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Independence Usurped: Tunisia's Central Bank Under Kais Saied's Rule

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Introduction

In 2022, the president of Tunisia, Kais Saied, used his powers to push through a new constitution, one that created a political system dominated by the presidency. Tunisia's economy, which was in bad shape, worsened. In 2023, there was still a chance that the country could avoid defaulting on its public debt, but this required the Saied-led government to resist the temptation to coerce the Central Bank of Tunisia (CBT) into lending it money. Alas, the very next year, the government failed to resist that temptation.

In February 2024, the Tunisian parliament passed an amendment allowing the CBT to lend the equivalent of $2 billion dollars directly to the country's treasury and thereby avert a fiscal deficit that year. The reason such a move required an amendment was because a 2016 law (2016-35) had stated: "The Central Bank cannot provide any loan to the treasury of the government either in the form of overdraft or loans, and is prohibited from purchasing any security or treasury bills issued by the state."

Eight years later, things have changed. To be sure, the 2024 amendment to Law 2016-35 was presented as an "exceptional" measure. Nevertheless, the damage was done. The amendment allowed the government to intervene in the decisionmaking process of the CBT. Effectively, this subordinated the institution to the government (which is now for all intents and purposes controlled by the president) and set a dangerous precedent. The country's financial situation has remained precarious since the amendement was passed, and the government's resorting to the central bank's reserves for funds is widely seen as a desperate move to postpone an inevitable crisis.

The CBT as Anchor of Economic Stability

The CBT was created in 1958, two years after Tunisia gained independence from France. Following the uprising of 2011, which ousted long-time ruler Zine el-Abidine Ben Ali, the bank successfully preserved the country's foreign reserves in the midst of a volatile political situation, with no fewer than six governments over five years. In 2016, a new constitution was promulgated, granting the CBT a large measure of autonomy. This autonomy was strengthened by Law 2016-35 later that year. The background to the law was an uncertain political situation characterized by a parliamentary regime, a president wielding only limited executive powers, and a revolving door of governments. Such political instability was a threat to policy continuity and made clear to all the need for the CBT's independence.

In drawing a clear line between the CBT and the government, Article 25 of Law 2016-35 made Tunisia's central bank one of the most independent of its kind in the Middle East and North Africa. The robustness of the CBT's position in the country's politico-economic landscape also derived from the nomination process of the governor and of other members of the management board. With the support of his parliamentary coalition, the prime minister selected a candidate, who then had to be confirmed by the president; if confirmed, the governor was given a mandate of six years that could be renewed only once. According to the same law, the president could dismiss the governor. However, the president's decision was subject to confirmation by parliament. All this shows that the governor of the CBT retained a distance from the political authorities, and was even largely independent of them.

Indeed, several economic indicators show that, until 2024, the CBT was operating in a largely independent manner. For example, responding to the dinar's devaluation following the government's acceptance of an International Monetary Fund (IMF) reform program in 2016 (an agreement that subsequently fell apart), the CBT raised interest rates significantly. This was despite the government's desire to stimulate growth, which generally requires a lowering of interest rates. The CBT went on to maintain high rates throughout a period of anemic GDP growth. In 2020, it cut rates in response to the COVID-19 shock, but not aggressively, lowering them to about 6 percent; this was a very modest reaction, given the unprecedented nature of the event.

Additionally, the CBT was able to protect and even increase the volume of foreign exchange reserves. Though the relative value of these reserves, measured in months of imports, has decreased over the past two years, it remains above the crucial three-month level, which is considered the minimal threshold for stability in emerging-market economies. The ability of the CBT to keep foreign exchange reserves stable despite Tunisia's situation compares well to Morocco, which has a more favorable economic performance and a regime that leans toward keeping interest rates high. It is a better outcome than that of the central bank of Türkiye, which suffers from very high instability, as well as the central bank of Algeria, which has seen a consistent and significant decrease in reserves, both in absolute and relative terms, over the same period.

In Tunisia, inflation rose between 2016 and 2019, and then fell due to COVID-19. But it rose again in 2022 with the rebounding of the global economy and, more importantly, the start of the Russia-Ukraine war. The latter had a particularly negative impact on the Tunisian economy, which is highly dependent on energy and food imports. During this period the CBT kept interest rates high in order to fight inflation, even though GDP growth remained anemic and GDP per capita was deteriorating significantly, which generated political unrest and instability for successive governments until July 2021, when Saied suspended parliament and began the process of consolidating his power.

The CBT's keeping interest rates high was undoubtedly harmful to growth. Yet the bank's success in enacting policies that protected foreign exchange reserves, maintained price stability, and promoted financial stability in a very degraded economic environment, all crucial factors in preserving the country's solvency, was clearly demonstrated. Moreover, from 2016 to 2024, the CBT proved able to maintain its approach despite friction with successive governments. Managing to do so in a context where, additionally, the credit worthiness of the country is in question and relaunching the economy, decreasing unemployment, and fighting inflation are all challenges, as was the case in Tunisia, is even more noteworthy.

Unanchoring Tunisia's Economy—and Casting it Adrift

In 2024, the Tunisian government amended the 2016 law guaranteeing the independence of the CBT, requiring the latter to directly fund that year's $9.2 billion budget deficit. Far from being a mere amendment, this contravened Law 2016-35. Admittedly, the government insisted that the amendment would be used only to plug the 2024 funding gap. Yet, with a president who had been stripping independent institutions of their power and destroying all institutional checks and balances, the governemnt's statement was scant comfort.

The amendment's effect was to weaken the capacity of the central bank to implement policies that are not in the interest of the government—something Law 2016-35 was intended to prohibit. The expected short-term relief from this measure by the government will be far outweighed by the damage inflicted on Tunisia's financial stability. And the critical financial pressures the president and his team are facing will become more difficult to absorb due to this ill-thought action. The combination of financial deficits, external funding gaps, high inflation rates, low GDP, and high unemployment has led to a very dangerous situation.

This danger has been compounded by a deep financial impasse that leaves the government no room for maneuver. Its access to international bond markets remains closed and Tunisian Eurobonds are trading at levels of probable default, with yields reaching 50 percent for some issues. Additional risks stem from the trade balance, which was running a deficit of $3.9 billion for the first eight months of 2024. This is a marginal improvement over the $4 billion for the same period in 2023, but is still unsustainable.

Against all these risks, the CBT has thus far managed to protect the level of foreign exchange reserves. In September 2024, those reserves were at the stable level of 117 days of imports. However, valued at $8.45 billion, they are lower than the 2023 level of $8.8 billion. The fear is that the depletion of reserves will accelerate, with their ratio to imports falling below the 90-day threshold. This could lead to a financial crash.

Inflation and economic growth are also matters of concern. Inflation reached 9.3 percent in 2023, and was between 7.1 and 7.3 percent throughout the first ten months of 2024. In its latest meeting, the CBT decided to maintain interest rates at 8 percent, due to persistent fears of inflation. Such high rates risk further slowing already anemic economic activity. The IMF projects that economic growth in 2024 will be 1.6 percent. This follows a dismal performance in 2023, when growth was a mere 0.4 percent. The continuous trend of low economic growth has caused unemployment to remain high at 16 percent, with unemployment among youth at an alarming 38 percent overall and 23 percent among university graduates.

The 2024 amendment to Law 2016-35 creates an additional uncertainty. Using the CBT to fund gaps in the funding of expenditures and deficits forces it to inject liquidity into the market. This effectively accelerates inflation and creates downward pressure on the value of the dinar. The CBT can compensate by raising interest rates further, but that would run the risk

of depressing GDP growth and potentially triggering a recession. Alternatively, it could bolster the value of the dinar through the sale of foreign exchange reserves—but that would make it difficult to maintain their level above the crucial threshold of three months. A working paper on the effects of the dinar's devaluation in 2016 shows that it has negatively affected Tunisia's external balance on goods and services, generating additional pressure on the country's foreign exchange reserves.

Saied's attempts to mollify jittery observers notwithstanding, the 2024 amendment to Law 2016-35 also raises concern that it will set a precedent for government meddling in the CBT's decisions. In this regard, it is instructive to look at what happened in Türkiye and Lebanon. In Türkiye, when inflation spiked in 2018, President Recep Tayyip Erdogan opposed any initiative by the central bank to raise interest rates. From 2016 until 2024, the central bank had seven different governors. This was because each presented a plan to raise interest rates in order to fight inflation—which reached 85 percent in 2022 and is trending at more than 70 percent at the time of this article's writing—and each was promptly fired by Erdogan. The Turkish lira lost 89 percent of its value against the euro during those eight years. This dealt a major blow to the the country's economy and generated worrisome current accounts deficits.

Lebanon provides an example of how a country's central bank repeatedly bailing out the government can lead to disaster. In Lebanon, the central bank funded successive governments' annual budget deficits. It did this directly, through loans and purchases of treasury bills, as well as indirectly, by pressuring the country's major banks to use their foreign currency deposits to purchase government debt. To reassure the banks on the risk involved, the central bank maintained a manipulated fixed exchange rate of 1,507 Lebanese pounds to the U.S. dollar. Yet this eventually proved untenable due to a surge of deposits that were transferred out of Lebanon, which provoked a rapid depletion of the central banks reserves and prompted the whole system to crash in 2019. According to the World Bank, Lebanon's resulting financial crisis was—in terms relative to the size of the economy—"likely to rank in the top 10, possibly top three, most severe crises episodes globally since the mid-nineteenth century." The value of the Lebanese pound plummeted and now stands at nearly 90,000 pounds to the U.S. dollar. As the country defaulted on its foreign debt, the banking sector collapsed due to the concentration of risk on the banks' balance sheets toward government debt, reaching up to 70 percent of credit exposure to the state, and the crowding out of the private sector's access to loans.

Today, as we approach the end of 2024, Tunisia's public debt—including that of state-owned enterprises—is close to 100 percent of the country's GDP. Almost 60 percent of the debt is external. This means that it is highly sensitive to any deterioration in the dinar's exchange rate and poses a direct threat to the level of foreign exchange reserves. Additionally, the level of credit directed toward public debt is increasing rapidly, a worrying trend that resembles what happened in Lebanon—even if we are far from the critical levels seen there. As shown by the Lebanese example, defaulting on the public debt would plunge Tunisia into further economic distress and throw an even larger part of the population into poverty. And this is a distinct possibility. Even Fitch's decision in September to upgrade Tunisia's credit rating from CCC- to CCC+, following recent and most likely short-term improvements in the country's trade deficit, does not change much. Indeed, according to Fitch's own definition, a CCC+ rating points to a "high probability of default."

In sum, the forecast remains bleak. The government's annual budget deficit is becoming extremely difficult to finance, yet Saied refuses to implement reforms that would grant the country access to international funding. Instead, he continues to rely on convincing

international partners—such as the Gulf Cooperation Council, as well as Asian countries farther afield—to provide new loans, and on coercing the banking sector, in particular the CBT, to fund the deficit. This approach is not only short-sighted; it also harms the credibility of the CBT, which is an invaluable element of financial transparency and stability.

Conclusion

There is a way out of the financial and economic impasse that Tunisia has reached. It begins with restoring the independence of the CBT. In this regard, it is important to recall that, in theory, the CBT is still independent and Law 2016-35 remains in force. Yet Tunisia has not reassured domestic and international creditors that the amendment was a one-off affair. It could do this, for example, by passing a law that increases the number of those members of the CBT's board whom the governor personally designates—thereby bolstering the institution's independence. While this alone would not halt Tunisia's slide toward bankruptcy, it would send a very strong signal to international investors and financial institutitions that Saied and his government are willing to implement the reforms necessary to attract loans from the IMF as part of a reform package.

Unfortunately, as this article goes to press, Saied, newly re-elected as president, appears to be giving in to ever more dangerous temptations. Indications are that members of parliament and the government are preparing draft legislation that would weaken the CBT's autonomy in determining interest rate levels. If this is confirmed and such proposed legislation is passed into law, the president and his government will have brought Tunisia even closer to the precipice. Pushing Tunisia over that precipice would result not only in a sharp economic downturn, but also quite probably generate political instability.

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