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When Do Autocracies Start to Liberalize Foreign Trade? Evidence from Four Cases in the Arab World

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Abstract

This paper argues that trade and capital account reforms within autocracies underlie the primacy of foreign currency procurement. A longitudinal comparison of four countries (Morocco, Tunisia, Egypt and Jordan) in the Middle East and North Africa region shows a historical sequencing of reforms. In the 1960s and 1970s, the foreign exchange scarcity was managed primarily by rising restrictions, accumulation of debt and a number of unilateral country-specific strategies, including broader economic openings (*infitah*) and isolated capital account liberalizations. However, IMF-friendly reforms (orthodox trade liberalization) only became a political option in the context of the extreme fiscal scarcity of the 1980s and 1990s, after the failure of these earlier policies and the drying up of alternative unconditional finance. Additionally, the time differences regarding when orthodox reforms are implemented within autocracies mainly relate to global and regional cycles of different external windfall gains. These findings complement recent debates about the rush to free trade in at least two regards. First, they point to distinct causal mechanisms depending on the type of political regime (for example, autocracy versus democracy), explaining the beginning of trade and capital account liberalizations among developing countries. Second, they reveal the conditional historical influence of neoliberal ideas among structurally similar autocracies.

Keywords: Autocracy, trade and capital account liberalization, Morocco, Tunisia, Egypt, Jordan

JEL Code: F13, F31, N45, N95, O24, P52

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Zusammenfassung

Wann beginnen Autokratien ihre Außenwirtschaftsbarrieren abzubauen?

Ein Vergleich von vier Fällen in der arabischen Welt

Im Papier wird argumentiert, dass die Reform von Außenwirtschaftsbarrieren innerhalb von Autokratien dem Primat der Devisenbewirtschaftung unterliegt. Ein historischer Vergleich von vier Staaten (Marokko, Tunesien, Ägypten und Jordanien) in der Region Nah- und Mittelost verweist auf eine historische Sequenz von Reformen. In den 1960er und 1970er Jahren reagierten die untersuchten Staaten auf Devisenknappheit mit steigenden außenwirtschaftlichen Regulierungsniveaus, externer Verschuldung und einer Reihe von unilateralen länderspezifischen Strategien, wie ökonomischer Öffnung (*infitah*) und selektiver Liberalisierung des Zahlungsverkehrs. IWF-induzierte Reformen (orthodoxe Außenwirtschaftsliberalisierung) wurde darauf folgend erst im Kontext extremer fiskalischer Krisen in den 1980ern und 1990ern opportun, nachdem diese früheren Reformen gescheitert und alternative nicht-konditionale Finanzierungsformen ausgetrocknet waren. Zeitliche Unterschiede bei der Implementierung orthodoxer Reformen lassen sich daher am besten mit Blick auf global und regional unterschiedliche Zyklen externer staatlicher Renteneinnahmen verstehen. Diese Erkenntnisse ergänzen aktuelle Debatten in Bezug auf die Determinanten von außenwirtschaftlicher Liberalisierung in mindestens zwei Aspekten: Erstens wird auf unterschiedliche kausale Mechanismen in Abhängigkeit vom Regimetyyp (z. B. Autokratie versus Demokratie) verwiesen, um den Beginn von Außenwirtschaftsliberalisierung in Entwicklungsländern zu erklären. Zweitens wird auf den kontextuellen historischen Einfluss der neo-liberalen Beratungspraxis innerhalb strukturell ähnlich aufgebauten Autokratien aufmerksam gemacht.

When Do Autocracies Start to Liberalize Foreign Trade? Evidence from Four Cases in the Arab World

Thomas Richter

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1 Introduction

While the recent world financial crisis has led many to fear a resurgence of global protectionism, academia still struggles to explain the unparalleled preceding global rush to free trade (Rodrik 1994; Milner 1999). Conventionally, quantitative studies have explained trade and capital account liberalization among developing nations according to one of two different causal mechanisms. First, it is argued that increasing trade and capital account openness corresponds to the rise of government accountability and popular representation. Democratization of political systems reduces the ability of governments to use trade and capital account barriers as a strategy for building support among domestic constituencies and therefore increases the probability of a more open economy (Frye/Mansfield 2004; Martin 2005; Milner/Kubota 2005; Kennedy 2007). Second, other researchers argue that the rise of neoliberal ideas within international financial institutions, especially the International Monetary Fund's (IMF) surveillance

power, has forced the liberalization of capital and trade account legislation among IMF member states (Broome/Seabrooke 2007; Chwioroth 2007b, 2007a; Lombardi/ Woods 2008).

However, both perspectives fail to understand the rationale of trade and capital account reforms within autocracies. Given similar external and internal conditions, why did some authoritarian regimes start to reform their trade and capital account legislation earlier than others? Concentrating on four cases from the Arab world (Morocco, Tunisia, Egypt and Jordan), this article argues that among stable and structurally similar autocracies, any time differences in trade and capital account reforms are contingent upon the state's aggregated foreign exchange. Thus, under constant levels of convertible currencies, there was no need to implement neoclassical reforms despite regular IMF consultations. Only under extreme fiscal scarcity, which ensued after the failure of alternative policies, did IMF-friendly trade and capital account reforms become a political option. Therefore, different cycles of external windfall gains have played an important role in augmenting IMF pressure for neoliberal reforms among Arab authoritarian regimes.

After this introduction, the region of the Middle East and North Africa (MENA) will be characterized as an outlier, being a nondemocratizer with the second-largest degree of trade and capital account liberalization worldwide. This makes the region particularly well suited for exploring the conditions of trade and capital account reforms and going beyond one of the two existing paradigms, thereby excluding democratization as a potential explanation. Four in-depth descriptions which summarize extensive analyses of original documents and highlight the motivations and rationales behind national leaders' decisions to implement trade and capital account reforms are then presented. Comparing the historical experiences of these four mostly similar Arab cases will eventually help to specify a possible causal mechanism that explains under what circumstances capital and trade account reforms have been initiated by structurally similar, and stable, autocracies.

2 Recent Perspectives on the Determinants of the Rush to Free Trade

During the 1990s research in (international) political economy was most often at odds about the determinants of foreign trade policies. In particular, the *primum mobile* behind the rush to free trade (Rodrik 1994; Milner 1999) was a matter of heated debate. Even though neoclassical welfare economics has established the almost universal consensus that an aggregated reduction of trade restrictions will lead to welfare gains within the economy at large, it remains entirely open as to why, then, most of the world's nations have erected trade barriers and have consistently kept them at high levels. One answer to this question highlights the influence of powerful domestic groups as preservers of the status quo. Depending on the theoretical models used, these interest groups are organized around actors (competing import producers and holders of import licenses), sectors (less competitive sectors), or factors (scarce production inputs) (Frieden/Rogowski 1996: 37-38; Milner 1999: 95 ff.). However, the litera-

ture is far from being in concord about which model best explains the comparative historical development of trade reforms (Milner 1999: 96).

In contrast, political scientists and sociologists argue that the regulation of international commodity flows is included in the sovereign rights of any nation-state. Based on this principal, these scholars are interested in the intentions, motivations, and structural determinants that influence the rise, and the dismantling, of trade restrictions among developing countries (Milner 1999: 92). During the early 1990s a rich cluster of case studies emerged wherein trade liberalization was analyzed within a broader framework of structural adjustment and economic liberalization.¹ Although these studies tried “to single out those [factors] that best explain why governments followed similar or different adjustment paths” (Nelson 1990a: 325), no generalization about the general patterns of these processes was achieved (Wilson 1991: 1478). It was Helen Milner who concluded in 1999 that “[n]one of our existing theories by itself seems to do very well in explaining this movement [the rush to free trade] [...] and none appears to have predicted it” (Milner 1999: 111).

Not until the dawn of the third millennium did a new paradigm emerge, one which emphasizes the causal influence of democracy and democratization upon the reduction of foreign trade barriers among developing nations (Frye/Mansfield 2004; Martin 2005; Milner/Kubota 2005; Bodenstein/Schneider 2006; Kennedy 2007). In light of this, it is now said that “authoritarianism may be associated with higher trade protection” (Banerji/Ghanem 1997: 188) and “autocrats are less likely to open up the economy” (Giavazzi/Tabellini 2005: 26).

Alternatively, a number of recent contributions have argued that neoclassical policies, as proposed by the IMF, have been a driving force behind capital and trade account reforms. For Broome and Seabrooke (2007), the IMF acts mainly as a provider of comparative knowledge for possible policy reform. Lombardi and Woods (Lombardi/Woods 2008) map out several deductively reasoned options concerning how IMF surveillance might convince countries to bring about policy change. In addition, Chwieroth (2007b; 2007a) shows in a statistical analysis that increasing capital account openness among emerging countries is significantly associated with the growing presence of neoliberal bureaucrats within the IMF.

3 Case Selection and Methodology

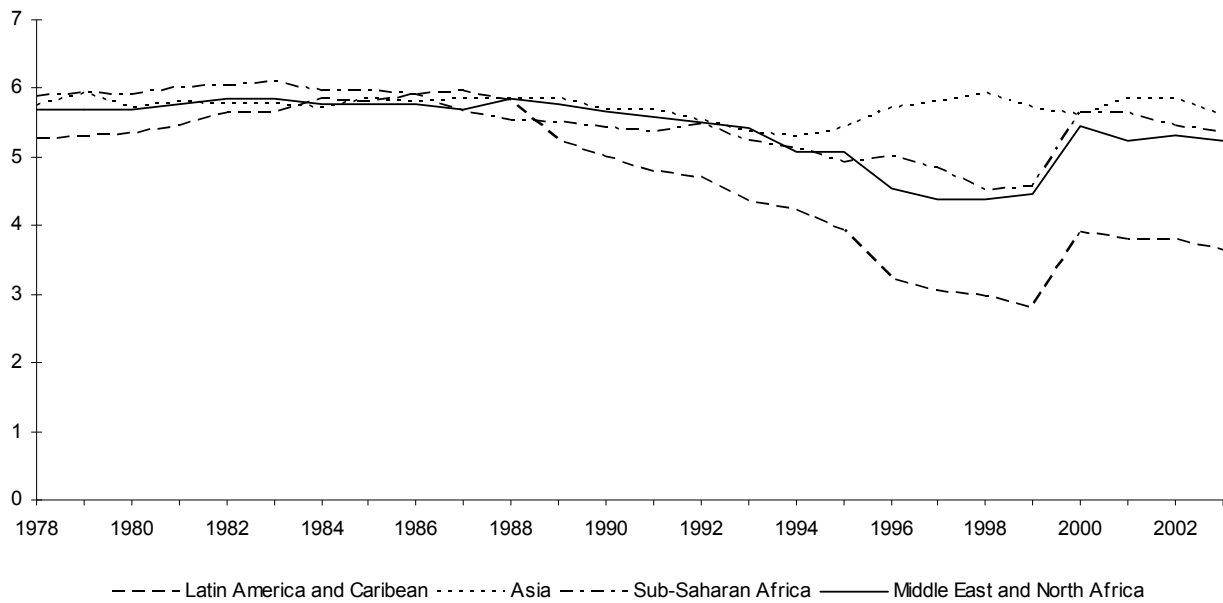
Surprisingly, from an interregional perspective, average trends between democracy and capital and trade account liberalizations are non-uniform. Figures 1 and 2 summarize average regional degrees of trade and capital restrictions between 1978 and 2003 using a recently developed index of trade and capital account openness.² The higher the value of the index, the

¹ See, among others (Nelson 1989; Herbst 1990; Nelson 1990b; Frieden 1991; Barkey 1992; Haggard/Kaufman 1992; Harik/Sullivan 1992; Haggard/Webb 1993; Nelson 1993; Niblock/Murphy 1993; Haggard/Webb 1994; Dornbusch/Edwards 1995; Henry 1996).

² More details about the construction and coding of the CACAO Index (CACAO stands for Current Account and Capital Account Openness) can be found in (Martin 2005) as well as on Christian Martin’s website, http://www.polsci.org/martin/forschung_eng.html.

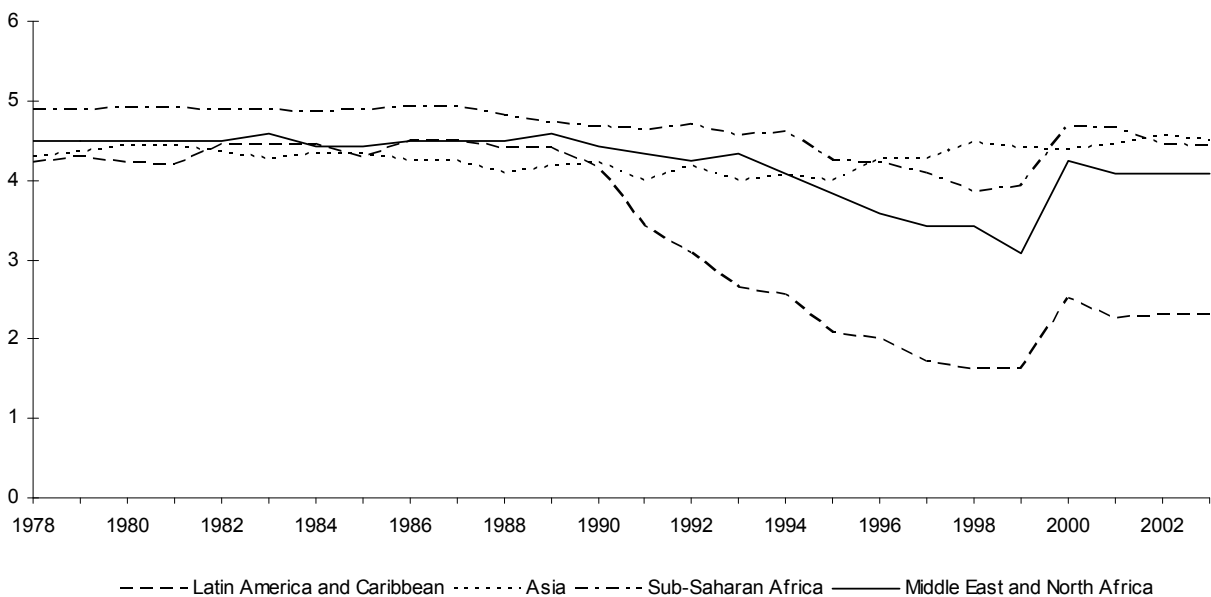
less open the economy. Trends in all regions show a general decline of trade and capital account restrictions since 1978. However, regions have adjusted to different degrees. Latin America has liberalized most, followed by MENA, to which sub-Saharan Africa comes very close. Asia has performed the worst in reducing trade and capital account barriers.

Figure 1: Degree of Trade Regulations (CACAO-TRADE) among World Regions, 1978–2003

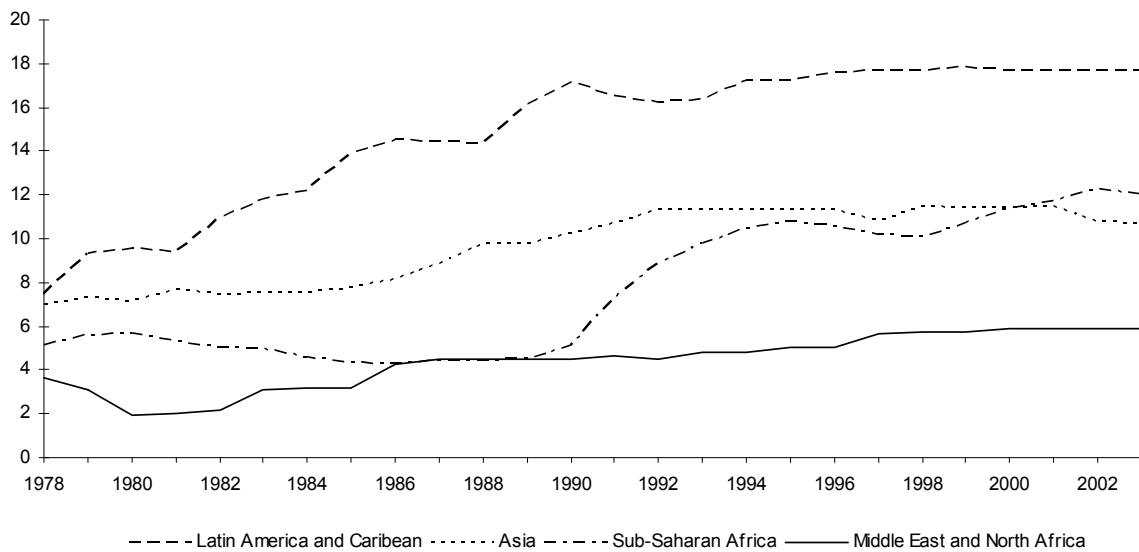


Source: CACAO Index (Martin 2005).

Figure 2: Degree of Capital Regulations (CACAO-CAPITAL) among World Regions, 1978–2003



Source: CACAO Index (Martin 2005).

Figure 3: Degree of Democracy (POLITY-IV) among World Regions, 1978–2003

Source: Polity-IV (Marshall et al. 2006), transformed to a 0 to 20 scale by the author.

Regional annual degrees of democracy (Figure 3) point to an even more fragmented picture. Latin America fits best to the democratization-cum-liberalization paradigm, followed by sub-Saharan Africa. In Asia, the initial degree of democracy was much higher than that in the Middle East, with both regions democratized to well below average degrees. Only MENA's political regimes implemented a comprehensive liberal reform of trade and capital account regulations. Therefore, it is the MENA region that deviates most from the recently developed democratization-cum-foreign-economic-liberalization paradigm.

As recent methodological debates on case selection suggest, deviant cases are a unique source for the (re)discovery of new or subsample causal argumentations (George/Bennett 2005; Seawright/Gerring 2008). More specifically, deviants provide a heuristic opportunity to explore new variables, hypotheses, causal mechanisms, and causal paths (George/Bennett 2005: 75, 80-81).³ In addition, the approach of focusing on cases within the same region is supported by Broome and Seabrooke's finding that the IMF constructs what they term associational context-specific and regional templates in order to customize advice to IMF member states (Broome/Seabrooke 2007: 582). Therefore, an exploration of trade and capital account liberalizers sharing a common consultancy perspective by the IMF, with the most stable degree of autocracy worldwide, yields an interesting subsample in which to explore fresh insights about the determinants of the rush to free trade.

Literature on the Middle East and North Africa argues that the scope, as well as the timing, of economic liberalization may be heavily influenced by the kind/type and degree of natural resource revenues (Waterbury 1989; Glasser 1995; Beck/Schlumberger 1999; Glasser 2001). But only resource-rich monarchies were able to avoid orthodox structural adjustment

³ For similar methodological perspectives, see also (Lijphart 1971; Eckstein 1975).

due to their unique amounts of oil revenues (Glasser 1995: 57; Schlumberger 2004). Using the idea of a most similar systems design (Przeworski/Teune 1970: 32-34), which suggests to select cases according to the principle of highest achievable homogeneity at the independent variables given the highest achievable variation on the dependent variable, Morocco, Tunisia, Egypt and Jordan have been chosen among the non-oil Arab countries because of their unique combination of several key characteristics. These four cases represent the Arab world's main resource-poor but largely stable authoritarian regimes, nation-states that have experienced no regime change since the 1950s, but which at the same time vary among themselves in terms of resource abundance and power structure. Tunisia and Egypt modestly depend on rent revenues earned from exporting oil and natural gas. Morocco and Jordan are non-oil countries, which have access to earnings from selling phosphates on the world markets. While, in Morocco and Jordan, traditional aristocratic elites and rural notables have survived until today—both are ruled by hereditary monarchies—Tunisia and Egypt have experienced political upheavals that brought to power modern and bureaucratic middle-classes and are now ruled by single-party regimes.⁴ All four countries are members of the IMF, have completed annual IMF staff-screenings and have implemented IMF-supported structural adjustment programs. Finally, the four countries exhibit different average foreign trade ratios.⁵ Most importantly, the beginning of foreign trade and capital account liberalizations among these four cases shows a significant variation over time. Morocco started to reduce trade barriers in 1983 and Tunisia quickly followed in 1986, whereas Jordan and Egypt began to implement orthodox trade and capital account reforms only in 1992 and 1991 respectively.

Table 1 provides an overview of this comparative logic showing that there is neither an obvious correlation between authoritarian regime type (authoritarian Monarchy vs. single-party Republic) nor the primary source of external revenues (phosphates vs. oil) with the onset of orthodox trade and capital account reforms. Interestingly enough, high or very high levels of commodity flows per GDP (foreign trade ratio) did not systematically influence the tendency to liberalizing trade and capital barriers. Last but not least, assuming that IMF consultancy and advice was guided by a regional template, as suggested by Broome and Seabrooke (2007), one should expect a simultaneous beginning of foreign trade and capital account liberalization within these four Arab autocracies.

⁴ Algeria, Iraq and Syria, the three other single-party Republics in the region, have not been chosen due to their high historical dependency on oil revenues, which tends to make them more like oil monarchies. Mauritania, Sudan and Yemen have been excluded primarily because of their permanently weak state structures, which makes them especially prone to low levels of policy implementation as well as being vulnerable to belligerent within-state groups. Yemen, further, has only existed as a unified nation-state since 1990.

⁵ Foreign trade ratios are calculated as the sum of imports and exports divided by the GDP. Average ratios between 1970 and 2003 are: Jordan, 120.08 percent; Tunisia, 86.03 percent; Egypt, 53.13 percent; and Morocco, 52.00 percent. Data are the author's own calculations using annual data from the Penn World Tables <http://pwt.econ.upenn.edu/php_site/pwt_index.php>

Table 1: Result of Case Selection within the MENA region

	Political System	Natural Resources	IMF Program	Foreign Trade Ratio	Beginning of Orthodox Trade and Capital Account Liberalization
Morocco	authoritarian monarchy	Phosphates	Yes	Medium	1983
Tunisia	authoritarian republic (single party)	Oil and Phosphates	Yes	High	1986
Egypt	authoritarian republic (single party)	Oil	Yes	Medium	1991
Jordan	authoritarian monarchy	Phosphates	Yes	(very) high	1992

Source: Author's own compilation.

What follows are four case-studies, one for each country, summarizing more extensive research about the political economies of these four authoritarian states. As the primary sources, original and recently de-classified IMF documents are used. These documents provide rich qualitative evidence about the reasons behind the eventual move of authoritarian elites towards a reduction of trade and capital account barriers.

4 Morocco—Phosphate Boom, Late Import Substitution, and Early Liberalization

After gaining independence from France in 1956, Morocco took the conservative pathway of development in the MENA region. With the exception of the departure of French settlers and colonial bureaucrats, all of the traditional rural and urban social elements have survived until today. Even though agrarian reforms were announced repeatedly between the 1950s and 1970s, none have ever actually been implemented (Swearing 1987: 168-170). Monopolies and oligopolies of the rural and urban economic and trade elite have remained largely unchanged. Although the state announced several economic development plans during the first three decades after gaining its independence, state penetration was modest and always took into account existing economic structures and actors' preferences. During the 1960s and 1970s, the state was exclusively engaged in key sectors such as phosphate extraction, land reclamation, sugar refineries, pulp, paper and petroleum refining, fertilizer production and vegetable canning (Zartman 1987b).

After two coup attempts in 1971 and 1972, the then Moroccan king, Hassan II, was faced with the potential demise of his postcolonial rule. A broad, distributive, state-led economic policy became the key of his new power-saving strategy.

[T]he king began [...] with a tabula rasa [...] he turned to a vigorous economic reform program to strengthen his position, nationalizing colonial lands and Moroccan-izing the service sector and other activities, launching an expansionist five-year plan based on heavy state investment. (Zartman 1987a: 8)

State spending accelerated. Real state consumption increased over 100 times between 1974 and 1976, and public investment rose over 340 percent. The public sector expanded, wages were on the rise and subsidies for food and public goods reached all-time records (Morisson 1991). Originally financed by increasing revenues from exporting phosphates, this expansion of state activities was later financed by massive external borrowing after world market prices for phosphates peaked in the mid-1970s.

At that time, Morocco's economy was protected by high quantitative and tariff barriers. Moreover, the state controlled the majority of exports by means of a central export agency. The exchange rate was highly overvalued. Interest rates and prices were fixed, and core services such as electricity, foodstuffs and public transport were largely subsidized. Import and export of capital was highly constrained. No foreign currencies were allowed to be held within domestic banks, and exporters had to surrender their foreign exchange. More than 40 percent of imports were restricted by annually established quotas. Average duty rates were over 50 percent, with a large spread between single rates. In other words, foreign trade regulations in Morocco were at least as restrictive as those within the so-called socialist Arab republics at that time.

It is interesting to note that evidence from IMF reports suggests that already during the late 1960s and early 1970s IMF staff members proposed the relaxation of some of these trade and capital account barriers.

Despite the substantial improvement in the balance of payments over the last few years, no major progress has been made toward relaxing restrictions on trade and payments nor simplifying the existing cumbersome controls. In view of the continued favorable balance of payments prospects and the relatively comfortable level of foreign reserves, further efforts should be made to liberalize and simplify existing restrictions on current inter-national transactions, including those on imports. Such measures should help to ease pressures on domestic prices, which are likely to be substantial in 1974, and would at the same time improve the climate for foreign private investment in Morocco. (IMF Archives 1974a: 16)

Morocco should consider policies to reduce [...] transfers of funds, including the adoption of more liberal foreign exchange allocations for personal transfers abroad. (IMF Archives 1968b: 14)

From a Moroccan perspective, the liberalization of capital and trade account regulations at that time was made dependent upon the future development of the balance of payments as well as a larger buildup of foreign currency reserves (IMF Archives 1969b: 14, 1970d: 13, 1971d: 17-18, 1974a: 16, 1975d: 12).

Being most worried about capital flight, Moroccan officials noted their intention not to reduce capital account regulations below the existing level at that time.

The Moroccan representatives explained that although they hoped to be able to carry out further liberalization of current payments in the future, they were unwilling to take any more substantial steps at the present time [...] because of the danger of capital flight. (IMF Archives 1973a: 20)

Additionally, the safeguarding of domestic industries was given as a main reason for the buildup of further trade barriers (IMF Archives 1969b: 14, 1970d: 13, 1970e: 41).

Caused by declining world phosphate prices and the mainly inefficient implementation of state-sponsored import substitution, the King's new economic policy collapsed in 1978 (Zartman 1987a: 9). As a first reaction, increasing budget deficits were covered by external borrowing at still relatively moderate international interest rates. As a second step, the government increased trade barriers (IMF Archives 1978g: 3 and 9, 1978f: 1, 1980b: 12) and also implemented a number of austerity measures (investment cuts, limitation of public spending, decrease of credit to public and private enterprises, higher taxes) in order to ameliorate the increasing current account and budget deficits (Morisson 1991; Richards/Waterbury 1996: 236; Denoeux/Maghraoui 1998: 56):

in view of the exceptionally low level of official reserves and in order to prevent a further deterioration in the balance of payments position, in June 1978 the authorities felt that it was unavoidable, as a precautionary measure, to adopt emergency exchange and trade measures aimed at tightening the import regime. (IMF Archives 1978f: 1)

Once again, it is important to note that this tightening of import restrictions was opposed by the IMF (IMF Archives 1978f: 5, 1980b: 15).

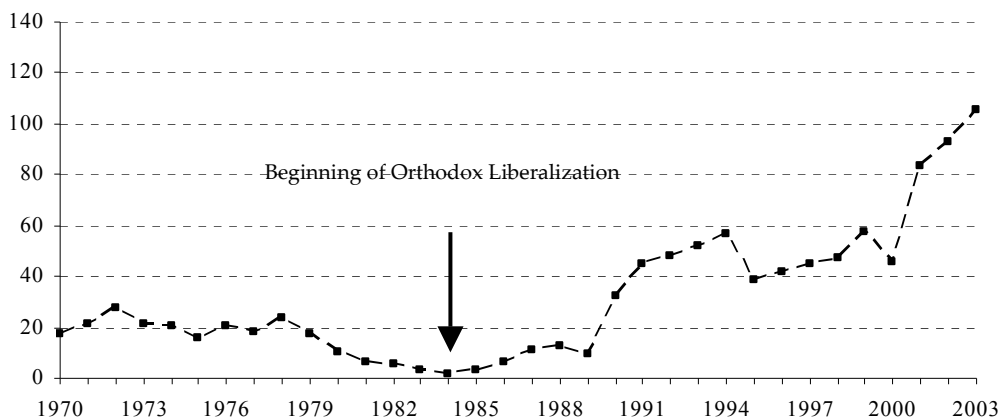
A first fiscal consolidation failed due to rising social opposition in 1979. In the following year, another IMF-sponsored adjustment program was implemented. Under this arrangement, a comprehensive liberalization of external trade barriers was agreed upon (IMF Archives 1980a: 49). Again, these measures were not implemented due to the violent resistance of parts of Moroccan society (Richards/Waterbury 1996: 237; Denoeux/Maghraoui 1998: 57), and trade barriers were maintained at a high level (IMF Archives 1980a: 6).

After this second unsuccessful attempt to curtail an increasing current account and budget deficit, another agreement with the IMF was concluded in 1982. Meanwhile, external debts mounted, and Morocco had to accept sharply-increasing international interest rates. Even though the IMF conditions were relatively moderate at that time, Morocco was only able to implement them using creative budget management (IMF Archives 1983b: 4-8). Once again, the primary objective of diminishing the current account deficit was not reached. However, the government began an expansion of state spending during the last quarter of 1982 and continued this policy during the first half of 1983. Caused by once again declining world phosphate prices and rising import costs on one hand and pressured by an increasing amount of external debt and bound by its distributive obligations on the other, Morocco's foreign currency reserves were almost completely depleted in spring 1983 (IMF Archives

1983b: 17; Richards/Waterbury 1996: 237). In the middle of this year, Morocco came close to state bankruptcy. In a first reaction, trade barriers were tightened further (IMF Archives 1983b: 17, 1983a: 10), and the IMF was again asked for help. The 1983 IMF standby program was the start of an orthodox neoclassical economic reform program, which also included a comprehensive reduction of trade and capital account barriers (IMF Archives 1983b: 29).

Figure 4 shows the historical development of Moroccan foreign currency reserves. This supports the argument that only in the context of impending state bankruptcy did trade and capital account liberalizations become a viable option among the Moroccan political elite.

Figure 4: Development of Central Bank Foreign Currency Reserves as Percentage of Annual Imports: Morocco 1970–2003



Source: Author's own compilation based on IMF Archives (several years and issues).

5 Tunisia: State-led Import Substitution and Liberalization since 1986

Shortly after gaining independence from France in 1956, the Tunisian elite, under the leadership of its president, Habib Bourgiba, started to regain control over the French-dominated national industries (Erdle 2006: 55–68). Originally obliged towards a liberal understanding of state intervention supporting an open economy and continuing the colonial incentive system towards private economic actors (King 1998: 111), it was the massive exodus of colonial settlers and foreign companies that caused an intensification in the decline of private investment rates (Grissa 1991: 110). Owing to this development, the state started to engage/position itself as an independent actor within the Tunisian economy. Key industries were nationalized and state-controlled financial institutions founded (White 2001: 81). This expansion came to a first peak with the introduction of a central state planning system in 1961. State-sponsored economic activities accelerated, eventually leading to a seven-fold increase in the number of state-owned enterprises. State investments reached one third of total investments (King 1998: 112). In addition, a comprehensive program of rural collectivization was implemented in the style of socialist Eastern European countries. Supplementing this, state-owned industrial

complexes were built to substitute for imports in order to satisfy the increasing demand from local markets (Bellin 1991: 46-52).

Trade and capital account barriers were high during the late 1960s, supporting this import-substituting development strategy. Similar to Morocco, a prospective liberalization of strict capital account restrictions was made conditional upon a further improvement of currency reserves, as evidence from IMF documents reveals (IMF Archives 1967: 11, 1969c: 23). In addition, new trade barriers were erected in order to safeguard imbalances within balance of payments accounts (IMF Archives 1967: 41, 1968c: 10). IMF suggestions to liberalize existing barriers were rejected, pointing to a balance of payments situation yet to be consolidated (IMF Archives 1971c: 20, 1972: 15).

It came largely as a surprise that the then-leading figure, Ahmed Ben Salah, who was responsible for the Tunisian state-led development strategy, was dismissed in September 1969 by President Habib Bourgiba. As a result, an eight-year period of socialist planning policies came to an immediate halt (Erdle 2006: 74). Under the new Prime Minister, Hedi Nouira, a former governor of the central bank, Tunisia returned to an economic policy that, according to official statements, resurrected the private sector to its previous importance. Officially referred to as 'opening' (*infitah* in Arabic),⁶ rural collectivization was abandoned, and the government increasingly sought fresh private international and domestic investments; but, at the same time, state engagement within the Tunisian economy did not diminish. To the contrary, it extended. Windfall gains from a phosphate price boom during the early 1970s, later rising world oil prices and increasing migration remittances enabled the state [to] pursue its developmental goals without an efficient, productive private sector. In fact surpluses engendered a private-sector dependence on, rather than independence from the state, leading to low productivity and economic rigidities" (King 1998: 113).

Although these new economic policies were described as economic liberalization at that time, the real consequence of this move was less a break with than a continuation of a comprehensive state-led developmental project. At the most, the previous strategy was trimmed down toward specific Tunisian national needs, removing all of its previous more radical socialist elements (Richards/Waterbury 1996: 234; Erdle 2006: 77 ff).

IMF documents provide ample evidence that throughout the 1970s, IMF staff members regularly advised the Tunisian government to relax trade and capital account restrictions (IMF Archives 1971c: 23, 1972: 25, 1973d: 12, 16, 18, 1975b: 75, 1975a: 14, 16, 18, 1977b: 12, 14, 16, 1978e: 19, 1979: 15). However, besides certain simplifications in favor of exporting industries (IMF Archives 1973e: 82), trade and capital account restrictions remained at their previ-

⁶ This notion is probably more common in an Egyptian context, therein characterizing the Egyptian economic opening since 1973. As a matter of fact, Tunisia was almost three years ahead of Egypt with such a policy.

ous levels. Documentary evidence shows that a key motivation behind the maintenance of existing trade barriers has been the protection of domestic industries (IMF Archives 1967: 41, 1972: 5, 1973e: 19):

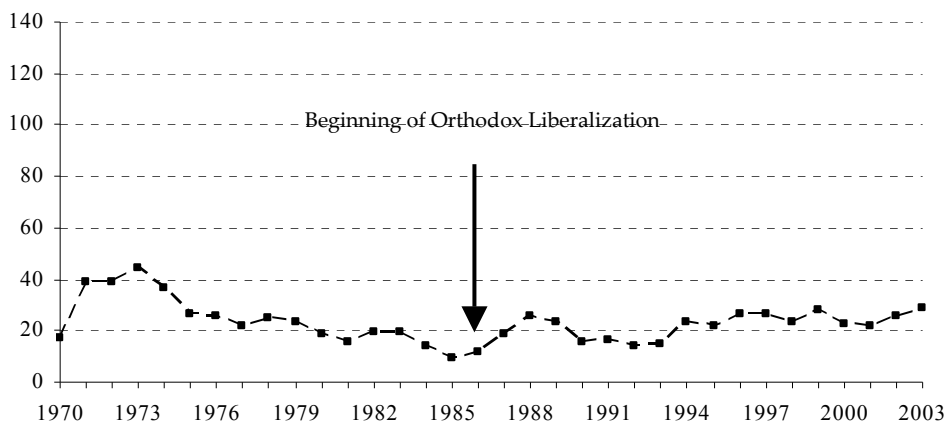
excess capacity and weak competitiveness in Tunisia's industrial sector did not permit a sudden liberalization of imports. For this reason, while imports of raw materials and spare parts had been virtually free of restrictions, imports of consumption goods and of equipment goods for unapproved projects were still subject to restrictive licensing. (IMF Archives 1972: 15)

In addition, trade barriers also contributed to the restocking of state coffers (IMF Archives 1972: 15, 1973d: 14; 1973e: 46, 81; 1975a: 12; 1977c: 70; 1981b: 59). Forced by declining world oil prices, as well as decreasing migrant remittances, budget and current account deficits were, beginning in the early 1980s, on the rise. State-led development became viable only at the cost of growing international indebtedness. Tunisia's foreign debt as a ratio of GDP increased from 38 percent in 1980 to 63 percent in 1986 (IMF Archives 1986b: 3; Richards/Waterbury 1996: 234). In response, a variety of austerity measures, additional trade and capital account restrictions, an increase in taxes and fees and a managed devaluation of the national currency were implemented. Public sector wages were frozen, food subsidies curtailed, quantitative restrictions on imports of capital and consumer goods tightened (IMF Archives 1983e: 41, 1983c: 12, 1984a: 4-6, 1984b: 50), the value of annual personal foreign currency amounts reduced (IMF Archives 1986f: 65) and tariffs and taxes moderately increased. In 1985, additional capital restrictions were implemented and further trade restrictions released (IMF Archives 1985e: 5, 1985f: 49, 1986f: 64-65, 1987c: 27, 1993b: 42) (IMF Archives 1985e: 7-8).

Nevertheless, the main goal of minimizing the current account and budget deficits was largely unmet. As a result, Tunisia's external debt rose, and foreign currency reserves dried up (IMF Archives 1986b: 3 and 5, 1986d: 4). This process continued into 1986. Once again, trade restrictions were sharpened (IMF Archives 1986d: 7-8, 1986f: 65), but foreign reserves became almost fully depleted in the middle of that year (The Economist Intelligence Unit 1996: 35, 1998: 33): "The external payments position remained under heavy pressure in 1986, particularly during the first half of the year when foreign reserves were virtually exhausted" (IMF Archives 1987b: 8).

Under these conditions, the Tunisian government asked the IMF for assistance (Bellin 1991: 55; Richards/Waterbury 1996: 234; King 1998: 114-115). Starting with a currency devaluation of 22 percent (IMF Archives 1988a: 32) and followed by a large program of orthodox liberalizations, the subsequently negotiated standby arrangement has been successfully implemented since November 1986 (IMF Archives 1993b: 41). Figure 5 shows the historical development of the Tunisian foreign currency reserves. It supports the conclusion that, despite earlier advice by IMF technocrats to relax trade and capital account regulations, orthodox liberalizations became an option only in the context of impending state bankruptcy.

Figure 5: Development of Central Bank Foreign Currency Reserves as Percentage of Annual Imports: Tunisia 1970–2003



Source: Author's own compilation based on IMF Archives (several years and issues).

6 Egypt: the Long Road from Arab Socialism to Orthodox Liberalization since 1991

Egypt was the prototype of Arab socialism during the 1950s and 1960s. After the 1952 revolution, a group of army officers under the leadership of Gamal Abdel Nasser started to turn the Egyptian economy upside down. During that time, the state invented a complex system of economic governance involving fixed domestic prices, a fixed foreign exchange rate, comprehensive subventions, a state-sponsored program of industrial investment and highly restrictive foreign trade regulations. An agrarian reform disempowered rural landowners, and a nationalization of industrial assets allowed the state direct access to the developmental capacities of the country (Waterbury 1983; Pawelka 1985; Hansen 1991; Weiss/Wurzel 1998: 17-20).

During the late 1960s, this process of state-directed development came to a halt. In particular, the economic and political consequences of the military disaster during the six-day war of 1967 forced the Egyptian state to redefine its development strategy. Basically lacking the necessary resources to continue the prewar state-sponsored import substitution, Nasser's strategy of 1968 was to retract selected principles of the previously implemented reforms. Modernization, efficiency and private sector engagement were newly emphasized priorities. Under these circumstances, the foreign trade system also became partially less restrictive.

The major element of this selective adjustment of foreign trade and current account regulations was the decision to allow for the holding of legally-obtained foreign exchange by nationals and foreigners within the state-owned banking system (IMF Archives 1969a: Part II, 29-30, 1970a: 34, 1971b: 15). Documentary evidence shows that the main reason behind this relaxation was to prevent a serious shortfall of foreign exchange by attracting capital from abroad and, in particular, funds from Egyptian nationals working in foreign countries (IMF Archives 1970a: 16; 1975e: 53; 1976a: 49; 1978c: 42). It is interesting to note that this develop-

ment, even though it was the first act of liberalization since the early 1950s, was only one incident in a series of still earlier trade and capital account reforms. Immediately after the revolution, balance of payments deficits were financed by drawing on originally high international reserves. After reserves were largely exhausted and foreign exchange positions worsened, strict import controls were imposed, even leading to temporary shortages in input and investment (IMF Archives 1973c: 37).

After Anwar al-Sadat's partial achievements during the October War in 1973, efforts to ally with both superpowers at once failed since the Soviet Union was denying Egyptian demands for debt relief, new weapons and economic aid (Dessouki 1991). As a consequence, the president began stimulating relations with the West. Calling the new Egyptian policy an economic "opening" (*infitah*), Sadat was trying to cope with the lasting problem of highly needed resources in order to rebuild the economy after more than five years of war. Egypt's *infitah*, similar to Tunisia's three years before, eventually led to a mere restructuring of state intervention and planning, resembling a rationalization much more than a threat of state domination.

Reforms regarding capital account restrictions at that time, especially the introduction of new multiple exchange rates, including a parallel market rate that was allowed to float freely, were once again motivated by the interest in channeling assets held abroad, foreign exchange from remittances and tourism into the system of Egyptian state-owned banks (IMF Archives 1973b: 13, 1974b: 17-18, 1974c: 72f, 1975e: 51-52, 1977a: 11, 1978c: 44). IMF staff members very much disagreed with the Egyptian decisions, strongly demanding a much more intense liberalization of the existing system of capital account controls (IMF Archives 1970c: 18, 1973b: 17, 1975c: 11).

After renewed and increasing pressure, beginning in 1976, regarding the balance of payments—arrears accumulated up to US\$669 million (IMF Archives 1977a: 15), and Arab oil states refused to provide fresh credit to the Egyptians (Dessouki 1991: 162; Adams 2000: 8)—the Egyptian government employed a two-part strategy: on the one hand, discussion of *infitah* was intensified in order to win/gain more Western and Arab investment, even though the regime strengthened several trade restrictions (IMF Archives 1976a: 50; IMF 1977: 164-165; IMF Archives 1978c: 55). On the other hand, negotiations were initiated with the IMF, Western and Arab governments over fiscal bi- and multilateral support. Under increasing pressure to reduce budget deficits and to prepare an agreement with the IMF, the Egyptian government decided to increase prices of subsidized foods drastically. Riots broke out only hours after the new prices were announced. Under increasing pressure from the public, it was the president himself who repealed all of the previously advertised austerity measures (Adams 2000: 9). Led by the IMF and supported by the Arab oil states, a fiscal package was designed providing Egypt with the necessary fiscal resources to cover its deficits without having to cut subsidies (IMF Archives 1978b: 14, 1978a: 2; Rivlin 1985: 178f; Adams 2000: 9). Although the following IMF standby arrangement was shaped by this previous social up-

heaval demanding only softened conditions of adjustment (IMF Archives 1977a), it was not implemented successfully (IMF Archives 1978a: 2), and neither the current account nor the state budget deficits were significantly minimized.

In July 1978, a second agreement with the IMF was signed, including an even larger amount of credit. Like the first one, this new arrangement was supported by a great financial contribution from Arab Gulf countries (IMF Archives 1980c: 1-8, 1981a: 1-8, 1982: 1-9; Rivlin 1985: 180). Only three months later, in November 1978, Egypt was once again unwilling to fulfill this program's conditions. On this occasion, the IMF immediately abandoned the agreement. Due to the rise of alternative sources of foreign exchange and, most importantly, because of Egypt's radical foreign policy decisions (the signing of Camp David accords in September 1978 and the Egyptian-Israeli peace agreement in March 1979) it was by then largely independent of IMF money (IMF Archives 1980c: 1-8, 1981a: 1-8, 1982: 1-9; Rivlin 1985; Hansen 1991: 198 ff):

between 1976 and 1980, Egypt's external account was transformed by increased oil, tourist, Suez Canal, and remittance revenues. Her need for IMF aid and the mark of respectability that it conferred decreased [...] Her international position vis-à-vis Israel meant that the United States had political reasons for providing economic support under certain circumstances. These were all factors that gave Egypt a special position among the nations that applied for assistance to the IMF during the 1970s. (Rivlin 1985: 181)

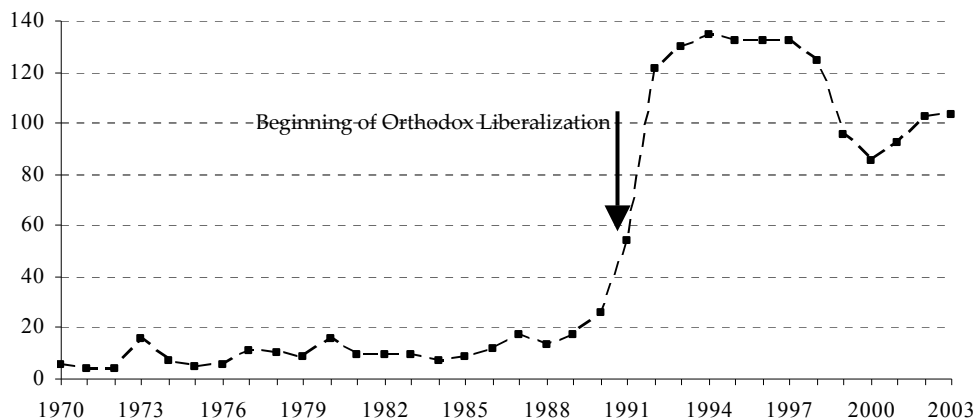
While Anwar al-Sadat's assassination in 1981 marked a leadership change at the helm of the Egyptian government, subsequent policy changes under the new president, Hosni Mubarak, were characterized by the continuation of previous policies (Amin 1995: 13; Abdel-Khalek 2001: 22). In reaction to a reemerging deficit in the current account in 1983-4, the Egyptian government adjusted some of the existing trade restrictions (IMF Archives 1987a: 2-3) in order to curtail foreign currency liquidity within the country's economy (IMF Archives 1983d: 61).

It was only at the beginning of 1985 that capital and current account deficits increased again. Repayment of credit given earlier by the Arab oil states was due, while oil exports, Suez Canal revenues and workers' remittances declined simultaneously. Consequently, a new foreign currency shortage started to emerge (IMF Archives 1986a: 4-5). Egypt's response was two-fold. Increasing deficits were covered by increasing foreign debt, and on the domestic front, minor restrictive policy changes were implemented, mainly related to the foreign exchange rate regime but also involving tightening of import barriers (IMF Archives 1985d: 62, 1985c: 8). On the international front, negotiations with the IMF were resumed, and after two years, in 1987, another standby arrangement was (under)signed. Simultaneously, negotiations with the Paris Club finished, leading to the release of the most immediate external debt burden. Even though the conditionality attached to the IMF agreement has been remarkably low due to pressure on the IMF from the USA (Springborg 1993: 153; Momani 2004), none of the policy changes agreed upon were implemented (IMF Archives 1988b: 1; Momani 2004: 890; Rivlin/Even 2004: 48). Since foreign currency scarcity revived within months, trade and capital account restrictions were increased again (IMF Archives 1989d: 4, 11).

In the mean time, Egypt's fiscal deficits started to increase again. In the context of the US-led invasion of Iraq in 1990, another accord with the IMF was negotiated, reaching final agreement in May 1991. This standby arrangement demanded a systematic change of governance principles according to the orthodox standards of the IMF. Accompanied by a massive debt relief of almost 50 percent (Weiss/Wurzel 1998: 24), Egypt undertook the most widespread adjustment of its economy since the 1952 revolution. Cutting subsidies, freeing of prices and privatization of the public sector were transformed from slogans into concrete policy changes (Weiss/Wurzel 1998). Following a lasting improvement of the situation in the balance of payments, the Egyptian authorities became willing to liberalize trade and capital account regulations starting in autumn 1991 (IMF Archives 1991a: 58, 1992: 50).

To conclude, Figure 6 shows the historical development of the Egyptian foreign currency reserves. As this time series illustrates, Egypt was close to state bankruptcy at several points during the 1970s and 1980s, since its comfortable exchange reserves were already exhausted during the 1960s. However, before the beginning of trade and capital account liberalization under an IMF agreement in 1991, it used several alternative strategies to acquire foreign exchange.

Figure 6: Development of Central Bank Foreign Currency Reserves as Percentage of Annual Imports: Egypt 1970–2003



Source: Author's own compilation based on IMF Archives (several years and issues).

7 Jordan: Public-private Import Substitution, Oil Boom and Liberalization during the Early 1990s

After gaining independence in 1946 from a British mandate, Jordan also gained control over the West Bank and East Jerusalem following the first Arab-Israeli war in 1948–49. During that time, difficult economic conditions pointed towards the necessity of creating from scratch a state-led development plan. Using a structural power vacuum, a group of nationalist bureaucrats evacuated important positions within the state apparatus. This group, supported by a nationwide nationalist movement, started to formulate a new economic approach from within the Ministry of National Economy. In co-operation with wealthy Jordanian traders,

the development of an import-substituting industrialization project using a number of private-public partnerships was initiated, mainly concentrating on heavy industries (Piro 1998; Wils 2003: 57-72).

After a first period of economic boom during the 1950s, and despite fierce conflicts between the Jordanian nationalists and traditional elements around the royal palace, this cooperation between state and private actors continued throughout the 1960s. The oil boom of the 1970s, and especially the financial assistance of the Arab Gulf states after the Arab defeat in 1967, integrated Jordan into the intra-regional system of Arab Petrolism (Korany 1986). State policies increasingly started to focus exclusively on the distribution of the resources flowing into the country in massive amounts. State bureaucracy expanded, and fixed prices and subventions for food, electricity and water supply were introduced. An overvalued national currency, launched earlier in order to support import substitution, promoted the import of foreign products and increased the prices of Jordanian exports abroad. Still-high current account and budget deficits were balanced through Arab financial support and migration remittances derived mainly from Jordanians working in the Arab Gulf (IMF Archives 1981c: 1-2).

Evidence in IMF documents shows that during the late 1960s and early 1970s the Jordanian trade system was incrementally restricted in order to support newly established domestic industries (IMF Archives 1968a: 7, 1970b: 12, 1970c: 33). Other regulatory barriers within a comparatively liberal foreign trade system were further reduced (IMF Archives 1976b: 45; IMF 1977: 276; IMF Archives 1978d: 51). Importantly, similar to developments in Egypt during the late 1960s, nonresidents of Jordanian origin were allowed, from 1973, to hold foreign currencies accounts within domestic banks (IMF Archives 1974d: 12).

However, during the late 1960s and early 1970s, IMF staff members advised Jordanian authorities not to increase trade barriers further (IMF Archives 1968a: 7, 1970b: 12, 1971a: 3-4), explicitly linking liberalization to the improvement of the balance of payments position:

Jordan has been following a fairly liberal trade and exchange system and recently further liberalization has been introduced. Nevertheless, the system still embodies some elements of restriction in the form of quantitative limitations on imports and restrictions on certain invisible payments. The staff believes that the Jordanian authorities should review their policies in this respect and introduce further liberalization as the balance of payments position improves. (IMF Archives 1975f: 8)

In 1982, Jordan was hit badly by declining world oil prices and the beginning of an economic recession within the Arab oil states. Economic growth decelerated, and budget and current account deficits increased due to the simultaneous shrinking of three important foreign exchange sources (direct Arab budget support, remittances, and earnings of Jordanian agrarian and food exports to the Arab Gulf) (IMF Archives 1983f: 2, 1985a: 2, 1989b: 3). In a first response, budget deficits were covered through foreign debt (IMF Archives 1989b: 5, 7; Brand 1992: 171; Schlumberger 2002: 226; Wils 2003: 117f). In addition, the Jordanian government introduced a number of consolidation measures. First, selective new trade barriers (restriction of license-free imports, increase of import taxes and duties, introduction of an advanced import deposit) (IMF Archives 1985a: 6, 1985b: 46, 1986e: 56, 1986c: 11) were erected in order to safe-

guard national industries (IMF Archives 1986c: 6) and to stabilize the current account deficits (IMF Archives 1986c: 11, 1989b: 29-30, 1989c: 60). Second, an expansive monetary policy was introduced in order to activate the economic capacities of the country (IMF Archives 1988c: 4).

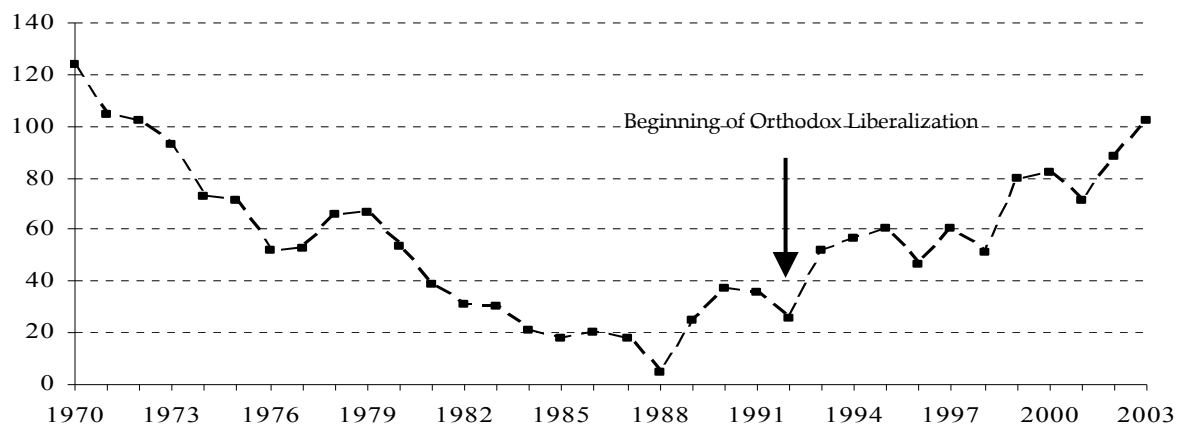
Major parts of this building up of new trade barriers were opposed by the IMF (IMF Archives 1985a, 1986c: 11, 1988c). "The staff representatives cautioned against tightening import restrictions as a means of promoting domestic industry: they stressed that such policies risked becoming entrenched while fostering inefficient industries and a misallocation of resources" (IMF Archives 1986c: 6). Eventually, the implemented policies were revealed as contradictory and showed only limited success (Brand 1992: 173ff; El-Said 2002: 260). External indebtedness increased further. Foreign currency speculations and bad loans led to a serious crisis of the domestic banking system, which, at its core, led the third largest Jordanian bank at the time (Petra Bank) to declare bankruptcy in 1988. The Jordanian separation from the West Bank in July 1988 also intensified the liquidity problems of the economy (IMF Archives 1991c: 53; Moore 2004: 147).

Central bank actions were not able to curtail the foreign currency difficulty (IMF Archives 1989c: 58, 1990: 3, 1991c: 53). Jordan's once comfortable foreign currency reserves melted down in the course of just half a decade (IMF Archives 1989b: 8). Three months later, in October 1988, the Central Bank started to discontinue the allocation of foreign currencies to the economy. Because of this, the Jordanian Dinar was devalued by more than 20 percent against the US Dollar (IMF 1989: 267; IMF Archives 1989a, 1989b: 27, 1993a: 96). At the same time, additional trade restrictions were implemented (increase of duties, import ban on high-quality consumer goods) (IMF 1989: 268; IMF Archives 1989b: 29-30, 1989c: 60, 1995: 61).

After one month of negotiations, a standby arrangement with the IMF was eventually signed, in April 1989 (IMF Archives 1989b). Linked to this agreement was additional financial support by the World Bank as well as a comprehensive program of debt restructuring. However, most of the softened conditions were not fulfilled by the Jordanian authorities (IMF Archives 1991b: 5; Knowles 2005: 92ff). Interrupted by the Iraqi invasion of Kuwait, further reforms were put on hold due to worsening domestic conditions (El-Said 2002: 131; Knowles 2005: 95). Western stabilization aid and, ironically, the exodus of Palestinians and Jordanians who had to leave the Arab Gulf due to the pro-Iraqi stance of the Jordanian government helped to stabilize current account deficits. These transfers led to an increase of state revenues and to higher foreign currency reserves (IMF Archives 1991b: 3; Wils 2003: 136). Jordan was therefore able to postpone a more painful adjustment of its foreign trade system for another two years. Only under the next IMF arrangement, beginning in February 1992, did Jordan begin a process of orthodox foreign trade and capital account liberalization.

Figure 7 shows the historical development of the Jordanian foreign currency reserves as a percentage of annual imports. As this data reveals, Jordan liberalized its trade and capital account regulations only after nearing state bankruptcy in 1988. However, similar to Egypt and Morocco, but not to the same extent as its westward neighbors, Jordan was able to postpone an orthodox adjustment under an IMF arrangement for several years, until the early 1990s.

Figure 7: Development of Central Bank Foreign Currency Reserves as Percentage of Annual Imports: Jordan 1970–2003



Source: Author's own compilation based on IMF Archives (several years and issues).

8 A Comparative Conclusion

Qualitative evidence from IMF documents about Morocco, Tunisia, Egypt, and Jordan supports three deductions about the reasons for the initiation of orthodox trade and capital account liberalization within these four autocracies:

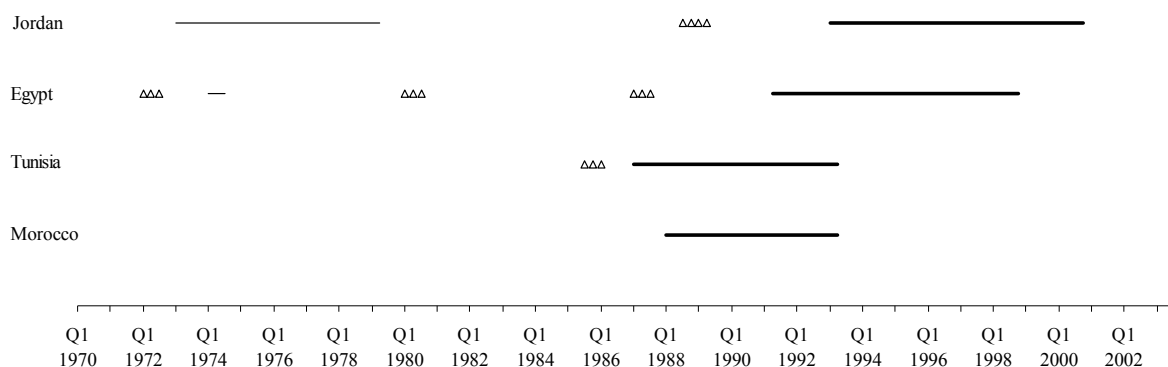
- 1) Despite detailed differences in frequency and speed, orthodox trade and capital account liberalization became a political option only in the context of utter foreign exchange scarcity. However, foreign exchange shortages are only a necessary condition for the commencement of the systematic downsizing trade and capital account barriers.
- 2) Periods of liberalization, as shown in Figures 8 and 9, were always predated by episodes of rising restrictions,⁷ which most often were direct reactions to (re)emerging deficits in the balance of payments of a given country.
- 3) Regular IMF advice to enhance trade and capital account openness was most often ignored by national policy makers.

The comparison of these most similar cases from the Arab world points, therefore, to the function of trade and capital account reforms as an important policy tool to secure the steady inflow of foreign exchange. As historical evidence reveals, there was a sequential strategy by authoritarian elites implementing trade and capital account reforms. Initially, decision-makers tried to cope with increasing balance of payments problems through country-specific intensifications of trade and capital account barriers. In addition, unilateral strategies of increasing foreign exchange have been a prominent policy device when trying to supply na-

⁷ The only exception to this statement is the case of capital account regulations in Morocco. However, these regulations were already at a very high level during the 1970s and early 1980s.

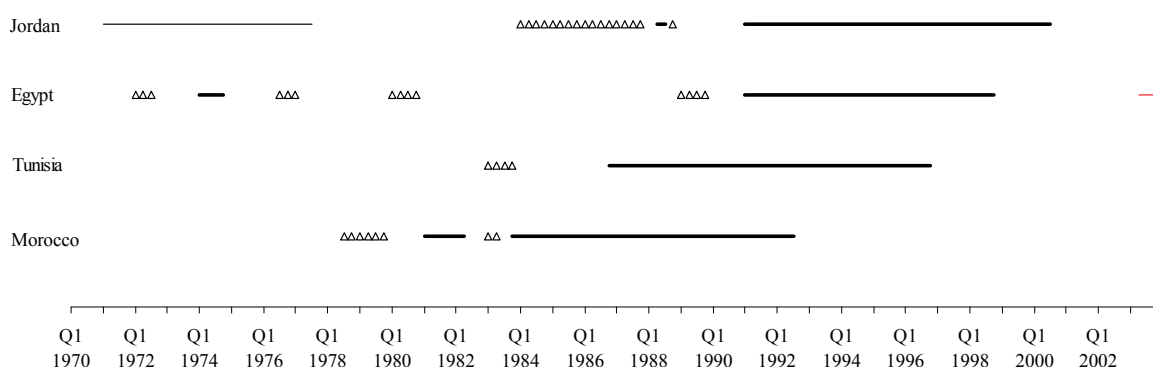
tional economies with the highly needed foreign currency. These strategies included broader economic openings in Tunisia and Egypt during the 1970s, but also consisted of tricks and noncompliance, as the cases of Morocco, Jordan and especially Egypt demonstrate. In addition, selected manipulations (enhancing as well as decreasing) of foreign trade and capital account regulations helped to overcome temporary foreign currency shortages, as evidence from all four cases has shown.

Figure 8: Reforms of Capital Account Regulations between 1970 and 2003
(triangles = increasing restrictions, lines = declining restrictions)



Source: Author’s own compilation. Coding is based on the reading of relevant IMF staff reports and the recording of restriction changes mentioned therein.

Figure 9: Reforms of Trade Account Regulations between 1970 and 2003
(triangles = increasing restrictions, lines = declining restrictions)



Source: Author’s own compilation. Coding is based on the reading of relevant IMF staff reports and the recording of restriction changes mentioned therein.

The evidence also points to a conditional causal influence of neoliberal ideas within authoritarian regimes. As Kahler (1992) has observed, looking, more than 15 years ago, at structural adjustments during the 1970s and 1980s, IMF economists’ advice to lower restrictions was to be dependent on the availability of alternative policy choices including regulatory reforms as well as the accessibility of nonconditional finance—directly or indirectly relying on natural resource revenues or payments of friendly governments within and beyond the region.

However, the fewer these alternatives, the more likely the implementation of IMF suggested reforms. Egypt is probably the most evident case in point here. Concluding several IMF programs since the early 1970s, she implemented orthodox trade and capital account reforms only in 1991, in between relying on alternative financing from the Arab Gulf and later, after the peace agreement with Israel, from the United States, but also experimenting with a number of regulatory reforms.

Table 2: Sources of Foreign Exchange and the Beginning of Trade and Capital Account Liberalizations in Morocco, Tunisia, Egypt, and Jordan

	Beginning of Trade and Capital Account Liberalizations	Natural Resources	Integration into Petrolismus	Resources by Western Countries
Morocco	1983	Phosphates	Low	Medium
Tunisia	1986	Oil and Phosphates	Low	Low
Egypt	1991	Oil	High (until 1979)	High (since 1979)
Jordan	1992	Phosphates	(very) High	Medium

Source: Author's own compilation.

In conclusion, neither democratization nor regular neoliberal consultancy through IMF technocrats (alone) explains the beginning of trade and capital account liberalizations in Morocco, Tunisia, Egypt and Jordan. It was the scarcity of foreign resources that pushed authoritarian elites to request IMF assistance. However, this move did not take place all at once. Time lags between early liberalizers and latecomers were a function of country-specific sources of foreign exchange. Morocco, as a phosphates but not oil-producing country with a low level of participation within the intra-Arab distribution system of oil windfall gains (Petrolismus), came up dry first. Tunisia and Egypt, because of their moderate direct income from oil, were able to delay state bankruptcy longer. Only the extensive inclusion into the system of Arab Petrolismus, as the examples of Egypt and especially Jordan show, as well as large transfers from Western countries in the case of Egypt after 1979, enabled both countries to delay orthodox adjustment further. This finding points to the importance of different sources of external windfall gains as co-determinants of trade and capital account reforms, although it remains an open question as to what extent this argument holds valid on a more universal scale.

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