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# Short Communication on the Tunisian Exchange Regime a Decade after the Revolution

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## Abstract

Over the decade following the revolution, the IMF annual reports on exchange arrangements and exchange restrictions show that the Tunisian de facto exchange regime is not compliant with the de jure regime announced by the Tunisian authority. The latter claims a floating regime, except in 2013-2015, whereas the International Monetary Fund (IMF) states that it is a rather crawl-like regime, except in 2017. This discrepancy between the real and the official exchange regime is neither new nor specific to Tunisia. The IMF was aware of it and it has adopted a de facto classification since 1999. Nevertheless, this dichotomy is a bit surprising for Tunisia for the next reason: Tunisia has experienced a revolution that ended in early 2011 a dictatorship regime and established a democratic political regime supposed to be more accountable and more transparent. This controversy raises an important question: The exchange regime dichotomy stated by the IMF, does it really exist despite the transition toward democracy, or it is only an allegation that can be attributed to the inaccurate verification technique used by the IMF? In this context, the Tunisian de facto exchange regime over the post-revolution decade. The paper can be reduced to two main parts. The first part summarizes the theoretical explanations of the divergence between the de facto exchange regime and the de jure exchange regime. The second part consists of empirical verification of the Tunisian exchange regime by using descriptive statistics and econometric models.

**Keywords:** Exchange regime • International monetary fund • Monetary policy • Bank profitability

## Theoretical Background

Theoretical studies show that the existence of a discretionary exchange regime is not necessarily directly related to a totalitarian political regime. It has two main explanation hypotheses: the corners hypothesis and the fear of floating hypothesis. The corners hypothesis states that intermediate regimes are unsustainable and only the polar regimes, the free-floating and the hard peg, can be long-lasting. Previous studies explained the non-viability of the intermediate regimes by the impossible trinity that is the impossible combination of a fixed exchange rate, a free capital movement, and an independent monetary policy. A budget deficit financed by an excessive money creation causes foreign reserves shortage and capital outflows, triggers speculative attacks, and precipitates currency crises. Face to this chaotic scenario monetary authorities have two alternative policies: (1) reinforce the exchange regime's credibility by adopting a hard peg (a corner solution); or (2) reinforce the independence of the monetary policy and adopt a free-floating regime (the opposite corner solution) [1-3]. That the trilemma cannot be the only cause of the flight to corners because the authority can choose an adjustable peg or 'leaning against the wind strategy'. Intermediate regimes are unsustainable because they are non-verifiable and have an overestimated credibility [2-4].

The fear of floating means the reluctance to allow the free fluctuation of the nominal or the real exchange rate. This fear arises, as stated by in their same-named paper, from the combination of the lack of credibility, the high exchange rate pass-through, and the inflation targeting [5,6]. On one hand, emerging economies cannot claim a pegged regime even if they really adopt it because they are not capable to resist speculative attacks challenging the peg. On the other hand, they need a fixed regime to reinforce their credibility challenged by the political instability and the low degree of accountability [7,8]. Besides, a high pass-through phenomenon as well as a high debt denominated in foreign currency, so-called 'original sin', increases also the fear of floating especially when the central bank adopts an inflation target policy [6-9,10].

## Main Results

That exchange regime verification techniques are not conceived to verify simultaneously the flexibility degree and the implicit weights of the reference currencies [4]. Consequently, they have developed a

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constrained econometric model that can achieve simultaneously three goals: verify the flexibility degree by introducing an exogenous variable named exchange market pressure (EMP); estimate the implicit weights; and impose the sum of the implicit weights to be one. This model to verify the flexibility degree of the Tunisian Dinar (TND) and the implicit weights of its reference currencies [1]. Nevertheless, it should be noted, before going further, that have addressed two serious critiques to Frankel and Wei's model. First, one component of the EMP is the dependent variable itself, which can produce a multicollinearity problem. Second, the constraint model is none other than the unconstrained model with a different numeraire [11].

Results based on the Japanese Yen (JPY), the Australian Dollar (AUD), and the Swiss Franc (CHF) numeraires have globally a similar pattern. However, the use of the special drawing rights (SDR), as recommended seems inappropriate and gives weak results. The EMP variable does not cause a multicollinearity problem, but its coefficient is always very low. The preliminary tests, as well as the overall econometric regression, show that the TND is discretionary anchored to a basket of currencies, whereas its flexibility is very low. The basket contains the United States dollar (USD) and the Euro (EUR). The exogenous breakpoint test, the Chow test, and the endogenous breakpoint test, the Bai-Perron test, show that the Tunisian exchange regime is not stable, and it records at least one structural change in 2017. The results are broadly compliant with the IMF classification. The Tunisian de facto regime is not floating, except in 2017. Nevertheless, the IMF has noted in 2018 that the EUR became the only anchor currency, but results show that from 2017 the weight of USD becomes higher than the weight of the EUR [1, 4].

To address this contradiction, applies the State-Space Model (SSM) technique allowing for time-varying parameters (time-varying implicit weights). The SSM results confirm the linear regression results [12,13]. The implicit weights are time-varying. From the beginning of the covered period until mid-2018, the weight of the EUR has experienced a negative trend, while the USD has experienced a positive trend. Nonetheless, the end of the covered period marks a trend reversal. In contrast to the 2018 IMF report, the results show that the TND continues to be anchored to the two world currencies and not only to the EUR. The discrepancy between the Tunisian de facto and de jure exchange regime may be explained by the fear of floating and the corner solution hypotheses. On one hand, the IMF pressure toward a more flexible exchange (a corner solution) forces the Tunisian authority to claim a floating regime. On the other hand, the high exchange rate pass-through, the original sin, and the high energy deficit press the Tunisian authority to support discretionary the TND in order to reduce the social and economic negative effects of a weak TND (fear of floating).

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