moroccan economist, 16 March 2021.



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## 4. Morocco's listing and subsequent fiscal reforms

Morocco is one of the EU's closest partners in the Mediterranean, with deep political and security relationships with several EU member states. The EU Single Market is by far Morocco's most important trade partner, making up 56% of its trade in goods in 2019, including 64% of Morocco's exports and 51% of Morocco's imports (EC 2021a). Morocco ended up on the list for what were widely perceived in the country as trade issues and not fiscal issues; notably due to tax incentives used to stimulate industrial policy, and these manufacturing regimes were linked with a large number of jobs, including as many as 116,600 jobs in the automotive sector alone (Naji 2020). Given the nature of the deep ties between the EU and Morocco and the importance of the tax incentives to Morocco's industrial policy model, the effort to treat the process as purely technical and to initially communicate via relatively low-level technical contacts, albeit those chosen by the Moroccan Ministry for Finance, caused further diplomatic tensions and contributed to turning the process into a two-year saga.<sup>8</sup>

As the weaker party, Morocco was ultimately forced to comply with the EU's requirements, but it managed to negotiate a grace period before many of the measures would be fully implemented (See Table 1). At the same time, Morocco sought to avoid being perceived as basing its fiscal policy on the EU's request. Instead, encouraged by civil society, it sought to make this process part of a longer term national conversation about fiscal policy and wider development.<sup>9</sup> This contrasts with the Tunisian case where no such changes took place. This suggests that the listing process triggers different policy engagement and reform dynamics in different countries.

The discussions between the EU and Morocco appear to have started on the wrong footing. The Moroccans did not understand why the EU was taking a fiscal route to get them to change their whole trade and industrial policy. The EU began communications with relatively low-level contact led by TaxUD, which was not appreciated by Moroccan counterparts. The Moroccans took a very political stance in response, including pointing out that Morocco already has a trade deficit vis-à-vis the EU, and pointing to the country's role in preventing migrants reaching Europe. Interviews suggested that Morocco was also very keen that it would not appear that the EU was imposing a change in policy. A consultant suggested that it would be a good opportunity to reform and develop a more rationalised tax system, something that civil society organisations had long been advocating.<sup>10</sup>

In May 2019, Morocco organised the Assises Nationales sur la Fiscalité, which included a variety of sessions discussing different aspects of the tax system with a view to discussing wider fiscal reform. However, Pierre Moscovici, then EU Commissioner for Economic and Financial Affairs, Taxation and Customs, who had been invited to the Assises by the Moroccan authorities, angered the Moroccans by appearing to dictate Moroccan tax policy when opening what was a domestic event on taxation. This created exactly the effect that the Moroccans were keen to avoid, suggesting that the EU was instructing Morocco what to do. Moscovici's speech produced strong reactions from certain Moroccan commentators, who found the EU's intervention in Morocco's domestic decision making intolerable (Dalil 2019).

The Moroccans were angered, and the EU became a little more pragmatic. In the end, compromise was found with Morocco phasing out all of the various regimes identified by the EU as harmful, but in several cases agreeing to grandfathering period, notably a 20-year period for the Free Zones, which would also maintain a lower 15% tax rate (CoEU 2020b. See Table 1 for details of grandfathering clauses). Morocco complied with all the EU's requirements by October 2020, but was only finally delisted in February 2021, adding tensions to relations between the EU and Morocco. EU officials underlined that the EU was waiting on the Forum for Harmful Tax Practices to approve the

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<sup>8</sup> Interview, Officials, 26 & 27 November 2020.

<sup>9</sup> Interviews, Official, 27 November 2020 & Civil society, 9 December 2020.

<sup>10</sup> Interviews, Officials, 26 & 27 November 2020, Civil society, 9 December 2020.

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delisting and this did not happen in time for the Economic and Financial Affairs Council (ECOFIN) meeting in October 2020.<sup>11</sup> The Moroccan case illustrates the high political sensitivity around the EU listing process, which is a potential source of diplomatic tensions, and highlights the need to address the process as such.

While the Assises included a cross-section of economic actors, including business, political parties, unions and selected think tanks, civil society organisations (CSOs) were largely excluded from the process and were unhappy with the lack of communication ahead of the Assises. They began to build momentum for wider fiscal reforms, with 7 CSOs developing a Platform for Just Taxation. Oxfam also published a highly critical report on Morocco's fiscal system 3 days before the Assises, including an array of recommendations to reform Morocco's fiscal system (Oxfam International 2019b). Despite the initial reluctance to include wider civil society, the Ministry of the Economy and Finance eventually engaged regularly with CSOs, including in a January 2021 event. Civil society and independent analysts remained unhappy with the slow pace of reform and with the highly technical way in which the reforms were being dealt with, arguing that this was ultimately a highly political issue.<sup>12</sup>

However, in June 2021 a law was finally promulgated following up on the recommendations of the Assises Nationales. It includes a reduction in the tax burden on taxpayers in parallel with the expansion of the tax base, the establishment of the principle of fiscal neutrality in value-added tax (VAT) matters, and of relevance for our research: gradual convergence towards a unified corporate tax rate, in particular for industrial activities, and preferential regimes applicable to industrial acceleration zones and services. Also improved contribution of public enterprises and of companies carrying out regulated activities or in a situation of monopoly or oligopoly. It also includes incentives to promote the development of innovative companies, notably in new technologies, research and development and in the social sector, as well as start-ups and support structures (incubator and accelerators) (Hadri 2021). It remains to be seen how effective the law will be and whether it will bring about the deep and lasting change in Morocco's tax system that it needs. Some Moroccan parliamentarians felt that the law had been rushed through without enough consultation in the end, while law Professor Youssef Oubouali points out that the application will be as important as the law itself (Jaidani 2021).

Overall Morocco's inclusion in the EU grey list and the way that the country negotiated its delisting points to the importance of political considerations. The listing complicated an important political relationship, and cannot be considered as a purely technical issue as too often argued. Morocco managed to "politicise" this process, extracting concessions in the form of grandfathering clauses and a compromise on key tax rates (see Table 1 for full details) and taking control of the narrative, which the EU reluctantly accepted to do in order to avoid damaging the relationship further. The reform of the fiscal system had already been advocated by domestic analysts and civil society and appears to have been an important step in terms of Morocco's own domestic revenue mobilisation, but it was an unintended consequence of the NCJ and had little impact on global tax avoidance. The EU should be conscious of the fact that more can indeed be achieved through a more conciliatory approach that recognizes that the context in each country is different. This is a further illustration of the complex political dimensions of the listing process, which is not simply a technical exercise, and should not be conceived as such.

## 5. Tunisia's listing and lack of wider reform

Tunisia's December 2017 inclusion on the black list also appeared to have come as a shock to a country so embedded economically in and politically dependent on Europe. Its economy is deeply integrated with its northern counterparts, particularly France, Italy, and Germany. In 2020 the EU represented 57.9% of its trade, with 70.9% of

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<sup>11</sup> Interview, Official, 26 November 2020.

<sup>12</sup> Interviews, Civil Society, 9 December 2020 & Economist, 16 March 2020.

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exports going to and 48.3% of imports coming from Europe. In 2019, EU companies also accounted for 85% of FDI into the country (EC 2021b). Since the 2011 uprising that led to the downfall of Zine el-Abidine Ben Ali's authoritarian regime and a transition to democracy, Tunis has also been a major recipient of EU financial and technical support. Indeed, from 2014 to 2020 Tunisia received €1.9 billion in aid and €800 million euros in loans from the EU (Debuysere 2019).

Domestic political instability was partly to blame for Tunisia's difficulty in dealing with this issue. The authorities had several months to respond to the EU's initial request to discuss the matter, as the first official communication was sent in January 2017. However, Tunis' response to this message was only ready by October, as in the meantime three successive finance ministers were appointed and had to familiarise themselves with the problem. Due to this delayed response and Tunisia's initial reluctance to commit to changes to its tax system already by 2018, as demanded by Brussels, the country ended up on the black list (Mzalouat and Lac 2017).

In the ensuing negotiations the Tunisian authorities struggled to effectively defend their interests, caught between the rock of the EU's strict approach and the hard place of domestic instability. A former minister complained about a "dialogue of the deaf" between Brussels and Tunis and argued that Brussels knew how politically and economically difficult Tunisia's situation was and, at the very least, could have given more notice about the country's inclusion on the black and, later, grey list. Instead, he said that "one day we woke up and found out we had been included on the list".<sup>13</sup> Government officials and politicians were frustrated with this approach and the lack of support for the country's democratic experiment.<sup>14</sup>

From the European perspective, there was concern about Tunisia's delicate political economy and initial resistance. An EU official was worried about Brussels' rigid approach and saw Tunisia as a "problematic partner" due to its domestic political constraints on reform. Indeed, the initial reaction by the local authorities was uncooperative, as they tried to convince the EU that modifying the tax incentives would be detrimental to its growth model.<sup>15</sup> The local media also reported rumours that Brussels was actually using the non-cooperative jurisdictions' black list to force Tunisia to accept the Deep and Comprehensive Free Trade Agreement – a highly controversial issue in the bilateral relationship (Chaabane 2019). The EU ambassador was later forced to publicly dispel this notion (El Oudi 2017).<sup>16</sup>

One of the sticking points in the conversation between the two sides was whether fiscal incentives in the manufacturing sector should be seen as "harmful tax regimes". According to an EU official, Tunis tried to argue that the country was not a tax haven and that these changes went against Europe's commitment to democracy.<sup>17</sup> From the North African perspective, tax incentives for export-oriented firms were a key policy in the development of the country's industrial sector and should not have been a concern for the EU, as these enticements benefited a large array of European SMEs that have offshored part or the entirety of their production to Tunisia, particularly in the textile sector.<sup>18</sup> Another former minister argued that the 1972 law that introduced this fiscal policy was actually very successful in promoting industrialisation.<sup>19</sup>

Eventually, Tunisia accepted Brussels' demands without negotiating any phase-out period or trying to take control of the narrative, for example by promoting a national reflection on taxation or a broader reflection on fiscal reform. This "collaboration" was praised by EU officials, who described it as the result of their "excellent relationship".<sup>20</sup> In

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<sup>13</sup> Interview, former Tunisian minister, 4 December 2020.

<sup>14</sup> Interview, former Tunisian minister, 9 June 2021.

<sup>15</sup> Interview, European official, 15 March 2021.

<sup>16</sup> Interview, European official, 15 March 2021.

<sup>17</sup> Interview, European official, 15 March 2021.

<sup>18</sup> Interview, former Tunisian minister, 4 December 2020.

<sup>19</sup> Interview, former Tunisian minister, 9 June 2021.

<sup>20</sup> Interview, European official, 26 November 2020.

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January 2018 Tunisia was transferred from the black to the grey list and in March 2019 it was finally removed. However, the local authorities were mostly passive about these changes, which were seen as inevitable and externally imposed. A Tunisian economist blamed the government for its failure to consult domestic stakeholders, coordinate the work of the various ministries involved, respond in a timely fashion to the Code of Conduct Group's initial messages, and negotiate grandfathering clauses and exceptions. In addition, he argued that the government did not seize upon this opportunity to launch a debate on the need to upgrade the country's outdated development model.<sup>21</sup>

In contrast with Morocco, this case highlights the impact that the asymmetric relationship between Brussels and Tunis has had on the latter. Weakened by domestic political tensions, Tunisia was slow to respond to the threat of blacklisting by the EU and engage in reforms. Former officials and ministers complained about the EU's alleged lack of support for the delicate democratic transition and considered this policy detrimental for the country and for the bilateral relationship. Although this issue played a relatively peripheral role in Tunisian politics, it contributed to damaging Europe's reputation in the eyes of local decision-makers and watchers. The EU ambassador at the time also recognized that, because of the special relationship between the EU and Tunisia, and the specific circumstances of Tunisia's democratic process, more time should have been taken to address the issue (Nawaat 2018). The episode analysed in this paper underscores Tunisia's complex political economy and the inevitable political dimensions of the EU listing process, which contributed to the recurrent misunderstandings in the bilateral relationship with the European Union.

## 6. Conclusion and looking forward

The EU's list of non-cooperative tax jurisdictions states that its aim is to prevent tax avoidance and evasion in non-EU countries, to address external challenges to EU countries' tax bases and to prevent money laundering (European Council/CoEU n.d.). Yet, it has come under criticism both from civil society and from within the EU Parliament, and reform of the process is already underway. The Code of Conduct Group, which is in charge of compiling the list, is currently in the process of reviewing its processes and will propose a new assessment framework to use to judge corporate tax systems that should be more transparent and more efficient (Amaddeo 2021). This process is being pushed along by the European Parliament's Committee on Economic and Monetary Affairs (ECON), which in January 2021 adopted a strongly-worded resolution highlighting that the list was not in fact living up to its task of preventing tax avoidance and tax evasion. It stated that the European Parliament: "...regrets that it does not live up to its full potential as jurisdictions currently on the list cover less than 2 % of worldwide tax revenue losses, making the list confusing and ineffective..." (EP 2021a) The statement proceeded to call for increased transparency and consistency, criteria that showed greater impartiality and strictness, and a stronger focus on tax avoidance. It specifically mentioned the case of the removal of countries such as the Cayman Islands, that have a clear record of promoting BEPS. It proceeds to set out a series of reforms. This was followed by an April 2021 expert hearing and a follow-up report on "Reforming the EU policy on harmful tax practices (including the reform of the Code of Conduct Group)." (EP 2021b)

This paper has reflected on two specific case studies, and does not claim to be a comprehensive study of the EU's list of non-cooperative tax jurisdictions. Yet, it points to some of the flaws in this process, particularly as it relates to the EU's closest neighbours. It will be vital that the reform of the Code of Conduct Group and of the listing process takes these elements into consideration.

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<sup>21</sup> Interview, Tunisian economist, 24 June 2021.

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Firstly, these two cases, particularly when taken alongside the Cayman Islands and Bermuda, for example, highlight that the list does not sufficiently target countries that play an important role in global tax avoidance and evasion arrangements. Indeed, the preferential measures that Morocco and Tunisia had in place mainly led to losses for their own exchequers, and had little if any impact on global losses due to tax avoidance. Civil society has consistently pointed to this mismatch in terms of the purported aims of the list, and the European Parliament has called for the Code of Conduct group to consider tax exemptions, transfer pricing mismatches, and to include “a standalone criterion on 0 % or very low tax rates” (EP 2021a).

Secondly, the lack of transparency around the process and questionable communication both within the EU institutions and with external stakeholders can be highly problematic, impacting both the credibility of the process and the EU’s external reputation. The European Parliament puts a strong focus on transparency and in its resolution calls for disclosure of: “...the participating authorities, topics of discussion, technical assessments, minutes or summaries and conclusions adopted; considers that to improve accountability and transparency, sources of data for the screening of jurisdictions should be made easily accessible when available to the public; considers that the methodology for assessing third-country regimes should be refined and fully disclosed; invites the Code of Conduct Group to systematically release a comprehensive summary of its interactions with third countries, the subject matter discussed and the commitments made by third countries during each step of the assessment process; (EP 2021a). Yet, this transparency is interconnected with the question of communication, which should be at the appropriate level and should contribute to ease, rather than raise tensions in relations with third countries.

Thirdly, while new criteria and greater transparency would greatly improve the process, it is wishful thinking to imagine that the process could be purely technical. All technical processes have a political undertone, and this is most certainly the case for such an important policy area as fiscal policy. Even within the EU, member states are reluctant to see this ultimate area of sovereign policy making fall under a common remit, and resent being finger pointed. It is thus to be expected that third countries would be more sensitive. As the cases of Tunisia and Morocco demonstrate, different states ultimately managed to negotiate (or not) in different ways, including in the case of Morocco the negotiation of considerable grandfathering periods. There should be a recognition that the process is also political, and the EU should become more agile in addressing the political dimensions of its listing process. Diplomats and officials working on EU foreign and development policy should be better harnessed in the decision-making and implementation of the listing process, alongside finance officials.

Fourthly, the specific situation of developing countries should be taken into account. Hence the need to involve EU diplomats and development officials. In Morocco and Tunisia, little attention was paid to the macroeconomic and industrial impact of the requested changes, nor to the wider political economy of the two countries and thus their asymmetrical ability to make meaningful changes. The decision-making process should include a careful analysis of the broader macroeconomic (GDP, employment, balance of payments, supply chain integration etc.) and social effects relative to each country’s contribution to global tax evasion. The EU needs to become aware of different political economy contexts and bake in a degree of flexibility in this and other policies to adjust to these different conditions. Again, the European parliament does touch on this point, although we would urge for an even stronger assessment: “Supports the broadening of the geographical scope of the EU list, while taking into account the position of least-developed countries; underlines that the fact that some developing countries might lack the resources to swiftly implement newly agreed tax standards should be systematically considered in future assessments;...” (EP 2021a).

Fifthly, while stronger countries and blocs like the EU undoubtedly have the ability to forcefully push for changes in smaller developing countries, the power asymmetries and the inequality with which different countries are treated by the process can be highly problematic. This process ultimately requires countries to enact changes in a policy area that is fundamental to their sovereignty; taxation. This calls for much greater inclusiveness in the process in third

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countries, emphasising the importance of bringing in a range of stakeholders. The European Parliament calls for changes on this front, bringing local authorities and civil society into the process: “Invites the Code of Conduct Group to increase the inclusiveness and external acceptance of the process by consulting developing countries and civil society organisations; suggests that a working group or a consultative body be set up with non-EU countries, in particular developing countries, members of civil society and experts, so as to facilitate dialogue on the decisions made;” (EP 2021a).

On a related point, the listing focuses on non-EU member states only and seems to target mainly developing countries, but not global powers such as the US. This again contributes to call into question the fairness of the list, and can make it appear to be a weapon used by the strong vis-a-vis the weak. This is a source of complaint by many CSOs and policy actors. A more inclusive process must apply the same criteria across the board – no matter how powerful the actor in question.

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This publication benefited from structural support by ECDPM's institutional partners: Austria, Belgium, Denmark, Estonia, Finland, Ireland, Luxembourg, the Netherlands and Sweden as well as funding from the Swiss Agency for Development and Cooperation.

ISSN1571-7577

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**HEAD OFFICE**  
**SIÈGE**

Onze Lieve Vrouweplein 21  
6211 HE Maastricht  
The Netherlands *Pays Bas*  
Tel +31 (0)43 350 29 00  
Fax +31 (0)43 350 29 02

**BRUSSELS OFFICE**  
**BUREAU DE BRUXELLES**

Rue Archimède 5  
1000 Brussels *Bruxelles*  
Belgium *Belgique*  
Tel +32 (0)2 237 43 10  
Fax +32 (0)2 237 43 19

[info@ecdpm.org](mailto:info@ecdpm.org)  
[www.ecdpm.org](http://www.ecdpm.org)  
KvK 41077447