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MA thesis

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**Neoliberal policies and evolution of crony capitalism in Morocco and Tunisia**

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I have written this Master's thesis independently. All viewpoints of other authors, literary sources and data from elsewhere used for writing this paper have been referenced.

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## **Neoliberal policies and evolution of crony capitalism in Morocco and Tunisia**

Ani Apresyan

### **Abstract**

The implication of neoliberal policies directed to lessen state interventionism and increase the role of markets making the economies more competitive and efficient. Neoliberal policies applied in Morocco and Tunisia during the 1980s and 1990s aimed to transform the state from the economy with strong state involvement and intervention into a liberalized market economy where market forces are free to make economic decisions. However, the applied neoliberal reforms have been used to favor the elites, family groups and clans. This study examines whether the neoliberal policies under non-democratic regimes might influence the evolution of crony capitalism. Specifically, the full package of neoliberal policies examined and detected the plausible mechanism that used by elites to develop crony capitalism. To be specific, the findings show that privatization used by cronies to consolidate the existing cronyistic network and transfer cronyism from interpersonal and cultural social phenomenon structural and systematic one: crony capitalism.

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## **Abbreviations**

Economic Competitiveness Adjustment Loans (ECAL)

Financial markets development loan (FMDL)

Foreign direct investment (FDI)

International monetary fund (IMF)

International financial institutions (IFS)

Industrial and trade policy adjustments loan (ITPAL)

Gross domestic product (GDP)

Moroccan Dirham (MDH)

Non-performing loans (NPL)

Omnium Nord Africain (ONA)

Public enterprise (PE)

Public enterprises restructuring (PERL)

Stand-by Arrangements (SBAs)

Sectoral Adjustment Loans (SECALs)

Structural Adjustment Loans (SALs)

Structural Adjustment Program (SAP)

Sectoral adjustment for agriculture (ASAL)

Specialized financial institutions (SFIs)

State-owned enterprises (SOE)

Societe Nationale d'Investissement (SNI)

Tunisian dinar (TD)

Value-add tax (VAT)

## **1. Introduction**

In the 1980s, fundamental liberalization processes took place and various regions have witnessed the widespread rise of neoliberal policies aimed to lessen the state interventionism in market regulations and to ensure fair competition in the market. The implication of neoliberal policies determined to decrease the state interventionism in the economy and increase the role of markets in the developing countries of MENA region demonstrated that instead of reducing corruption, cronyism and patronage had been used to favor the elites, family groups, and clans.

The given study aims to examine whether the neoliberal policies under non-democratic regimes might influence the evolution of crony capitalism based on research of two countries.

Since 1980s Morocco and Tunisia have been under pressure of Structural adjustment programs (SAPs) imposed by the International Financial Institutions (IFIs). The structural policies are the prescriptions to strengthen macroeconomic performance and tended to transform the state from the economy with strong state involvement and intervention into a liberalized market economy where market forces are free to make economic decisions. However, more than two decades of neoliberal policies served in the hands of autocratic regimes as tools for preferential treatment of privileged ones through various forms of state interventionism and supported to the domination of clans and families in Morocco and Tunisia. The prescriptions did not help to transfer the functions to the market moreover the existence of cronies' economic interests had been defended in the system of the new market rearrangements. In this way, the elites supported to the structural and systematic transition of cronyism to crony capitalism.

Morocco and Tunisia are chosen as cases since both had the extensive adjustment efforts, with an extended period of implementation, and both are perceived by IMF and the World Bank as the most successful reformers in the region. Studying the experience of successful reformers of the MEAN region is an excellent opportunity to understand how successful neoliberal economic reforms could endorse the possible evolution of crony capitalism.

The issue of cronyism has been addressed in many studies, but fewer specifically have focused on the influence of neoliberal policies on the development of crony capitalism. The attempts to focus on neoliberal reforms as an extensive policy framework of Washington Consensus and link it to the evolution of crony capitalism have less attention in the region. It is valuable to examine neoliberal policies directed to lessen state interventionism in the market and therefore reduce the cronyistic characteristic of the economy and see whether the reforms provide with the explanation of crony capitalism evolution.

We investigate comprehensive structural changes in Morocco and Tunisia from the 1980s till 2011 Arab uprisings and examine whether the package of neoliberal reforms effected on the evolution of crony capitalism. Based on ten policies of Washington Consensus, the macroeconomic stabilization policies and the main structural reforms are studied relating to price liberalization, privatization, trade liberalization and financial sector reforms applied to Morocco and Tunisia. The “capture mechanism” is secluded and analyzed which might make possible the evolution of crony capitalism.

Process tracing as a fundamental instrument is conducted for this research, more specifically we are based on the theory-building type of process tracing which is a more inductive form of research. Though process tracing is a single-case method, it can also be used in combination with other methods. For this study, we supplement theory-building type of process tracing with comparative research methods to identify, analyze and explain differences across cases while maintaining similarity on the outcome.

We refer to the Structural adjustment programs within the Washington Consensus ten policies and rely on Laws, reforms, official reports, assessments, and working papers of World Bank and International Monetary Fund. For the comparative study, we rely on legal guidelines regarding privatization modalities and instruments as well as on privatization transactions data obtained from the relevant state institutions official sources and World Bank Privatization Transaction Database for the double check which provides privatization transactions in 139 developing countries from 1988-2008 (World Bank Privatization Database, checked 2015). Both national sources and World Bank Privatization Database has limitations on privatization list regarding deal types. In this regard, we refer to relevant

materials from international agencies and organizations and news from leading news organizations offering a broad range of information on business, finance, and economy.

The study is composed of the introduction, theoretical framework, research design and method, empirical analysis, and conclusion. The theoretical framework introduces an overview of the theory of neoliberalism and crony capitalism, the review of the relevant literature and the discussion of Washington Consensus. In methodology section, we describe research design and method applied for empirical testing, provide with data and the review of the literature on measurement. In the empirical part, the first section discusses the pre-reform period and financial crisis in both countries. In the next section, the neoliberal reforms with the relevant timeframe of implementation are discussed in both countries separately in a comparative perspective to examine the progress of reforms aiming to illustrate the differences between cases with a focus on their approach towards a market economy and regime type. The separate section is devoted to finalizing the results of neoliberal reforms in Morocco and Tunisia. The second part of the empirical part is dedicated to the analysis of crony capitalism evolution in Morocco and Tunisia with finalizing the results of findings in comparison. Finally, concluding remarks are provided in the conclusion section.



## **2. Theoretical framework**

Economic liberalization has undergone an extensive rise in countries of MENA region stipulating the implication of neoliberal policies which are tended to transform the state from the economy with strong state involvement and intervention into a liberalized market economy where market forces are free to make economic decisions (Boone and Henry, 2007).

Saadatmand and McGann and Choquette (2013) state that “the main purpose of structural adjustment programs was to have an export-focused economy, transforming the defunct non-westernized economy into the free open market” (p. 152). Nevertheless, the politically connected elite benefited mostly, and the result was an intense concentration of economic wealth in the hands of the ruling elite, increased corruption and deepening inequality (Mossallem, 2015).

In case of Morocco and Tunisia private investors were not on an equal level of competition with state-owned companies and politically connected companies and firms. Despite that neoliberal policies were considered as productive for economic growth, those also had a destructive force as created fertile ground in non-democratic countries for the concentration of wealth on hands of elites and their families (Johnson & Martini, 2012).

While the literature on Arab world economic reforms and growth is rich in analyzing business-state relations in autocratic states, however, few studies have systematically examined the relationship between neoliberal policies and crony capitalism, and there is no direct evaluation of the neoliberal reforms’ impact on the development of crony capitalism in Morocco and Tunisia.

Within the framework of this study, a comparative analysis of two countries from MENA region, Morocco and Tunisia, is conducted covering the period from the 1980s till 2010-2011 Arab revolts. In the theoretical framework, we consider that the development of crony capitalism under non-democratic regimes might be the consequence of neoliberal policies. We put forward the following hypothesis: Neoliberal policies under non-democratic regime will likelihood develop crony capitalism.

The non-democratic regime in our hypothesis is not considered to be a variable but rather a characteristic of the chosen cases.

According to our hypothesis, neoliberal policies likely help to develop crony capitalism to the contrary idea that market-oriented neoliberal policies will help to reduce corruption.

Holcombe (2013) states that crony capitalism is a product of big government as the increased government involvement in economy signals that the profitability of business depends on government policy (p. 556). With less government, less corruption will emerge as a government will be deprived to have significant influence in various spheres. Neoliberal doctrine deeply opposed to state interventionist theories, and many studies dedicated to examining whether corruption can be the result of big government became one of the researched topics when neoliberal policies applied in developing countries.

Neoliberal assumptions about economic efficiency and free markets adhere to the idea that reduced state intervention can be the practical means for deterring cronyism. According to Haber, the absent of limited government can cause crony capitalism (Haber, 2002, p.14). Khatri (2013) in his study concludes that “the greater is the political/government influence in economic decision making, the greater the crony capitalism (corruption) in the society” (p. 5).

The neoliberal approach is to limit government involvement in the economy through the policies of Washington Consensus considered as the best path to ensure economic growth and combat corruption, particularly in developing countries. The theory of neoliberalism and the logic of neoliberal policies determine the necessity for the reduction of state control over market and establishment of a fair competitive economic environment by distributing equal opportunities to business actors. Nevertheless, cronies, in order not to lose the advantages to extract and expand their privilege opportunities, may view neoliberal policies as the method to protect their interests in the process of economic rearrangement. In this context, the examination of neoliberal policies’ implementation in our chosen countries is a valuable contribution to understanding whether cronyism, considered to be eliminated in the result of neoliberal reforms, registered the evolution to the crony capitalism.

According to World Bank (1997) “economic policy reform should be the central pillar of an anti-corruption strategy in many countries” and “deregulation and the expansion of markets

are powerful tools for controlling corruption” (p.35). Infrastructure privatization, tax reforms, lowering tariffs and other barriers to international trade, public expenditure reduction, etc. is market tools that help to decrease corruption (World Bank, n.d.). Hence, it is considered that policies of Washington Consensus applied in developing countries of MENA region will not only lessen state intervention in the economy and ensure economic growth and increase market efficiency but will also deter corruption/cronyism. The neoliberal economic policies implemented in Morocco and Tunisia since the 1980s, on the contrary, supported to the development of crony capitalism.

Several approaches will be provided to ensure the robustness of the various contributions to the variables, as well as Washington Consensus will be discussed which constitutes the baseline for the research of the policies in the chosen countries.

## **2.1 Neoliberalism and neoliberal policies**

The term neoliberalism has widely used so far that there are too many overlapping and at the same time contradictory opinions. Various conceptual definitions of this complex phenomenon led to its ambiguity in nature, and now in literature, it is acknowledged as a controversial concept. We tend to discuss the origins of neoliberalism, to give some overview on opponents and proponents of neoliberalism and to ensure with various reflections of this complex phenomenon adhering to the one best accommodated to our research paper.

According to Stedman Jones (2014) “the history of neoliberalism has at least three distinct phases, and the first phase was from the 1920s until 1950” (p. 6). The neoliberal ideas of monetarism, deregulation, and market-based reforms are not new (Stedman Jones, 2014). Stedman Jones (2014) states that "Austrian school economists and the German ordoliberals sought to define the contours of a market-based society, which they believed was the best way to organize an economy and guarantee individual liberty" (p. 6).

However, the word “neoliberalism” is shaped by the doctrines promoted by the Mont Pelerin Society counting number of neoliberal intellectuals and the central node of initial

organization of the neoliberal thought collective, created in 1947 by Friedrich Hayek and Wilhelm Röpke (Denord, 2009).

The second phase of neoliberalism lasted from the 1950s until the 1970s (Stedman Jones, 2014, p. 7). Mirowski and Plehwe (2009) note that “the purpose of the Mont Pelerin Society was to create a unique space where people of like-minded political ideals could gather together to debate the outlines of a future movement diverging from classical liberalism” (p. 430). Harvey (2005) indicates that “the members of the society depicted themselves as “liberals” because of their fundamental commitment to ideals of personal freedom” (p. 20). The neoliberal label indicated their adherence to those free-market principles of neoclassical economics that had emerged to displace the classical theories (Harvey, 2005, p. 20).

Van Horn and Mirowski (2009) state that “neoliberalism is first and foremost a theory of how to re-engineer the state to guarantee the success of the market” (p.161). The neoliberal doctrine was extremely opposed to state interventionist theories, such as those of Keynesian and even more to theories of centralized state planning (Harvey, 2005 p. 20). However, Hayek (1944) considered that “opposition to socialist and collectivist planning should not be confused with a “dogmatic laissez-faire attitude” (as cited in Stedman Jones, 2014, p. 66). Hayek (1944) emphasized that “state must have a legitimate role in the regulation of monetary system, the prevention of private monopolies and the supervision of natural monopolies” and an “essential to guarantee the conditions of free competition” (as cited in Stedman Jones, 2014, pp. 66-67). This statement distinguishes him from Milton Friedman who with other Chicago neoliberals, after 1950, redefined the classical doctrine concerning monopoly and corporations (Van Horn, 2009, p. 206).

Keynesianism as the dominant theoretical framework in economics and economic policy-making could not be able to solve the crisis of unemployment and inflation rise in the 1970s thus putting an end to the state’s traditional interventionist policies (Denord, 2009). In Keynesianism also known as demand-side economics, the demand is the driving force of the economy, in other words, the government is responsible for increasing the demand to ensure the growth thus making the accent on state intervention in the market (Babb, 2013). The neoliberal supply-side economics as a new neoclassical orthodoxy based on favoring

business to expand by tax cuts and deregulation (Babb, 2013). Therefore, supply-side economics aim to work free market more efficiently in the less-state system, in other words, it reduces government protectionism and interference.

The expansion of the Mont Pelerin Society infrastructure accelerated in the 1970s and spread to most corners of the world pushing for a new economic project founded on neoliberal assumptions about economic efficiency, reduced state intervention and free markets (Mirowski & Plehwe, 2009). Since then neoliberalism was introduced as new orthodoxy with the goal to weaken the welfare state and central planning aimed to introduce less severe state control on the economy by privatization, deregulation, and financial and trade liberalization counted as the key “MPS doctrines”(Mirowski & Plehwe, 2009).

The Chicago School as a complement to the Mont Pèlerin Society was established after the war committed to “the reconciliation of the neoliberal ideas with a rather simplistic form of neoclassical economics” (Mirowski, 2018, para. 12). “Chicago boys” became as a direct result of Chicago school of neoliberalism. The group of technocrats trained in neoliberal theories of Milton Friedman at the Department of Economics at the University of Chicago and boosted monetarist view through criticizing Keynesian approach in Chile and trying to reconstruct Chilean economy. In particular, Hayek and Friedman's main objective was the reduction of state intervention in the economy (Dunn, 2017, p.439).

Friedman (1951) as one of the greatest neoliberal theorist, in his paper Neo-liberalism and Its Prospects, argued that “laissez-faire must be the rule.... it lacked the necessary ingredients for the success of free markets. It must give high place to a severe limitation on the power of the state to interfere in the detailed activities of individuals; at the same time, it must explicitly recognize that there are important positive functions that must be performed by the state... it would have the function of providing a framework within which free competition could flourish, and the price system operates effectively” (p.3).

After the first experiment of neoliberal policies in Chile, neoliberalism as a new economic orthodoxy had been expanded in the capitalist world in 1979, mainly in the United States and Great Britain as a leading paradigm (Harvey, 2005). It was an answer to chronic state stagflation consisted of inflation, unemployment, and a stagnate economy (Harvey, 2005).

The third phase of neoliberalism started in the 1980s when market liberalization and fiscal discipline advanced into development and trade policy (Stedman Jones, 2014, para. 17). The global crisis of the 1970s and rising influence of the Washington-based international financial institutions, mainly the IMF and the World Bank, promoted their roles as agents of neoliberalism by setting broad policy guidelines for a severe neoliberal development model over the economies of the countries. Adopted by economists and policymakers of the IMF, the World Bank, the World Trade Organization (WTO), neoliberal policies later were notably enlarged with institutional reforms. Harvey (2005) states that since the 1980s “IMF and the World Bank became centers for the propagation and enforcement of ‘free market fundamentalism’ and neoliberal orthodoxy” (p. 29).

Due to the complexity of the term with numerous versions of explanations which in recent years used to describe any tendency in various disciplines with different meanings complicates our task to define what kind of phenomenon is neoliberalism. Therefore, the more prominent ones of this overloaded term will be discussed ensuring with various patterns of criticism of neoliberalism encountered in the literature and the relevant one will be accommodated to the study.

In his work *Against Neoliberalism as a Concept*, Dunn discusses Brenner and Theodore’s view on neoliberalism. Brenner and Theodore (2002) argue that “probably the most influential accounts see neoliberalism as an ideology, championing ‘open competitive, and unregulated markets’” (as cited in Dunn, 2017, p. 438). Mirowski (2009) considers that neoliberalism was “an intricately structured long-term philosophical and political project,” or in our terminology, a “thought collective” (p. 426). But when this “thought collective” became influential it is then interpreted as a ‘project for radical system transformation’ and as Jessop (2002) and Gamble (2001) mention “neo-liberalism jumped the barrier into practical politics’ (as cited in Dunn, 2017, p.439).

In the recent literature about neoliberalism, David Harvey (2005) gave one of the wide-ranging definitions of neoliberalism concept in his *A Brief History of Neoliberalism*.

Harvey (2005) states, “*Neoliberalism is in the first instance a theory of political, economic practices that proposes that human well-being can best be advanced by*

*liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets, and free trade. The role of the state is to create and preserve an institutional framework appropriate to such practices. The state has to guarantee, for example, the quality and integrity of money"*(p. 2).

Harvey (2005) continues *"state interventions in markets (once created) must be kept to a bare minimum because it cannot possibly possess enough information to second-guess market signals (prices) which powerful interest groups will inevitably distort supporting bias state interventions (particularly in democracies) for their benefit"* (p. 2).

Hence, Harvey emphasized that neoliberalism is a theory of political, economic practices rather than a purely political ideology (Harvey 2005). In the same book, he criticizes neoliberalism as a form of the political economy associated to some degree with the restoration or reconstruction of the power of economic elites (Harvey, 2005). Harvey (2005) states that "neoliberalization is either as a utopian project to realize a theoretical design for the reorganization of international capitalism or a political project to re-establish the conditions for capital accumulation and to restore the power of economic elites" (p. 19). He continues, "In what follows I shall argue that the second of these objectives has in practice dominated" (Harvey, 2005, p. 19).

Arguing about capital accumulation and economic power, Harvey (2005) emphasizes that "neoliberalization has not been very effective in revitalizing global capital accumulation, but it has succeeded remarkably well in restoring, or in some instances (as in Russia and China) creating, the power of an economic elite" (p. 19).

A Nobel Prize-winning economist and ex-vice-president of the World Bank Joseph Stiglitz turned into critique neoliberalism in his last interview Criticism of Neoliberalism to Trend Online Zeitung, on February 2004. Stiglitz (2004) criticizes that "neoliberalism doesn't produce growth and creates social inequality" (para. 1). He (2004) continues, "markets left to themselves, particularly in developing countries, are inefficient" (para. 1). "What is sold nowadays as economics is, in reality, an ideology or a religion" (Stiglitz, 2004, para. 1).

Economists Duménil and Lévy (2016) in their latest work *The Crisis of Neoliberalism* argue that the primary objectives of neoliberalism were to restore the power of upper classes and to increase their profits and capital (para. 2).

This criticism towards neoliberalism is the direct response to the failure of neoliberal policies in developing countries. Moreover, what is turned to emerge as a useful tool to reduce state control on the economy and to ensure economic efficiency, on the contrary, supported the concentration and consolidation of capital in the hands of elites in developing countries and promoted the increase of poverty, inequality, and corruption.

According to Larner (2006), neoliberalism was a “shift from Keynesian welfarism towards the new approach of governments to focus on enhancing economic efficiency and international competitiveness and as a consequence, the “rolling back” of welfare state activities with a new emphasis on market provisioning of formerly “public” goods and services” (p. 6, 7). Craig and Porter (2006), Ward and England (2007), Boas and Gans-Morse (2009) state that as an economic doctrine, neoliberalism was “a package of economic reform policies including, inter alia, liberalization, privatization, deregulation and public spending cuts, and carried out in developed and developing countries alike”(as cited in Kreitmeyr-Koska, 2016, p. 11). However, the attempts to define neoliberalism as merely the process leading to the “hollowing out” of state will be too simple for such a complex phenomenon.

On the contrary, literature about neoliberalism is not limited to the theories of political and economic practices, and a lot of authors consider that neoliberalism is the hegemonic political-economic project as well. Peck and Tickell (2002) argue that neoliberalism can be characterized as a movement from “proto-” to “roll-back” neoliberalism: a move from the philosophical project of the early 1970s to the era of neoliberal conviction politics during the 1980s (p. 388).

Ward and England (2007) note that neoliberalism is not considered a political and economic doctrine solely, but it is also a hegemonic ideological project; neoliberalism as governmentality; neoliberalism as policy and program; neoliberalism as state form (as cited in Giannone, 2016, p.496).



Birch and Mykhnenko (2010) continue elaborating the notion of neoliberalism and specify it as “a political project allied to specific state-led strategies incorporating neoliberal ideas and promoted through the different processes characterized by privatization, liberalization, marketization, deregulation, and monetarism” (p.6). Larner (2000) indicates that neoliberalism in critical social science literature appears to refer to specific political projects such as Thatcherism and Reaganomics (p.5).

In turn, Kreitmeyr-Koska (2016) defines neoliberalism as “not merely an economic, a development or a socio-political project that promotes market rationalities in all spheres of social life but it encompasses all these different facets at the same time and interlinks economic, development and socio-political issues, spheres and actors in a given spatial and temporal context”(p. 10).

We go further and elaborate on the notion what neoliberal policies are. As Babb and Kentikelenis (2018) define, by ‘neoliberal policy’ they mean “any measure intended to lessen the role of states and enhance the role of markets in at least one national economy” (p.16). Bunce provides a more detailed explanation of neoliberal reforms. According to Bunce (2001), “neoliberal reforms refer to all policies that promote marketization, privatization, and free trade”, which usually include macroeconomic stabilization, microeconomic liberalization, and institutional reforms” (p. 46).

For this research, we will address neoliberalism as policy. Neoliberalism as a policy aimed to lessen state interventionism in market regulations to ensure fair competition in the market but also we rely on the definition of Venugopal (2015) that extends the notion of the withdrawal of the state from the market: "economic agenda that promotes not just the withdrawal of the state from market regulation, but the establishment of market-friendly mechanisms and incentives to organize a wide range of economic, social and political activity" (p.171). So the neoliberal policy is a mechanism in the hands of the state to abstain from using a political control to intervene in the market and create the strict regulations that will promote economic activities.

## **2.2 Washington Consensus**

During the late 1980s, the extension of neoliberalism to the Global South through the Washington Consensus promoted reforms in Southern countries (Williamson, 2000). The term "Washington Consensus" has been invented and coined in 1989 by John Williamson, an English economist (Williamson, 2000). Washington Consensus was not written as a policy prescription for development but rather a set of policy reforms that Williamson claimed most of official Washington would agree to be needed to be good for Latin American countries (Williamson, 2000). Stedman Jones (2014) mentions that "in 1971 the collapse of the Bretton Woods international monetary system indicated that fixed exchange rates practicing is over " (para. 3). The aftermath of the Bretton Woods the promotion of a set of policies is addressed to Latin American countries as of 1989 by Washington based institutions such as IMF and World Bank.

According to Williamson (2004), ten reforms that constituted Washington Consensus list are as follows: "1. Budget deficit; 2. Public expenditure; 3. Tax reform; 4. Interest rate; 5. A unified exchange rate; 6. Trade liberalization; 7. Foreign direct investment (FDI) inflows; 8. Privatization; 9.Deregulation; 10. Provision of secure property rights" (p. 3). By proposing to reduce regulations, Williamson's argument was the opportunity to minimize the potential for corruption, primarily in Latin America.

Criticism around Washington Consensus was not limited only to the theoretical and ideological opposition, but there are also problems that have been associated with its application in developing countries. The privatization is considered to be as one of the most important policies not only in developed but particularly in developing countries. Regarding developing countries, the privatization is necessary to achieve the economic development in a long-term perspective by solving the problem of inefficient state-owned enterprises (SOEs) (Kim, 2005). The second essential factor is the fiscal deficit and the increasing foreign debt burden that force developing countries to support the privatization (Kim, 2005). However, as mentioned, the application of neoliberal policies and their effects can be diverse in developed and developing countries, and the privatization can have

various impacts because of different levels of the institutional and regulatory framework of the current state.

Kim emphasizes that privatization programs typically have several objectives and one of them is to promote the development of capital market and to improve financial performance (Kim, 2005, p.888). At the same time, it also has the political objective. It is necessary to include a significant segment of the middle-income class into the privatization process, thus supporting large segments of society to enlarge property ownership (Kim, 2005, p.888). The author mentions that to realize the real objective of privatization, it is also essential to maintain the economic stability and transparency of privatization process, the factors which developing countries lack (Kim, 2005).

The criticism towards privatization in developing countries is the belief that the process of privatization has been unfair, hurting the marginalized workers, and benefiting the privileged and powerful, providing opportunities to enrich the corrupt and negatively affects distribution of wealth, income, and political power (Birdsall & Nellis, 2005). According to Kim (2005), “the concentration of economic powers and polarization of capital do not enhance competition. In markets, in reality, privatization abolishes state monopoly and secures private monopoly.”(p.891). It is a contra argument to the supporters of the privatization that it promotes competition. Hence, the process of privatization as one of the essential pillars of neoliberal policies should encompass the mentioned concerns. Though it is directed to address the issue of competition and enhance the efficiency of the market and moreover, the developing countries may gain from privatization covering fiscal deficit, but the problem of transparency of the process can be a challenge to register it as a success. The success of privatization should be assessed against the objectives the governments seek to complete. As these objectives may vary from country to country, the success can also be linked to the regulatory framework which depends on the political and institutional setting of the current state as well.

So, in the context of developing countries, the application of Washington Consensus policies might register quite the opposite picture. As Mavroudeas and Papadatos mention there is a widespread perception that it failed, led to crises and impoverishment and

increased the gap between developed and developing countries (Mavroudeas & Papadatos, 2007, p.47).

Washington Consensus and its ideological and political background are undeniable being not only a simple policy proposal but constituting a backbone of IFIs to transmit the policy norms around the world.

Washington Consensus has its defenders and supporters, but much critique has been written, not mentioning that it was used at least for two distinct interpretations significantly different to what Williamson assures he has intended. Williamson emphasizes that the coined term and its original usage served to numerous interpretations varied from the original one (Williamson, 2004). The policies have been much criticized by economists such as Joseph Stiglitz and Paul Krugman (Stedman Jones, 2014). Stiglitz (2002, 2008) argued that “Washington Consensus was presented as a ‘market fundamentalism’, kind of a dogmatic and literal interpretation of the principles of classical and neoclassical economics” and the concept of development has too narrow perspective summarized as liberalization, stabilization, and privatization (as cited in Babb, 2013, p. 270).

Williamson’s response to the criticism is that the original meaning of Washington Consensus is ten specific policy reforms combining a set of macroeconomic policies intended to restore economic stability and principally focuses on policy reforms that reduce the role of government (Williamson, 2000). Williamson (2004) was concerned that Washington Consensus is considered as a synonym for what is often called "neoliberalism" or market fundamentalism which is “a thoroughly objectionable perversion of the original meaning” (p. 201). He emphasizes that only privatization as one of the Washington Consensus policies has distinctively neoliberal origins (Williamson 2004).

Williamson (2002) mentions, *“I of course never intended my term to imply policies like capital account liberalization, monetarism, supply-side economics, or a minimal state (getting the state out of welfare provision and income redistribution), which I think of as the quintessentially neoliberal ideas. If that is how the term is interpreted, then we can all enjoy its wake, although let us at least have the decency to recognize that these ideas have*

*rarely dominated thought in Washington and certainly never commanded a consensus there or anywhere much else except perhaps at meetings of the Mont Pelerin Society”(para. 5).*

Mirowski (2009) in his work “The Road from Mont Pelerin” claims that critics outside of the economics profession had taken to equating Williamson’s list with a roster of policies characteristic of neoliberalism (p.8). Williamson (2004) states “I use the word ‘neoliberalism’ in its original sense, to refer to the doctrines espoused by the Mont Pèlerin Society” (p. 2). The part of criticism was that the policies were considered as universalistic without taking into account the national peculiarities. Notably, in Stiglitz (1998b) view: “ideological debates should be over; there should be agreement that while markets are at the center of the economy, governments must play an important role. The issue is one of balance, and that balance may depend on the country, the capacity of its government, the institutional development of its markets”, so in other words, development advice should be adapted to the circumstances of the country” (as cited in Snowden, 2001, p.48).

Stiglitz criticism is based on the recent tendencies of neoliberalism decline when the core essence of neoliberalism to rely entirely on the free market economy, excluding state intervention gives the opposite effect (Stiglitz, 2004). According to Stiglitz (2004) “markets left to themselves, particularly in developing countries, are inefficient. The state must intervene with these “incomplete” markets” (para. 17). He considers that "the liberalization of capital markets exposes developing countries to an enormous risk" (Stiglitz, 2004, para. 18).

Williamson argued in his later articles that the various interpretation of Washington Consensus as a policy manifesto made to believe that it can be valid for all places and at all times (Williamson, 2000).

Another concern raised by Williamson is that IMF and World Bank use a set of economic policies in a most conservative interpretation stipulating the transformation of a set of broad policy guidelines to a severe neoliberal development model advocated for developing countries by official Washington and later enlarged by the international financial institutions with a heavy emphasis on institutional reforms and with strong impose on client countries (Williamson, 2004, p.2).

Other supporters of Washington Consensus consider that both the neo-liberal character and the policy prescriptions are correct and the failures of the Washington Consensus in developing countries were the result of incorrect implementation and unwillingness of reformers (Mavroudeas & Papadatos, 2007).

Whatever interpretations and opponents or proponents of Washington Consensus emerged, we tended to present the original version of ten policies of Washington Consensus and its neoliberal origins. The purpose is to have a vision about original set of policies as they constitute the basis for examining the implemented reforms in this research. The institutionalization of neoliberalism by IFIs and the promotion of Washington Consensus agenda with a focus on the importance of SAPs is a backbone for our study of reforms in the chosen case countries. It was necessary to understand what is considered to be neoliberalism and what kind of interpretations of the term influenced on its usage particularly in Washington Consensus framework.

Primarily developed for Latin America countries Washington Consensus was not only used as a set of policy proposals in developing countries, but it was also augmented with institutional reforms by the World Bank and the IMF to impose on client countries as a condition for receiving any international assistance. It was described as a development prescription by transforming its ideological and political background to severe neoliberal model for development. The imposed aggressive neoliberal policies proved to have an adverse effect in many developing countries.

### **2.3 Crony Capitalism**

Neoliberal doctrine deeply opposed to state interventionist theories. Examination of corruption in developing countries as the result of big government became one of the researched topics. Cronyism is a broad and vague concept and has rarely been used in the academic literature and is still poorly understood. The term has been affirmed regarding Asian financial crisis of 1997 when Krugman tried to describe a particular economic system considered to be specific to Far Eastern countries (Krugman, 1998). Krugman primarily criticizes the East Asian economic model based on a close linkage between

government and big businesses (Krugman, 1998). So, the term is both economic and political phenomenon.

Holcombe considers that crony capitalism is possible in all market economies because it is not realistic to detach economic power from the influence of political decisions (Holcombe 2013, p.555). Hence, the phenomenon of cronyism may resonate in developed and democratic countries as well.

It is also demanding to understand whether the term cronyism has the same meaning as the concepts of corruption and rent-seeking. These terms defined in various ways taking into account their multifaceted nature, and are relatively full functional and widely used in scholarly literature. Scholars raise the question whether it is practical to label a new term as it will be an attempt to duplicate already functional terms. Our effort will be, first of all, to provide with various examples of definitions of cronyism to draw a line between cronyism and corruption and second, to ensure with the conceptualization of crony capitalism for our research.

Khatri and Tsang and Begley consider that due to the problem of ambiguity, there is a necessity to distinguish cronyism from corruption as it has been used as an all-encompassing classification (Khatri, Tsang & Begley, 2006, p. 62). There are various versions of definitions of corruption, and not only scholars try to define it but also organizations. The most popular definition of corruption is “the abuse of entrusted power for private gain” (Transparency International, n.d.).

Khatri et al. (2006) treat cronyism as “a subset of corruption found in social networks characterized by complex, indirect, and mutually reinforcing social exchanges” (p. 63). Similarly, Aligica and Tarko point out that there are distinctions between cronyism and “corrupted” behavior, emphasizing that the latter is based on family ties or close connections, often over an extended period, whereas corruption involves more direct payment (bribery) for specific services (Aligica & Tarko, 2014, p. 159). They state “the most significant and consequential form of cronyism usually involves relationships between members of high echelons of society or between large firms or political class” (Aligica & Tarko, 2014, p. 33).

Examining crony capitalism in Asian countries, Krueger (2002) chooses the following definition of cronyism “those close to the political authorities receive favors that have large economic value. Usually, these favors are not outright transfers of wealth such as forgiving taxes or providing subsidies but rather take place through the provision of economic entitlements” (p. 2).

As such, Smith and Sutter in their attempt to define the cronyism through the lens of differences between corruption and rent-seeking and cronyism pointing out that various forms of cronyism are generally legal (Smith & Shutter, 2012). As an example, Smith & Shutter (2012) elaborate on lobbying, “cronyism refers to unequal competition, where those with the closest connections to the political process gain an advantage over their competitors in the pursuit for consumers’ dollars” (p.8).

Soreide (2006) considers that cronyism is when “political networks dominate important private assets, or ‘state capture’ in which private firms can influence public power to their benefit” (as cited in Smith & Shutter, 2012, p. 8).

Now having a particular picture what cronyism is and how to differentiate it from corruption it is necessary to define crony capitalism.

According to Salter (2014) “crony capitalism is a form of corruption wherein private parties make the undue profit from abuse of public authority benefiting from the public purse by their group membership and relationships with public office holders, rather than their “individual and universal citizenship”(p.8).

It is already mentioned that the term cronyism has been used to describe also a system and particularly political-economic systems in developing countries, and Aligica and Tarko consider that in this context we can talk about truly “crony capitalism” (Aligica & Tarko, 2014, p. 159). Haber (2002) mentions that “crony capitalism is usually thought of a system in which those close to the political authorities who make and enforce policies receive favors that have a large economic value” (p. 12). He notes “crony capitalism is not solely an economic phenomenon. It is a political creation and has political consequences” (2002, p. 18).

Similarly, Khatri (2013) thinks that “a politicized or rigged economic system is dubbed as crony capitalism” (p.5). Holcombe characterizes crony capitalism as insiders with political



connections in a system who can get benefits if their business depend on political connections (Holcombe, 2013, p.556). In a similar way Wei (2001) defines crony capitalism as an economic system where the profitability of business depends on political connections and “the adjudication of commercial disputes and the allocation of resources” generally made to favor those who have a close relationship with political leaders or government officials (by blood or by bribes) (p.16).

Though crony capitalism is a relatively new term, the attempts to define and analyze it are extensive. Moreover, the efforts to put forward a precise definition of the term crony capitalism are not limited to individual scholars. In recent years it is also the prerogative of IFIs such as World Bank to frame the term cronyism and crony capitalism. As such, the World Bank’s definition of cronyism and crony capitalism relates to economic and business sphere. “Cronyism is partiality to long-standing friends, especially by appointing them to positions of authority, regardless of their qualifications, or granting privileged access to economic opportunities and/or preferential treatment in dealing with administrative procedures” (World Bank, 2014, p. 111) according to World Bank. World Bank (2014) defines that in the economic sphere, "crony capitalism is a term describing an economy in which success in business depends on close relationships between business people and government officials(p. 111).

"It may be exhibited by favoritism in the distribution of legal permits, government grants, special tax breaks, or other forms of state interventionism” (World Bank, 2014, p. 111)

It is specifically important to incorporate the definitions for this research, taking into account the varieties of the definition of cronyism and crony capitalism. First, we rely on the concept of cronyism defined by Aligica and Tarko (2014) “Crony exchanges based on trust, loyalty, family, and long-standing social networks,” “the most significant and consequential form of cronyism usually involves relationships between members of high echelons of society or between large firms or political class” (p.159). The choice of this definition relies on the study purpose to understand the relations between family, clan, and elites in case countries as it influences not only the development of interpersonal and cultural phenomenon of cronyism but as Aligica and Tarko mention effects on the transition from an approach to cronyism as interpersonal and cultural social phenomenon to

cronyism as a structural and systematic feature: crony capitalism (Aligica & Tarko, 2014). Second, the World Bank's (2014) definition of crony capitalism stating "an economy in which success in business depends on close relationships between business people and government officials and may be exhibited by favoritism in the distribution of legal permits, government grants, special tax breaks, or other forms of state interventionism" (p. 111). We decided to incorporate two definitions as it provides with explanations on how various forms of state interventionism for granting economic opportunities ensure the robustness of crony capitalism development in case countries.

Though crony capitalism is rarely new phenomenon, there are several studies focused on the causes of crony capitalism development. Exploring the phenomenon of crony capitalism in Croatia, Ivanković considers that crony capitalism as a phenomenon emerged under conditions of political instability and the transition and privatization stimulated the development of crony capitalism in Croatia (Ivanković, 2017, p.40). The model examines whether there were features of crony capitalism as a consequence of privatization and the transition from socialism and concludes that the collapse of Agrokor, the largest Croatian conglomerate, illustrates the development of crony capitalism in Croatia and its relation to the privatization process (Ivanković, 2017, p.40). Similarly, examining crony capitalism in Bulgaria, Peev emphasizes that the emerging system, based on the policy of ownership and control transformation in Bulgaria, can be described as 'crony' capitalism (Peev, 2002, p. 73).

The political literature is quite rich in studies of Arab cronyism and some works specifically address the issue of business-state relations created by liberalization processes both in Morocco and Tunisia. Several studies represent a rich analyze how global markets helped local business groups to mobilize. In this context, Cammett's study is noteworthy based on documentary research and interviews with over 200 Moroccan and Tunisian businesspeople and other professionals on how neoliberal reforms may or may not engender collective political capacities of business communities (Cammett, 2007). Some scholars focus their attention on studying specifically crony capitalism in Morocco. In this regard it is worthy to mention Saadi's research on cronyistic business-government relations in Morocco and whether these relations positively or negatively influence on competition

and economic growth (Saadi, 2016, p.2). Economic research on this topic was scarce due to the problem of access to firm ownership data. Hence the quantitative method of measurement and Saadi's quantitative approach was an attempt to find out whether or not Moroccan cronyism has contributed or hampered economic growth.

Kreitmeyr-Koska examined how neoliberalism and neoliberal approaches contributed to the authoritarian renewal in Egypt, Jordan, and Morocco (Kreitmeyr-Koska, 2016). Oubenal focused on crony capitalism examining Moroccan companies and the role of the financial sector by applying a network analysis of board members of the Moroccan listed companies confirming and proved the centrality of finance compared to other sectors (Oubenal, 2016, p. 2). Diwan and Chekir conducted another research on crony capitalism in Egypt to understand the reasons of constraints to economic growth in Egypt. They compared corporate performance and stock market valuation of politically connected and unconnected firms, before and after the 2011 uprisings and came to the conclusion that granted privileges allowed connected firms to increase their market size and power (Diwan & Chekir 2012, p. 1). Regarding studies focused on Tunisia, Freund and Nucifora and Rijkers' research identified the relationship between the business interests of ex-President Ben Ali and his family examining the behavior of 220 Tunisian firms benefited from FDI restrictions (Freund, Nucifora & Rijkers, 2014). Bergh conducted the study of the effects of neoliberal reforms on local governance and showed that such reforms are often subordinated to established patterns of political contestation among actors (Bergh, 2012, p. 303). Gerring and Thacker tested the relationship between neoliberal economic policies and political corruption, by applying a large cross-national data set from the mid-to-late 1990s and found that open trade and investment policies and low, effective regulatory burdens do correlate with lower levels of political corruption (Gerring & Thacker, 2005, p. 233). However, no consistent relationship was detected between the aggregate size of the public sector and political corruption (Gerring & Thacker, 2005, p. 233). Holcombe developed a hypothesis linking crony capitalism with big government involvement in the economy and suggested retaining small government as the most effective means of controlling crony capitalism" (Holcombe, 2013, p. 557).

The issue of cronyism has been addressed in many studies, but fewer specifically have focused on the influence of neoliberal policies on the development of crony capitalism. The process of trade liberalization and its relation to political corruption and business-state relations do have attention. Nevertheless, the attempts to focus on neoliberal reforms as an extensive policy framework of Washington Consensus and link it to the evolution of crony capitalism have less attention in the region. It is valuable to examine neoliberal policies directed to lessen state interventionism in the market and therefore reduce the cronyistic characteristic of the economy and see whether the reforms provide with the explanation of crony capitalism evolution.

The existing studies aim to examine the relations of crony capitalism with only one or two neoliberal reforms such as trade and FDI liberalization. We want to extend the possibility to explore the whole package of macroeconomic stabilization policies and the main structural reforms through investigation of two different ('shock therapy' approach and the 'gradualist') approaches towards a market economy applied in Morocco and Tunisia. In this study, the starting point is the varying political and economic background conditions of the countries which registered worsening situation of crony capitalism. Moreover, the examination of market economy approaches helps us to understand whether there are divergent results in main macroeconomic indicators and structural reforms in both countries.

We examine the issue of crony capitalism linking it with neoliberal policies through the process of privatization and show that the neoliberal policies served in the hands of autocratic regimes as tools for preferential treatment of privileged ones. We address neoliberal arguments and develop a framework to show the causal path between two phenomena.

## **1. Methodology**

Morocco and Tunisia are chosen as cases since both had the extensive adjustment efforts, with an extended period of implementation, and both are perceived by IMF and the World Bank as the most successful reformers in the region. Studying the experience of successful reformers of the MEAN region is an excellent opportunity to understand how successful neoliberal economic reforms could endorse the possible evolution of crony capitalism.

The focus is on the 1980-2011 period because first, the 1980s were associated with an economic collapse in the early 1980s when the conditions in the world market changed causing a severe economic crisis in Morocco and Tunisia. Second, the period of the financial and external debt crisis followed by a period of economic reforms initiated by World Bank and continued till the events of 2010-2011 in Arab uprisings against the regimes. The Arab revolts led to Tunisian Revolution ending up with 30-years presidency of Ben Ali in Tunisia, whereas the Monarchy in Morocco could keep its dominant political positions despite promises to undertake comprehensive constitutional reforms.

Though the autocratic regime of both countries is not a variable for the current research, this characteristic might be an essential supplemental element in the understanding of the overall picture of political culture and approaches to the reform implementation in these countries.

### **1.1 Measurement and Data**

There are several ways for the measurement of neoliberal policies. Friedman focused on systematically analyzing the reforms and policies that had transformed the socialist, economically backward nations to market-driven capitalist economies (Friedman, 2010, p. 4). Saadatmand et al. employed a polynomial panel-data regression from 1997-2010 and used Freedom Index Scores for the measure of neo-liberal economic policies while investigating the impact of the economic changes on female primary education rates in Africa (Saadatmand et al., 2013, p.150). Gerring and Thacker applied two measures of trade openness, one measure of inflation, and one measure of the regulatory environment

while focusing on three areas of the neoliberal economic policy agenda: trade, inflation, and regulation (Gerring and Thacker, 2005, p. 233). The study conducted by Bergh directed to reveal the effects of neoliberal economic reforms on local governance in Mediterranean region through exploring the reforms on decentralization, public-private partnerships, outsourcing in the area of public service delivery, labor market reforms, public accountability and state-society relations (Bergh, 2012).

Various measurement approaches are developed from the concept of crony capitalism. In his study, Oubenal used a methodology of a social network analysis of board co-membership among listed companies of the financial sector based on quantitative measures showing that clans and families in power use the neoliberal reforms to gain economic resources and confirmed that the centrality of finance compared to other sectors exists in Morocco. Peev used survey's information collected from the Bulgarian Central Statistical office (1990-2001) and his empirical studies of firms and industries in Bulgaria and proved that that dual enterprise sector is the most important aspect of the emerging 'crony' capitalism in Bulgaria during 1992-99 (Peev, 2002). Diwan and Chekir in an attempt to understand crony capitalism in Egypt compared politically connected and unconnected firms' corporate performance and the stock market valuation before and after the 2011 uprising, and showed that the mechanisms used to grant advantages and privileges allowed connected firms to increase their market size, power and their borrowings (Diwan & Chekir, 2014, p.1). Saadi examined Moroccan cronyism by applying a quantitative approach to explore the relationships between capture mechanisms and the performances of politically connected firms using the database of public administration in charge of surveys of manufactures, which comprises 8,372 manufacturing firms with around 83,725 observations (Saadi, 2016, p. 7). As well as, he used firm-level data, contains equity amount, turnover, production, number of permanent employees, investment, gross income (i.e., before taxes, interest, and depreciation), net income, and added value (Saadi, 2016). By combining these two databases, he identified that political connectedness is a part of an extensive patronage network and Moroccan cronyism has contributed to unleashing economic growth (Saadi, 2016). One of the latest studies examining the relationship between the business interests of the Tunisian ex-President Ben Ali and his family

conducted by Freund et al. (Freund et al., 2014, p. 2). The authors identified 220 firms owned by the Ben Ali family that were confiscated in the aftermath of the Jasmin revolution (Freund et al., 2014). They merged the data with administrative data from the tax authorities, containing balance sheet information, and create a database of the evolution of the Tunisian investment law from 1993 until 2010 (Freund et al., 2014).

We aim to examine the evolution of crony capitalism as a consequence of neoliberal economic reforms and process tracing as a fundamental instrument of the qualitative method is conducted for this research. According to Beach (2017), “process-tracing research probes the theoretical causal mechanisms linking causes and outcomes together” and mechanisms are not causes but are causal processes that are triggered by causes and that link them with outcomes in a productive relationship (p.3). The process tracing importance is not only to trace on what happened but also on how it happened. Moreover, process tracing allows the researcher to develop an analytical explanation of a causal path that leads to a specific outcome. Many plausible mechanisms can be included in the relation between the variables and to identify which one works, the choice of process tracing is priceless. It will allow identifying the mechanism between neoliberal reforms and the probability of crony capitalism development.

We are based on the theory-building type of process tracing which is a more inductive form of research and it starts with the structured analysis of empirical material and uses it to detect a plausible hypothetical causal mechanism whereby X is linked to Y (Beach, 2017).

Though process tracing is a single-case method, it can also be used in combination with other methods. Particularly for small-N studies, it is possible to combine Millian methods with process tracing. For this study, it is necessary to supplement theory-building type of process tracing with comparative research methods to identify, analyze and explain differences across cases while maintaining similarity on the outcome.

The purpose is to underline and make an argument that despite the varying political, economic backgrounds and pre-conditions, structures and models of transition, the comprehensive neoliberal reforms caused the similar worsening situation of crony capitalism in both countries.

We take into account the political, economic and institutional structures of both countries with varying and specific characteristics of histories of political economy, existing economic resources and political and institutional infrastructure. Both are interesting in regard to neoliberal policies with variations with approaches towards a market economy: the 'shock therapy' and the 'gradualist' approaches which we take into account to underline the preferred approaches for market liberalization. In this regard, Tunisia adhered to gradualist model with more evolutionary process towards a market system, whereas Morocco applied shock therapy approach with rapid implementation of reforms. Apart from the economic approaches, both countries differ from each other with their political and economic structure and resources.

Returning to the theory-building type of process tracing, we examine the roots of cronyism and trace the sectors of the economy under the control of cronies during the pre-reform period to identify the potential sectors of the economy that cronies and business groups will try to maintain the control and expand their network.

We start with our empirical material such as tracing the implementation of neoliberal reforms and cronyism to detect the plausible causal processes connecting these two variables. Thus we use the evidence as hints to indicate the causal mechanisms that link the variables with the outcome. We detect the probable mechanism, which is the process of privatization, linking our variables. Thus, privatization is identified as a mechanism which leads to crony capitalism in the context of neoliberal policies.

For neoliberal reforms examination, we refer to the SAPs in Morocco and Tunisia to track the improvements applied. We rely on Laws, reforms, official reports, assessments, and working papers of World Bank and IMF. Based on ten policies of Washington Consensus, we examine and trace macroeconomic stabilization policies and the main structural reforms concerning price liberalization, privatization, trade liberalization and financial sector reforms. We stick to World Bank and IMF as these institutions are the promoters and supporters of political economic reforms in the chosen countries and have an enormous amount of documentation and reports on the implemented SAPs, as well as the required data is transparent and open. The examination of reforms will show whether the state



protectionism reduced, what kind of reforms implemented and whether the reforms supported to the liberalization of the various sectors of the economy.

We mainly detect that privatization, as one of the essential neoliberal policies, which is under the criticism of being unfair regarding competition, transparency and the used modalities in the chosen countries. For the implementation of privatization, the defined goals of the elites are determinant to understand the driving forces pushing the process forward and whether the implemented steps committed to these goals. We take into account the objectives of the privatization process and the purposes of the regimes which may lead to the resource allocation in the hands of the elites extending its cronyistic links and supporting to the evolution of cronyism. We trace the sectors of the economy being privatized in both countries and we detect the level of transparency, competitiveness and the choice of privatization techniques. We seclude several methods and instruments of privatization to check whether the elites use privatization as a mechanism to redistribute the wealth in the higher echelon of the society and path the way for the development of crony capitalism; 1. The privatization options, such as full or partial, concession, management contracts. 2. The privatization modalities, such as open tender, private placement or direct negotiation, or share issues for privatization, etc.; 3. The initial list of companies for privatization: the inefficient/loss-making enterprises or more profitable companies; 4. foreign participation in privatization process to ensure foreign purchase of shares.

Thus we focus on tracing the process of privatization, determine the modalities used and based on the chosen options, analyze whether they supported to the real objectives of privatization or not.

We rely on the Laws and Decrees on privatization, the reports and publications of World Bank and IMF regarding the privatization process, analyze these documents which help to understand the level of transparency, openness and competitiveness. For the comparative study, the privatization transactions data is obtained from the relevant state institutions with relevant data on owners and stick to World Bank Privatization Transaction Database for the double check which provides privatization transactions in 139 developing countries from 1988-2008 (World Bank Privatization Database, checked 2015). The current dataset ensures with deals type and privatization options for the privatized companies. We also use

the literature published in many journals concerning the process of privatization in both countries.

The limitations of World Bank Privatization Database relates to the list of the owners of privatized companies and sometimes deal type, as the Database gathers the corresponding data from national agencies which do not always provide with information on privatization list. In this regard, we will rely on news from leading news organizations offering a broad range of information on business, finance, and economy. Another obstacle is the language barrier for using the data from official national sources, as the official documentation in Morocco and Tunisia is in Arabic and on official websites may also be posted in French. In this case, an appropriate approach is to use the relevant materials from international agencies and organizations.

We will not be able to trace all processes which might support the evolution of crony capitalism in the case countries. For process tracing method a thorough and wide-ranging search of the empirical evidence is required and we do not claim that the detected process is entirely sufficient to explain the outcome and for the more profound result, it will be useful to identify other potential mechanisms that can provide with supplemental evidence of the evolution of crony capitalism.

## **2. Pre-reform period and financial crisis in Morocco and Tunisia in the 1980s**

Oil price downward in the 1980s left several MENA region countries in debt crisis. Morocco and Tunisia's economies characterized as rentier states taking rents in the form of oil and phosphate revenues, remittances and aid which grew rapidly during the 1960s and 1970s (Harrigan & El-Said, 2010). However by 1983, the financial situation worsened and both countries found themselves unable to meet the external debt obligations (Harrigan & El-Said, 2010).

After the independence, Moroccan economy was prosperous during 20 years mostly due to the rise in prices of its primary exporting product, the phosphate, in the international market (Awad & Tayem, 2015). However, the situation had changed in the 1980s in the world market when the phosphate prices dropped predominantly which impacted on the economic situation of Morocco (Awad & Tayem, 2015). Morocco found itself in a massive foreign debt unable to address. According to World Bank, Morocco's external debt grew dramatically from US\$ 1.8 billion in 1975 to US\$ 13.4 billion in 1983 with an increasing proportion being owed to commercial banks (World Bank, 1995, p. 3). By 1982 Morocco's external and budget deficits had both reached around 12% of Gross domestic product (GDP) (World Bank, 1995, p. 3). Moreover, unemployment increased significantly and economic growth and living standards fell at the same time (Pfeifer, 1999).

The crisis was not only linked with the external factors but also deeply rooted in the economic management of the country and its weak structure.

In the 1970s Morocco began state-led growth with control of the key sectors of the economy and "Moroccanization" that is at least 50% of the Moroccan firms be owned by Moroccan nationals (El-Khawas, 2002, p.139). Moroccanization of the national economy allowed the King who has a supreme power to centralize power and wealth taking direct ownership of the industries. The direct revenues coming from the nationalized phosphate industry helped the King to further nationalize other sectors, such as steel and cement (Friedman, 2010).

Morocco could increase its phosphate export revenue and lead to an unprecedented expansion of government expenditures. Morocco's national economy was characterized by

strong state domination, interventionism and protectionism, particularly in the agricultural sector. Local products did not have the competitive advantages in comparison with analogous products in the international market and the budget was exhausted to cover the cost recovery of the goods and services (World Bank, 1995).

The mistakes were also apparent in trade policy. New industrial groups with high positions in public administration had benefited from protectionism. These new industrial groups were benefited in the system of clientelism and the selective initiatives of the government only contributed to the channeling of the state resources to less productive sectors. Protectionist behavior towards these groups only deepened the discriminatory attitude towards the disadvantaged ones.

The rise of demand for and the prices of phosphate stipulated the government to invest raising gross fixed capital formation from 14 % of GDP in 1973 to 33 % in 1977 (Pfeifer, 1999, p. 445). This policy promoted faster economic growth but simultaneously stipulated the increase of fiscal and trade deficit and widened the gap between savings and the investment (Pfeifer, 1999, p. 445). Increased public investment in all economic sectors and especially considerable investments in the industrial large state enterprises from phosphate export revenues became a burden for the state budget. With the fall in phosphate prices, Morocco borrowed from abroad to finance the increasing gap between revenues and expenditures (Awad & Tayem, 2015, p. 78).

In addition to the external shocks, defense expenditures for the Sahara war and growing internal pressure to ensure social services and consumer subsidies to population led to rapid growth in the government current expenditures (World Bank, 1984). Morocco increased its external borrowings considerably to finance current account deficit and meet debt payments, thus raising its external medium- and long-term debt to \$9 billion or 61% of GDP (excluding military debt) by 1982 (World Bank, 1984, p. 4). In 1983, its total external debt including military and short-term commercial debt reached an estimated \$13 billion (World Bank, 1984, p. 4). As a result of growing debt and the increase in international interest rates, Morocco's debt service (excluding IMF) amounted to \$1.2 billion in 1980 and \$1.4 billion in 1982 of which \$0.6 billion in interest (World Bank, 1984, p.4). Burdened with the external debt and unable to overcome the deepening financial

crisis, Morocco received the World Bank's Structural Adjustment Loan (SAL) in 1980 but later abandoned as could not adopt several demanding reforms (World Bank, 1995). The second stabilization program was suggested in 1981, but in the light of nationwide strike and civil unrest, it was postponed (World Bank, 1995). On the macroeconomic level, the main problem still was the external debt estimated to be around 19% of GDP in 1974 and reached 96% of GDP, and the debt service ratio had reached almost 40% in 1983 (World Bank, 1995, p. 3). Mansouri and Elmorchid and Ziky and Riger mention that at the local level, fiscal deficits considerably went off from 2.8% of GDP in 1973 to 16.7% in 1981. Inflation, reached 13% in 1978 and 1981 (Mansouri, Elmorchid, Ziky, & Riger, 2005, p. 5). In contrast to Morocco, Tunisia began a premarket strategy during the 1970s and promoted export-oriented growth, mostly toward Europe with pro-Western, more liberal political orientations (El-Khawas, 2002, p. 139). After independence, Tunisia pursued socialist policies, and by the late 1970s, the implemented reforms directed to some degree of liberalization and the encouragement of the private sector (Pfeifer, 1999). While starting a liberalization process, the state stayed an essential actor in the economy and had a regulatory power in the main sectors of the economy.

Tunisia had impressive economic growth in the 1970s and 1980s, due to the growing textile-manufacturing and light industries and remittances from citizens working overseas (El-Khawas, 2002). Increases in oil production and oil prices in the world market also influenced on the growth of oil income which promoted rapid economic growth performance (Dinh, 1984). Rapid growth of GDP, about 30 %, was conditioned by not only oil export and production but also to high levels of investment (World Bank, 1988).

Despite the rapid growth the difficulties emerged when the prices of oil in the world market dropped which resulted in declining the rents and oil production. The fall of oil revenues led to foreign exchange crisis. Apart from the oil factor, the country experienced difficulties in public and private industries. The industries were dependent on the state protectionism being even not feasible. Problems arose as the inefficiency of public enterprises (PE) became apparent and slowed down economic growth, real wages increased faster than productivity in the public sector firms, while the reverse was true in the private sector (Pfeifer, 1999).

One of the policies of the government was to attract foreign investment and it was proposed to reduce the investment rate increasing emphasis on exports and slowing the growth of recurrent budget expenditures (World Bank, 1988). As the unemployment was high, the government decided to shift the intensive investment into the labor by creating new jobs (World Bank, 1988). Instead, the government continued to keep the investment high around 32 % of GDP from 1980 to 1984 mainly in public sector with enormous capital investment which in reality created few jobs and did not have high economic returns (World Bank, 1988).

During the five year plan of recovery, the inflation rose to an average of 10.0 %, exports slowed and the deficit grew to 10.9% of GDP in 1984(World Bank, 1988). The purpose was to keep the growth high. Nevertheless, Tunisia's external debt increased to 47 % of GDP and the debt service ratio to 21 % (World Bank, 1988, p. 3). The government attempted to restrain its expenditures; nonetheless, the overall budget deficit stayed close to 6.7% of GDP (World Bank, 1988).

Civil riots in 1984 over higher food prices and public sector strikes in 1984 and 1985 led to a series of crackdowns on labor, political parties, and the press (Dillman, 1998).

Faced with a heavy debt-service burden, Tunisia turned to the International monetary fund (IMF) for Stand-by Arrangements (SBAs) and then to the World Bank for SAP in exchange for debt relief (Pfeifer, 1999, p. 450).

This part of the paper tended to present shortly the pre-adjustment period, the domestic economic policies and external factors leading to the financial crisis and instability. We showed that the economic and financial crisis might be the result of the economic development model with strong state interventionism. Both states had the same patterns of state domination in the economy which accompanied with external factors leading to the crisis.

## **5. Washington Consensus: Structural Adjustment Programs (SAPs)**

### **5.1 Morocco**

#### **5.1.1 First Phase of Adjustment: Macroeconomic stabilization**

Taking into account the external enormous debt burden and harsh economic conditions, Morocco started negotiations with World Bank and IMF to get the first loan directed to the macroeconomic stabilization and initial structural reforms. The stabilization contract was offered in 1983 suggesting as debt relief for the start of the SAP I (Pfeifer, 1999).

During the first phase of reforms, in total from 1983 till 1993 the comprehensive economic reform program was supported by seven SBAs, seven Sectoral Adjustment Loans (SECALs) and two Structural Adjustment Loans (SALs) with the Bank. SECALs consisted of two loans for industry and trade (ITPALs I and II), two for agriculture; sectoral adjustment for agriculture (ASAL I and II), one for public enterprises restructuring (PERL I), one loan for education (ESAL) and one loan for financial markets development (FMDL) (World Bank, 1995). World Bank adjustment loans alone amounted to US\$ 1.065 billion (World Bank, 1995, p.2).

According to Nsouli and Rached and Funke, the reform outcomes among other various factors, also depend on the timing and sequencing of reforms (Nsouli, Rached & Funke, 2002, p. 4). “The adjustment speed can be defined as the time elapsed between the move from an initial set of macroeconomic variables to a targeted set of such variables” (Nsouli et al., 2002, p. 4) as Nsouli et al. state. It also refers to the time elapsed in moving from one organizational structure to another like time involved in moving from a centrally planned to a market-oriented economy (Nsouli et al., 2002, p. 4).

Nsouli et al. (2002) mention that “sequencing involves the order in which macroeconomic reforms are introduced, whether reforms are undertaken across sectors (whether fiscal adjustment or stabilization should be a prerequisite for introducing liberalization and price decontrolling) and the order in which reforms are undertaken within sectors (whether in case of capital account liberalization, FDI or short-term capital flows should be liberalized first)” (p. 4).

Taking into account the approaches for the speed of implementation, Morocco needed to adhere to one either rapid adjustment or the gradual one to implement reforms. The high-speed adjustment referred to shock approach with rapid and surprising reforms, whereas the gradual approach is based on a package of incremental and multistage reforms (Nsouli et al., 2002, p. 4). Morocco's destabilized financial and economic situation pushed the government to apply shock approach for macroeconomic stabilization plan, which is fiscal austerity and monetary restriction.

IMF, operating on the conditions outlined in the "Washington Consensus," recommended stabilization measures calling for massive cuts in public spending, introducing new and broader taxes, and high, positive interest rates (Harrigan & El-Said, 2010, p. 9). Under the SAL I, World Bank tended to promote the macroeconomic adjustment operations with several sectoral adjustment programs focusing, first of all, on stabilization of the economy through restrictive budgetary policies; implementation of a comprehensive program of adjustment of the system of protection (tariffs and quantitative restrictions), initiation a reform of the fiscal and financial system and reformation of the system of industrial incentives and export promotion (World Bank, 1984, p.8).

To ward off inflation, as one of the primary objectives of the stabilization plan, the government decided to apply a restrictive monetary policy to regulate aggregate demand through restricting the liquidity of the economy (Mansouri et al., 2005). The government planned to keep consistent the monetary growth rate with the rate of growth of nominal GDP, as well as presented a new interest rate policy based on certain flexibility in 1985(Mansouri et al., 2005, p. 13). Since 1985, a maximum was fixed for loan interest rates to dissuade banks to distribute credits with higher interest rates and a minimum was fixed for deposit interest rates to promote remunerated deposits and therefore to encourage savings (Mansouri et al., 2005, p. 13).

To make quick corrections in a short period, Morocco undertook a fiscal adjustment adopting a Finance law in July 1983 to start fiscal austerity policy aiming to reduce fiscal deficits (Mansouri et al., 2005). The primary emphasis of the Law was on a reduction of consumer food subsidies. Followed the recommendations of World Bank, the government also adopted the measures on reduction of the wages by implementing a 'public salary



freezing policy' and limited the hiring process in the public sector (Mansouri et al., 2005, p. 15). In spite of wage freeze during 1981-85 helping contain the public sector wage bill, the real problem was the excessive number of employees in public sector (World Bank, 1997). These were only short-term measures, whereas it was essential to implement long-term fiscal reforms.

As Sewell and Thirsk mention, the tax system in Morocco was extremely weak having too many taxes, too many rates, too many exemptions and fine distinctions for the definition of tax bases, and too many special tax regimes (Sewell & Thirsk, 1997). Two most prominent components of direct taxes were the tax on business profits, on wages and salaries (Sewell & Thirsk, 1997, p. 333). The business profits tax was applied to all enterprises, no matter what their organizational form, and professionals' net earnings (Sewell & Thirsk, 1997, p. 336). It was the most important source of direct tax revenue before the reforms not mentioning that tax on agriculture, urban property and on dividends, yielded small shares of total revenue (Sewell & Thirsk, 1997, p. 336).

Under the stabilization program the target of the balance of payments deficit is set at 6.5% of GDP in 1985, and 4.5% in 1986 (World Bank, 1985, p. 15). For the realization of this target, the government decided to increase budget revenues and to limit its expenditures. One of the ways to increase revenues was to introduce a major reform of both direct and indirect taxation (World Bank, 1985). The government adopted a comprehensive tax reform which was complemented in 1984 with a reform of the system of indirect taxation with the purpose to establish a general value-added tax (VAT) over the medium-term (World Bank, 1984, p. 9). Hence, the following years, a new VAT and a new tax on business profits and personal incomes were introduced correspondingly in 1986 and 1989 (Thirsk and Sewell, 1997, p. 341). Government maximized tax revenues through better levying and enlargement of tax bases for existing taxes and restructured the system of taxation for incomes and commercial transactions, increased prices for services commercialized by SOEs (water, electricity, railways, etc.) (Mansouri et al., 2005, p. 15). The government imposed oil levy in 1986 generating revenues of about 2.7% of GDP (World Bank, 1995, p. 3). The tax reforms led to the recovery of government revenues rising from 20.9 % of GDP in 1987 to 26.4 % in 1993 (Thirsk and Sewell, 1997, p. 341).

In 1980 the government had initiated flexible exchange rate policy for exports encouragement and imports limitation which continued in 1983 with the dirham devaluated by about 10% (World Bank, 1984). However, Mansouri et al. emphasize that if the government had an intention with the devaluation of the dirham to boost exports, it might also be contributed to increasing prices of imported investment, intermediate goods and rising debt service (Mansouri et al., 2005, p.19).

Macroeconomic imbalances were addressed by implementing public spending rationalization through reducing public investment and public revenue improvement (World Bank, 1995). The next step was to cut the government investments due to the shortage of resources. With the decline in spending, the government projected to decrease the levels of expenditure for public investment reducing from 18.7 billion Moroccan dirhams (MDH) to MDH 13.6 billion for 1983, and actual Treasury investment expenditures to decline from MDH 12.5 billion in 1982 to MDH 8 billion in 1983 (World Bank, 1984, p.9). PEs had become extensive accounting for 20% of GDP and 30% of all investment (World Bank, 1991, p. 2). The government initiated public sector reform aiming at financial restructuring several key public sector monopolies and utilities, establishing management and performance system for monopolies regulating public service enterprises to enhance efficiency and productivity, and initiating divestiture programs to privatize a significant number of SOEs (World Bank, 1991, p. 2). Besides, the government started cutting operating subsidies and limiting the role of the state to equity contributions (World Bank, 1991, p. 2). In combination with reduced public expenditures on subsidies for consumer goods, decrease of financial flows of the compensation funds, and cut in public investments in several sectors, the expenditures harshly reduced from 13% of GDP in 1982 to only 4 % in 1986 (World Bank, 1995; Mansouri et al., 2005, p. 15). Moreover, the government reorganized certain inefficient public services to make the activities of SOEs profitable (Mansouri et al., 2005). The finance of ineffective large-scale and capital-intensive projects was also a budget burden (World Bank, 1984). Hence many ongoing projects in the industrial, education and agricultural sectors had been delayed or scaled down to reduce costs (World Bank, 1984, p.9).

As a result of these measures, the fiscal deficit fell from 12% of GDP in 1983 to under 5% in 1987 (World Bank, 1995, p. 3). Besides, GDP growth during the period 1983-1988 averaged around 4.5% while inflation remained under 5% continuing to decline constituting 3% in 1989 (World Bank, 1995).

The government achieved the macroeconomic stabilization primarily by cutting public expenditures and investments. However, the revenues remained unchanged at around 22.5% of GDP, the total external debt remained at 94% of GDP, and the debt service to exports ratio at 26% in 1988 (World Bank, 1995).

The adopted policies for the reduction of budget spending by making changes in taxation, reducing public investment, cutting expenditures in public sector and applying restrictive monetary policy played an important role in macroeconomic stabilization. The continued macroeconomic measures were considered necessary for the essential growth of the economy and the solution of the debt problem. However, in spite of Morocco's macroeconomic achievements, unemployment remained very high, at around 15% in urban areas, and wealth distribution imbalances grew (World Bank, 1992, p. 5). The growth rate was still low and the external debt, though decreased in the following years, was still high.

### **5.1.2 Reforms under structural adjustment programs I and II: 1983-1993**

Each Loan consisted of several conditions obligatory to implement in various sectors and our purpose is to present and discuss the reforms and applied measures taking into account the time of Loan allocation. During 1983-1993 Structural Adjustment Loans I and II implemented.

Achieving macroeconomic stabilization, Morocco started main structural reforms relating to price liberalization, trade liberalization, privatization and financial sector reforms under SAL I Agreement.

Moroccan decision-makers decided to undertake a relative shock approach to price liberalization at the beginning of the SAP intended to harmonize trade and price liberalization with fiscal and monetary measures (World Bank, 1995). However, Mansouri et al. mention that the rising severe popular dissatisfaction made them reoriented their price

liberalization therapy toward a more gradual approach (Mansouri et al., 2005). The government removed price controls to increase the competition and productivity. From 1983 till 1985, the government initiated to eliminate price controls on about 40 products and services, except on subsidized food products, public utilities, and products where competition is limited, either as a result of the existence of natural monopolies or where imports were still restricted (World Bank, 1985).

Mansouri et al. emphasize that some of them remained controlled at the provincial level, also the government continued to limit competition and to control prices for certain services on which industry heavily depends, especially transports and insurance (Mansouri et al., 2005, p.15). As to agricultural sector the removal of price control encountered with challenges postponing its implementation during the following SAPs (World Bank, 1995).

Moroccan decision-makers adopted measures in favor of trade liberalization to set up a market-oriented economy. The provided bank loans for industrial and trade policy adjustments (ITPALs I from 1984-1985 and II from 1985-1986) aimed to promote exports, tariff reform, import liberalization and reforms in industry. Tariff reform has been implemented by gradually lowering the ceiling rate for import duties (World Bank, 1987). Tariffs have been reduced from levels as high as 400% on some items, to a maximum of 45% in 1988 (World Bank, 1987, p. 3).

Following the recommendations of the World Bank, the government focused on improving industrial efficiency, lowering manufacturing costs, and restoring dynamism to industrial growth through a significant reduction of the bias against export production (World Bank, 1985, p. 8). It was estimated that in 1978 this bias resulted in the rate of effective protection in the manufacturing sector which was 50% higher in import-competing sectors than in export-oriented activities (World Bank, 1984, p.15). Moroccan previous system of trade protection was significantly restrictive and practicing the export and import licensing, and high tariffs (World Bank, 1985). Given the fact that the government had provided substantial incentives to import, the applied measures directed to balance the existing bias against exports. The government initiated elimination of import licensing requirements and reduction of anti-export bias due to the failed politics of restrictive trade policies implemented previously. The import liberalization process included the removal of import

licensing on about 350 product categories and elimination of import prohibitions on 60 product categories (World Bank, 1985, p.8). Moreover, export licensing was removed for all, but a few products and the monopoly of the state marketing board (OCE) on exports of processed food products was abolished (World Bank, 1985, p.8). This measure allowed firms freely choose their own commercial and shipping agent and sign their contracts, as well as their exports would no longer be submitted to price controls or commissions charged by OCE (World Bank, 1985). Another applied measure was the reform of export credits and export credit insurance (World Bank, 1985).

The government reduced special import tax from 15 to 10%, the remaining prior import deposit requirements were eliminated, and the maximum rate of customs duty was reduced to 60% to decrease the excessively high incentives previously granted to some import-substituting industries (World Bank, 1985, p.8).

The trade liberalization policies were continued aiming to eliminate all quantitative import restrictions (World Bank, 1985, p.8). As a result, the share of freely imported goods rose from 21% of the value of imports in 1983 to 75% in 1984 (World Bank, 1985, p.8). Already in 1992, the new trade law was based on three main principles: further freedom of imports and exports of goods and services, further removal of quantitative restrictions and the use of tariffs as the main protection instrument (Mansouri et al., 2005, p. 16). New amendments in law resulted in the adoption of a unique list of goods subjected to import license, beginning in 1992 resulting in preparing a list contained only 9.6 % of imported goods instead of 57 % in 1982 (Mansouri et al., 2005, p. 16). The applied measures also directed to reduce the maximum tariff to 35%, simplify the tariff structure, trade-related procedures and reduce industrial reference prices on domestic industrial production to 10% in 1992 (World Bank, 1995, p.20).

High customs duties also were influencing the imbalance. The government improved the existing custom regimes, as an important element of trade liberalization, to promote export. Morocco began improvement of its customs administration and customs services well before the SAPs however there is a necessity to develop the system for trade promotion and eliminate trade barriers. For this given reason, in 1983 special customs regimes for exporters were extended and improved and export procedures simplified (World Bank,

1985, p.8). The applied measures intended to do the depreciation of the effective exchange rate to raise the profitability for export (World Bank, 1985). In 1980-82 dirham was devalued its real effective exchange rate by about 6% (World Bank, 1985, p.8). However, under the IMF Stand-by arrangement it was required to further reduce the bias against exports of the system of incentives and Morocco devalued its exchange rate by 10% in August 1983 (Mansouri et al., 2005). Additionally, the Moroccan policymakers reduced the tax burden on exports and especially on phosphate (World Bank, 1984).

In 1973 when Morocco started Moroccanization, the government was practicing policies directed against foreign investment and adopted measures were restricting foreign ownership of certain industrial, commercial, and service activities to no more than 49 % (Haddad & Harrison, 1993, p.4). Haddad and Harrison point out that the main purpose of this policy was political rather than economic aiming to reduce the dominant role of French firms in the Moroccan economy (Haddad & Harrison, 1993, p.4). The negative impact of this law on foreign investment was evident from the fact that even enterprises not subject to the law voluntarily handed over their capital share to their Moroccan partners (Haddad & Harrison, 1993, p 4).

A significant reform of the investment code implemented in 1983 allowing full foreign ownership of Moroccan companies in certain sectors (especially manufacturing), eased restrictions on the repatriation of capital and dividends and introducing fiscal and other incentives for FDI (Haddad & Harrison, 1993, p 4). By 1985, the Moroccan majority-ownership restriction no longer applied to any segment in the industrial sector, which meant that foreign firms could have equity participation of more than 49 % (Haddad & Harrison, 1993, p 4). Further liberalization of the investment code was implemented in 1988, adopting the simplified system of FDI approval and the rules extended to nonresident Moroccans similar to those granted nonresident foreigners (Haddad & Harrison, 1993, p 4). The Moroccan agricultural sector has one of the highest levels of state intervention in the world characterized by strong government involvement in production decisions, marketing, and international trade (Arndt & Tyner, 2001). ASAL I started in 1985 had four main objectives; to restructure the agricultural investment program; re-orient the prices and incentives framework; strengthen agricultural support services; and build institutional

capacity for agricultural planning and policy analysis (Arndt & Tyner, 2001). The government reduced agricultural subsidies on fertilizers by 40 %, water charges were increased and the private sector was allowed to enter into fertilizer distribution and seed production, the activities considered to be previously the prerogative of the state (World Bank, 1987, p. 3). State interventionism in exports of agricultural products was quite strict. Export licensing was required for practically all agricultural products. However, in 1984 the government reviewed the present system of export licensing and significantly reduced the number of products subject to it, except for subsidized basic food products (World Bank, 1984, p. 16). These measures helped to reduce state control and intervention in export markets. The initial results were promising. However, Arndt and Tyner emphasize that some conditions in the Loan Agreement regarding the marketing and protection systems for agricultural commodities were not met (Arndt & Tyner, 2001).

For the first phase of trade liberalization policies, the result of trade reform showed good results. Export earnings increased from 23% of GDP in 1980 to 32% in 1985 but since 1985 earnings have stabilized between 28% and 32% (World Bank, 1995, p.10). In total, manufacturing exports increased from 12% to 22% of total exports, including non-factor services, however, despite the changes, exports remain narrowly based on a few products: fish, processed foods, phosphate derivatives, and clothing (World Bank, 1992, p. 2). The industrial sector reforms were also demonstrating positive results showing the increase of manufactured goods from 15% of total production in 1982 to 25% in 1988 (World Bank, 1992, p. 2). Processed foods increased from 16% of agricultural exports in 1972 to 47% in 1988 (World Bank, 1992, p. 2).

World Bank's FMDL was one of the main pillars in the SAP aiming to stipulate Moroccan policymakers to improve policies and introduce greater competition in the financial sector. The objective was to establish the regulatory framework which would allow Moroccan financial system to operate in line with international norms and standards (World Bank, 1991).

Morocco's financial system included Bank Al-Maghrib (the Central Bank), 15 commercial banks, and five specialized credit institutions, the Treasury, the postal checking system, the National Savings Bank, and the Caisse Centrale de Garantie (World Bank, 1991, p. 13).

There were also six leasing companies, mostly owned by the banks, and several insurance companies (World Bank, 1991, p. 13). Capital markets were still in their infancy, and the Casablanca stock exchange had, so far, played a limited role in mobilizing equity finance (World Bank, 1991, p. 13). According to World Bank financial assessment, most banks had significant foreign participation in their capital and foreign shareholders typically own 20 to 40% of the stock. In addition to the commercial banks, five government-controlled specialized credit institutions were lending for industrial projects, for the agricultural sector, to local governments, money market, to housing and tourism projects, to private companies engaged in public works (World Bank, 1991, p.14). Moreover, the postal checking system could receive deposits from the public throughout the country, as well as the National Savings Bank, also operating within the postal system, was collecting small savings from the public (World Bank, 1991, p.14).

The Treasury had mobilized domestic resources (pension funds and social security) directly from households and placed most of them in Treasury, particularly in the form of deposits into the postal checking system and other public securities (World Bank, 1991). The main policymaking body on monetary and credit matters was the Credit and Financial Market Committee (World Bank, 1991, p.14). By achieving macroeconomic progress by mid-1980s, the Government decided to move forward with the improvement of the financial sector aiming to reform the banking system.

Extensive control of Moroccan financial system had reduced the scope of competition and efficiency in bank lending and deposit mobilization, and selective credit policies were also limiting the scope for competition and contributing to the segmentation of the credit market (World Bank, 1991, p. 17). Moreover, the government was practicing granting specific advantages to specialized financial institutions (SFIs) such as special accounting procedures, tax treatment and mandatory purchase of their bonds by commercial banks (World Bank, 1991, p. 17). The government's program included the liberalization of interest rates on deposits, the elimination of quantitative credit ceilings thus promoting competition in the banking system, strengthening the Central Bank's indirect control instruments, obligatory lending by commercial banks to selected sectors, and strengthening of the regulatory and supervisory framework of banks (World Bank, 1995, p. 11).



As selective credit policies had limited the scope for competition, the government decided to eliminate selective credit policies gradually. The gradual elimination of selective credit policies aimed at removing any subsidies resulted from preferential treatment granted to SFIs (World Bank, 1991, p. 18). Thus Banks had more flexibility in their lending decisions allowing competing directly with SFIs (World Bank, 1991).

The measures applied to remove credit ceilings to have a competitive determination of interest rates, to free most interest rates and to implement a transparent and market-based foreign exchange risk coverage system (World Bank, 1991). Mansouri et al. (2005) indicate that “the overall objective was to break up the rigidity of old institutions characterizing the administrated economy and therefore to set up the bases for market finance” (p.27).

By the adopted “Bank Law” the legal framework was reformed to unify the legislation concerning all credit institutions, to set up the new institutional framework to enlarge dialogue between monetary authorities and the bank profession and to protect bank clients (Mansouri et al., 2005, p.27). Full process of liberalization of direct controls on credits and interest rates were finished only in 1996 (Mansouri et al., 2005). By stock market reform of 1993, the mechanisms of functioning for Casablanca Stock Market was redefined allowing improving the optimal allocation of financial resources transiting through the market (Mansouri et al., 2005, p.27).

One of the basic components of SAP was the privatization of SOEs. World Bank promoted the idea of privatization policies which would constitute the base for the extensive privatization. In general, Morocco had a large PE sector accounting for about 20% of GDP, with more than half of value added in mining, energy, water supply, and roughly half of transport and communications (World Bank, 1995, p. 5). So, totally from about 330 firms, the state had a majority holding, 14 largest PEs mainly had operated in power, water, transport, and mining and phosphate processing (World Bank, 1995, p. 5).

In 1986, King Hassan announced the start of a privatization emphasizing that all state holdings should be privatized to raise the level of efficiency of private investment and open key infrastructure services such as water, electricity and communications to private financing, to raise revenues for the government and to support for the development of capital markets (Najem, 2001). In 1989, a Privatization Law was passed mandating the sale

of 112 companies and hotels. The exception was the companies in the phosphate industry, electricity, water, the rail system, air transport and the telecommunications system (World Bank, 1995, p. 6). However, the implementation of the privatization process was conducted only in 1993 (Mansouri et al., 2005).

Facing with severe economic and financial crisis in the 1980s, Morocco changed its economic course of development following the recommendations of IMF and World Bank, transforming its economy from the inward-oriented, public-sector led development into export-oriented and private-sector led growth economy. Monetary and exchange policies played an important role in macroeconomic stabilization. Undertaken actions brought the external debt down from 2.9 times current receipts in the balance of payments in 1988 to 2.5 times in 1993 (World Bank, 1995 p.33). The deficit in the current account in the balance of payments was reduced substantially, from an equivalent of 4.4% of GDP in 1989 to some 2% of GDP in 1993 (World Bank, 1995, p. 34). Foreign investment increased on average in dollars 35.2% on an annual basis between 1988 and 1993, rising from US\$129 million in 1988 to US\$584 million in 1993 (World Bank, 1995, p. 34). Inflation was under control and the stabilization was achieved, economic growth was nevertheless satisfactory until 1991, more than 5% on average per year (World Bank, 1995, p. 34). The economic growth as one of the main objectives of both SALs was satisfactory until 1991, but because of droughts in 1992 and 1993, the growth decreased. The poverty was another problem that could not be appropriately tackled, especially in rural areas. Poverty constituted around 20 % of the population, and urban unemployment, about 22 % (World Bank, 1995). The increase in agricultural production ensured growth to some extent in urban employment and with some income benefits to the poor, but the total budgetary transfers to the population declined, mainly because of the reduction in food subsidies which target some of the poor (World Bank, 1992, p. 16). Since Morocco had substantial external debt, one of the components of the Loan was the improvement of external debt management which was addressed by establishing debt management system allowing having a more reliable analysis of the country's debt profile (World Bank, 1995). However, the debt service payments will be one of the acute problems for the government in the following years. As

to implemented structural and sectoral reforms, the result was promising but with the necessary improvements need to be addressed.

### **5.1.3 Reinforcement of structural reforms: 1994-2001**

While the profound transition has been implemented and SALs during the 1980s and at the beginning of 1990s, but the World Bank and IMF tended to provide specific loan for the improvements in various economic sectors.

Two SAPs aimed to lessen the role of the state in economic regulations and as it was shown the results were evident. However, the necessity of extensive reforms still was in demand. Morocco's strategy for the 1990s aimed to continue the reforms directed toward an outward-oriented economy.

Since the 1990s the economic performance was slowed down and particularly droughts in 1992, 1993 and 1995 significantly influenced on economic growth, increasing poverty and urban unemployment (World Bank, 1997). GDP growth was negative during the drought years, the fiscal deficit rose from 2.2 % of GDP to 5.7 % between 1992 and 1995, and the current account deficit widened from 1.7 % of GDP to 4.9 %, leading to a reduction in the level of reserves (World Bank, 1997, p. 2).

Droughts specifically affected the increase of poverty in rural areas. Urban unemployment has also increased rapidly, reaching 23 % in 1995 and poverty was back to its level in the early 1980s (World Bank, 1997). The budget deficit was still too high and moreover the structure of its expenditures was not growth-oriented, as 24% of revenue was used to service interest on the public debt and 47% toward paying the wage bill (World Bank, 1997). Public expenditures were inefficient and poorly allocated (World Bank, 1997).

In parallel, in 1996 the constitutional referendum took place introducing a new two-chamber Parliament made up of a Lower House elected by universal suffrage and an Upper House by representatives of regional and local communities (World Bank, 1997). Main opposition parties formed a new coalition government for the first time in 1997 since Morocco's independence, and in 1999 King Mohammed VI acceded to the throne after his father, King Hassan II death (World Bank, 2005). Reform of local governments adopted in

1996 allowed ensuring more autonomy on a local level and efforts for decentralization (World Bank, 2005).

During the mid-1990s the government continued deepening macroeconomic stability as well as structural changes in trade liberalization, customs reform, financial sector reforms, private sector development, and privatization.

The government adopted several measures for trade liberalization to achieve necessary results in outward-oriented policy, especially in the fields of transportation, energy and agricultural modernization. In 1994 liberalization included basic agricultural products (grains, sugar, oilseeds) and liberalization of energy products was moved forward to January 1, 1995 (World Bank, 2001). Trade liberalization also led to an Association Agreement signed with the European Union in 1996 and implemented in March 2000 (World Bank, 2005). Licensing system also was subjected to improvements, but it was only applied to products covered by international agreements signed by Morocco (World Bank, 1995).

Since 1990, most restrictions on foreign ownership had been lifted and FDI rose from about 0.9 % of GDP to an annual average of 1.7 % in 1992 and a high 2.8 % of GDP in 1994 (World Bank, 1997, p. 1). Following the international norms and standards, by the Decree of 1998, the government initiated public procurement reform aimed to maintain the principle of competition, transparency and efficiency in public procurement, to develop integrity in the public procurement management, to enhance guarantees provided to competitors and strengthen the settlement of disputes (Bensouda, 2012, p. 2126).

As customs duties were the vital source of revenue accounting for 4.2% of GDP in 1995, the authorities paid significant attention to the improvement of the system, and the process of dismantling customs duties accelerated particularly after signing the trade agreement with European Union, (De Wulf & Finateau, 2002). Morocco was obliged to abolish customs duties by 2010 (De Wulf & Finateau, 2002). Customs duties were lowered on some non-agricultural products (De Wulf & Finateau, 2002). Finance Law allowed reducing tariffs to 5% on a large number of imports that had not competed with domestic products. In 2000 to simplify import duties, the fiscal levy on imports (PFI) was incorporated into customs tariffs. In 1996-2000 annual revenue from customs fell to 3.6 %

of GDP, while revenue from the VAT on imports rose to 3.3 % of GDP (De Wulf & Finateau, 2002). As to measures directed boosting export, the government granted certain benefits under customs regimes. Enterprises benefited from the free export zone regime (WTO, 2003). The system of subsidies extended for the exports of certain agricultural products, however keeping levies to exports of maize, plant fiber and crude phosphates (WTO, 2003).

A package of policy measures was applied for reforming the tax system. The government lowered the maximum personal and corporate income taxes and reduced the tax on stock dividends (World Bank, 1995).

During the SAP I and II periods, to support to private sector development the government increased the share of private sector in the economy. During the mid-1990s the private sector accounted for an increasingly significant share of economic activity in Morocco, about 70 % of value added, 90% of employment and 75 % of investment and it contributed virtually all of the value added in agriculture, commercial construction and trade, 75 % of industry, and 70 % of banking and financial institutions (World Bank, 1995, p. 5). However, despite the applied policies, PE sector still constituted the important part of the economy. It still accounted for about 20 % of GDP, with more than half of value added in mining, energy, water supply, and roughly half of transport and communications (World Bank, 1995, p. 5). Policy measures of the 1990s related to the increase of private sector investment and to ensure private sector growth. Profound privatization of PE sector was required to reduce the budget deficit and open the key sectors of the economy for private financing. Moreover, privatization would raise revenues and contribute to the development of capital markets (World Bank, 1995, p. 5). In October 1994, the Minister of Privatization launched the second phase of the privatization program covering key infrastructure sectors such as water, electricity, transport, and communication (World Bank, 1995). At the end of April 1995, some thirty companies had been sold generating revenues of 7.2 billion MDH (US\$785 million) (World Bank, 1995, p. 6).

Morocco's policy of liberalization and privatization in communication was considered as auspicious. This success was conditioned by structural reforms and Morocco's membership to World Trade Organization's commitment to gradually liberalize the telecommunication

services (World Bank, 2005). A new Telecommunications Law of 1997 had been drafted supporting the creation of an independent telecommunications company operating on commercial principles (World Bank, 1995). Post Office and Telecommunications Board were restructured and two entities were created in 1998: Itissalat Al-Maghrib (IAM) or Maroc Telecom S.A. for telecommunications, and Barid Al-Maghrib for postal services (Achy, 2005, p.3). The law also set up the National Telecommunications Regulation Agency, an independent entity in charge of regulating the telecommunications services (Achy, 2005, p.3).

The previous reforms in the financial system of Morocco were considered quite successful from an institutional perspective, but the role of markets was still limited as the government was still the owner of the most of the financial institutions. The level of competition outside of the banking system tended to be limited as a result of the dominant position of three large private financial conglomerates (IMF, 2006). Government-controlled institutions still held around 43% of all banking system assets at the end of 2001 (IMF, 2006). Though the reforms helped to increase the role of private sector in non-bank financial institutions, the substantial presence of the state was apparent (IMF, 2006). Hence, the extensive role of the government, limited competition led to the uneven development of the system which in turn could not sufficiently contribute to the economic growth of the country.

In the financial sector, in 1995 a new financial adjustment program Financial Markets Development Loan (FMDL) was confirmed and the government supported to indirect monetary control including the liberalization of lending rates (World Bank, 1995). According to Jbili and Klaus and Volker, limited controls on some deposit rates remained (Jbili, Klaus & Volker, 1997). Indirect and market-based instruments of monetary policy were also developed, stock market legislation was updated, the bourses were privatized, and independent supervisory institutions were established (Jbili et al., 1997).

Under new banking and Central Bank laws, the government strengthened the regulation and supervision of the financial system. New banking laws granted increased autonomy to the central banks and strengthened prudential regulations in line with international standards (Jbili et al., 1997, p. 30). Virtual full convertibility had been established for foreign investors, and restrictions on foreign borrowing and certain outward investments by

residents were relaxed (Jbili et al., 1997, p. 30). In 1996 Morocco established interbank foreign exchange markets directed to the decentralization of the management of foreign exchange (Jbili et al., 1997, p. 30).

Under FMDL Loan privatization was implemented regarding the financial sector in 1994 and 1995 and ten financial institutions (banks, insurance companies, and a large financial holding) were successfully privatized contributed about 30% of total value added of the sector (World Bank, 1995, p. 7). In 1995 the new single document called the “Investment Charter” investment code was adopted replacing acting code of 1983 to promote investments through the improvement of the investment conditions (Bouoiyour, 2007). The investment law included separate sectoral codes covering industry, tourism, housing, maritime, mining, petroleum exploitation and exports except for the agricultural sector (Bouoiyour, 2007).

In parallel to the reinforcement of the reforms, Morocco also continued stabilization programs pursuing monetary policies. Inflation was kept under control below 3% (World Bank, 2001). The government had relied more on domestic financing sources to meet fiscal needs and gradually reduced external debt to about 55 % of GDP in 1997, and domestic debt amounted to 43 % of GDP (World Bank, 2001, p.4). Because of droughts, growth dropped from an annual average of 4.4 % during 1986-1991 to 1.9 % during 1991-1998, turning Morocco from one of the best to one of the worst performers in the MENA Region (World Bank, 2001, p.5). The fiscal deficit was mostly covered by cuts in public investment, while the wage bill remained high (World Bank, 2001). Liberalization of financial sectors had been done by gradually eliminating almost all regulations that ensured direct state intervention in the economy. Despite the progress in recent years implemented in various sectors, Morocco confronted challenges, especially regarding economic growth. The country was vulnerable to rainfall registered low living standards, social disparities between regions and high unemployment rates as well as the increase in poverty. Among the continued structural reforms, these challenges will be one of the priorities for the government to combat in the following years.

#### **5.1.4 Last phase of extensive structural reforms: 2001-2011**

As a result of policies implemented in the early 1990s in many areas such as trade facilitation, customs reform, financial sector liberalization, telecom privatization, agriculture and public sector modernization, Morocco was significantly ahead of the economic environment in 1980s.

As to the macroeconomic stability, inflation remained low, and successful privatization attracted FDI. Inflows from tourism and remittances were stable and high. However, in late 2002, the main concerns of the government were low growth, unemployment and fiscal sustainability (World Bank, 2005). The country was vulnerable to variable rainfall and growth in Morocco was highly dependent on weather (World Bank, 2007). Growth remained somewhat vulnerable to agriculture, whereas dependency on agriculture to rainfalls was significant (World Bank, 2005). On the contrary, non-agricultural output continued to grow, slowly but steadily, at a rate of 3.2 %, with dynamic contributions from the manufacturing and service sectors such as tourism and information technology (World Bank, 2005). Morocco also had high energy import dependency, so it was vulnerable to instabilities in the international oil market. As to living standards, the problem of poverty was still a challenge and large segments of the population remain socially and economically marginalized (World Bank, 2007).

Fiscal sustainability remained one of the main problems. During the last privatization process, half of the financing of the fiscal deficit came from the privatization proceeds, but it phased out and there was a necessity to make the fiscal adjustment in 2005-2006 (World Bank, 2005). The government needed to implement medium-term fiscal consolidation strategy relying on a mix of expenditure and revenue measures (IMF, 2006). On the expenditure side, the authorities decided to reduce wage bill growth, the fiscal cost of energy subsidies by gradually adjusting domestic petroleum prices to international prices, gradually replace inefficient food subsidies and to switch to performance-based budgeting within a medium-term expenditure framework (IMF, 2006, p.11). On the revenue side, the objectives were to improve the transparency and efficiency of the tax system, particularly of the VAT (reducing number of rates), and



strengthen domestic revenue mobilization to offset revenue losses from continued trade liberalization (IMF, 2006, p.11). There was a necessity to improve the overall efficiency of public spending to have sustainability of expenditure savings and the government with the advice of IMF implemented a broad civil service reform helping to gradually curb wage bill growth (IMF, 2006, p.11). By 2005 Early Retirement Program, the size of the civil service reduced and 39,500 employees (8 % of the civil service) left under the voluntary program (IMF, 2006, p.11). The subsidy system was reformed to improve the inefficient current subsidy system by reducing the cost of food subsidies (0.8 % of GDP in 2005) and better targeting the most vulnerable groups (IMF, 2006, p.12). Comprehensive reform in energy sector helped to reduce the fiscal cost of energy subsidies (1.6 % of GDP in 2005) (IMF, 2006, p.12). The authorities' medium-term objective was to reduce the fiscal deficit to 3 % of GDP and to bring the public debt to GDP ratio below 60 % (IMF, 2006, p.12). By the budget law of 2007, the government was trying to reduce a deficit of about 13.5% of GDP (IMF, 2006, p.12). Due to applied measures and reforms the public debt to GDP ratio declined to 57.4 % of GDP, down from 62.7 % the previous year, the budget deficit was reduced to 2.7 % of GDP, down from 5.8 % of GDP in 2005 (World Bank, 2007, p. 2).

For integration to the world economy, Morocco signed Free Trade Agreement with the United States in March 2004 (IMF, 2006). The government initiated several sectoral reforms in tourism, industrial and service sectors. The Plan Azur supported the expansion of the tourism sector, the Plan Emergence of 2005, aimed both at modernizing the existing industrial sectors, such as the textile industry, and facilitating the expansion of new industrial sectors and service activities (IMF, 2006, p.15). The authorities implemented a broad range of incentives to foster the development of offshoring activities, including tax incentives, and the outfitting of four offshore zones (IMF, 2006, p.15).

The modifications in public procurement regulations in the following year had closely related the process of transparent management of public services. Law on public services management of 2006 facilitated the process for public entities and local authorities were allowed concluding a partnership with private service for the performance of public

service(EBRD, 2013, p.3). Moroccan authorities had issued new public procurement regulations in 2007 aimed to fill the identified gaps of the 1998 Decree (OECD, 2009, p. 9). The new Decree set the conditions and terms for public procurement applicable to central government and local authorities regarding competition (scope for informing firms of tender notices) and transparency (negotiated contracts, an automatic notification for unsuccessful tenderers, etc.) (OECD, 2009, p. 9). Morocco was still in the process of the improvement of legislation concerning property rights and specifically for commercial rights to be in line with the European Union standards (Morocco - Protection, 2017). Morocco streamlined the process for registration and transfer of property, but rates of land titling and land rights registration were still low (Heritage Foundation, 2018, p. 305). The law was well defined however because of judiciary lack of independence, implementation of property rights was threatened (Morocco - Protection, 2017). Morocco permitted foreigners to own land, although they were prohibited from possessing the agricultural land (Morocco - Protection, 2017).

Under Financial Sector Development Policy Loan in 2005, the government was obliged to strengthen financial sector's legal, regulatory and supervisory framework f, as well as the restructuring of weak public financial institutions (World Bank, 2005). In the banking sector, the amended law on Central Bank (Bank AL-Maghreb (BAM)) provided more autonomy to the Central Bank to implement monetary policy, banking supervision and authority to intervene in troubled commercial banks. Broadening banking supervision to institutions previously excluded from regulatory oversight strengthened BAM authority (World Bank, 2005, p. 6). Such institution was the Caisse de Depot et de Gestion, a non-bank financial institution which had a significant role through its management of pension fund assets, ownership interests in state-owned banks, investments in national development projects, and substantial holdings of government securities (World Bank, 2005, p. 6). Pursuing the goal of gradually decreasing the role of government in the banking sector, its share in private commercial banks dropped from 40% in 2002 to 23% presently in 2007 (World Bank, 2008). The restructuring of the former specialized state-owned banking sector was mostly complete, mainly the institutional and financial reorganization of Credit Immobilier et Hotelier (CIH) and

Credit Agricole du Maroc (CAM) (World Bank, 2008). The policy of liberalization of the capital account and increased flexibility of the exchange rate in the medium term was one of the objectives of the government (World Bank, 2008). In 2007, the authorities lifted certain restrictions on transactions by residents and increased the scope for financial institutions, banks and enterprises to invest abroad, at the same time, transactions by non-residents had been already liberalized (World Bank, 2008).

During following years, the authorities will try to address the fiscal risks and to keep inflation stable and low, but since 2009 Morocco will experience series of shocks related to international crisis and the political developments of Arab spring. According to Bertelsmann Stiftung's Transformation Index (BTI), during the Arab Spring, the Moroccan government attempted to buy social peace by spending 20% of its budget on subsidizing bread, fuel, and electricity which brought Morocco's deficit to 6% of its GDP in 2012 (BTI, 2016). Government expenditures increased from 27.4% to 29.9% of GDP and government debt from 46.5% to 64.6% since 2009 (BTI, 2016, p. 17).

Since the 1980s the liberalization principles applied in Morocco which reinforced later by Washington Consensus as a package of comprehensive structural reforms, aimed at promoting deep structural changes. IFIs institutionalized neoliberalism in the framework of Washington Consensus as a model of development for developing countries. In the context of critical crisis deep structural reforms aimed to decrease the role of state intervention in the economy and diminish protectionist policies in various sectors. Under SAP I and II, Morocco applied first restrictive budgetary policies implementing massive cuts in public spending and planned a strategy to address the problem of expenditures and revenues. Following the recommendation of World Bank and IMF, the government reduced wage bill growth (civil service reform reducing the size of civil service), cut the energy and food subsidies. However, harsh methods to stabilize expenditures resulted in the increase of unemployment and poverty in urban areas.

After fiscal adjustment, trade liberalization and price decontrolling followed with the program adjustment of the new system of protection by eliminating quantitative restrictions, new tax system, as well as the reform of the financial system, the system of incentives and export promotion. Despite the implemented trade liberalization, the

Moroccan agricultural sector, considered to have the high level of protectionism, remained under state control especially in exports of agricultural products requiring licensing.

The increased autonomy of Central Bank allowed reinforcing prudential regulations. Though the reforms helped to improve the financial system, the role of the government was still extensive. Limited competition led to the uneven development of the system which in turn could not sufficiently contribute to the economic growth of the country. The profound privatization of PE sector allowed opening the key sectors of the economy for private financing. Privatization was also considered as the source of raising revenues which would contribute to the development of capital markets.

The property rights legislation improved considerably. Nevertheless, because of judiciary's lack of independence, the implementation of property rights raises questions. Though foreigners were allowed to have properties/lands in Morocco, this regulation prohibited them from owning agricultural lands.

The neoliberal model of development was considered by IFIs neoliberalism promoters as a panacea for all client countries under debt burden and an only bargain to get new international financial assistance in the form of loans. The package of policies in trade and price liberalization, financial sector and privatization was considered the only way to ensure market competitiveness. Those reforms were deemed to be significant to ensure growth, but the goal of World Bank and IMF for the promised growth and sustainability turned into increased unemployment and widespread poverty in Morocco. Moreover, the applied shock measures and then the low pace of harsh reforms of liberalization in Morocco were accompanied by weak institutional capacities and continued resistance by the government to implement the reforms, particularly in sectors where the state control was powerful.

## **5.2 Tunisia**

### **5.2.1 Macroeconomic stabilization**

In the mid-1980s, the economic situation in Tunisia was worsening with external current account deficit reaching a record level (10.9% of GDP) and encountering serious difficulties in borrowing abroad (World Bank, 1991). By 1985, debt outstanding had risen to 50% of GDP and the debt service ratio to 22% (World Bank, 1991).

In 1986 the decline of oil prices, the fall of hydrocarbon exports volume, lower revenues from tourism, workers' remittances, and the rise of unemployment was putting further pressure on the balance of payments (World Bank, 1991). The decline in net hydrocarbon exports required the development of other sources of export revenues and import substitution (World Bank, 1987, p. 5). Moreover, high and growing unemployment and underemployment rate and the growing rate of active population was also a challenge requiring urgent measures (World Bank, 1987, p. 5). Inflation rose to an average of 10% over this period, and exports slowed (World Bank, 1995, p. 1). Though the policies directed to keep growth high, at about 4.5 %, but the authorities continued external borrowing, constituting 46 % of GDP by 1984 (World Bank, 1995, p. 1). Faced with a heavy debt-service burden, Tunisia turned to the IMF for a Stand-by agreement and then to the IMF and World Bank for SAP in exchange for debt relief (Pfeifer, 1999, p. 450). By late 1985 and 1986, the response to the situation was the preparation of a medium-term adjustment strategy by the World Bank both at the macroeconomic stabilization and reforms in the industrial and the agricultural sectors.

In general, SAL had a broad objective to adjust the expenditures taking into account the debt burden and the decline in oil revenues, as well as to create conditions for rapid growth of an economically efficient private sector and strengthen the increasing export orientation of the economy (World Bank, 1988).

Several Loans were signed under the single SAL lasting from 1987-1991. The corresponding sectoral loans related to agriculture and industry and trade, and PEs restructuring: Two Agricultural Sector Adjustment Loans (ASAL), an Industry and Trade Policy Adjustment Loan (ITPAL) and Public enterprises restructuring Loan (PERL), as

well as Economic and Financial Reform Support Loan. Specifically, the sectoral loan for agriculture aimed to focus on improvements of agricultural policies in the areas of incentives and pricing (at the consumer and producer levels), public expenditure, etc. (World Bank, 1991). ITPAL focused on measures to support the first stage of industrial pricing and trade liberalization (World Bank, 1988). The mission of PERL was to improve management and competitiveness of PEs, support private sector development through privatization and financial/technical recovery of certain enterprises in need (World Bank, 1995).

Tunisia needed to make the economy more outward oriented, and in this regard, primary reform areas were trade liberalization, price liberalization, financial sector reforms and taxation. Stabilization as the first phase of the adjustment process started in 1985 (World Bank, 1992).

Tunisia adhered to the gradual implementation of reforms. In comparison with Morocco where severe economic condition pushed the government to apply shock therapy, Tunisia's macroeconomic environment was very close to being in crisis but still allowed to adhere to the gradual implementation of reforms.

Austere measures were applied to bring the macroeconomic environment to balance by reducing aggregate demand in the economy through some steps; cuts in public spending, consumption, and investment (World Bank, 1993). Macroeconomic stabilization aimed to introduce wage and salary policy, the investment incentives for high priority projects, a competitive exchange rate, an upward adjustment of interest rates, to decrease budget deficit, to liberalize economy including the abolition of price controls and to eliminate quantitative restrictions on imports and reform of the tariff system (World Bank, 1991).

One of the first stabilization measures was the depreciation of the Tunisian dinar (TD) by 23 % in nominal terms in 1986, yielding 17 % depreciation in real terms over the year (World Bank, 1987). In 1985, the government introduced a flexible exchange rate system to maintain the real effective value of the TD and ensure the international competitiveness of the Tunisian economy (World Bank, 1987).

With flexible exchange rate, the government could the rise in the value of the TD to the currencies of partner countries and improve competitiveness on the export markets (World

Bank, 1987, p.57). The next step was the liberalization of interest rates. Mostly liberalizing interest rates allowed bringing up to positive levels in real terms during 1985-86 (World Bank, 1991, p. 5). By 1987, the government set free 75% of lending rates except those for agriculture, exports, small and medium enterprises, energy efficiency projects and about two-thirds of interest rates on commercial banks' deposits were also decontrolled (World Bank, 1991, p. 5).

Regarding monetary and credit policy, the government planned the steps to decline budget deficits. As to monetary and credit policy, the Central Bank reduced net credit to financial institutions by TD 140 million in 1987, and by a further TD 283 million in 1988 as the liquidity of the economy (deposits, capital accounts, and other items) increased (World Bank, 1991, p.5). The existing credit policy toward agricultural sector inhibited the development of a private banking sector and allowed for extremely low levels of repayment (World Bank, 1991, p.8). The government reduced its budgetary allocations to the loan component of its principal subsidized credit program (World Bank, 1991, p.8).

From 1980 to 1984, investment was quite high, around 31 % of GDP and notably, the public sector was characterized by substantial capital investment in inefficient investment projects could provide few jobs and had low economic returns (World Bank, 1993). Wages increased in real terms and exceeded productivity increases (World Bank, 1993). In 1985 and 1986 the government introduced a program of reducing budget deficits first by sharply decreasing public investment and mainly cutting government's contribution towards PE investments. The public sector in Tunisia was quite large including 600 PEs where the state was holding at least 10% ownership and accounted for about 25-30% of value added, 30% of formal sector employment excluding agriculture, nearly half of total enterprise investments, and 75 % of export earnings. The overall increase in indebtedness mirrored in the PE (World Bank, 1989). The public sector had the problem of excess employment. The reduction of excess employment and restructuring or liquidating of targeted PE helped to solve the problem of public expenditures (World Bank, 1995). A program of the restructuring of unprofitable enterprises under PERL Loan reduced budgetary transfers from 7% of GDP in 1990 to 4 % in 1994 (World Bank, 2004, p.10). The next step in PE reform would be the quick privatization process.

The government approved measures on reduction of public investment to cover the gap in the budget deficit. The project selection criteria were set to implement the reduction of the development project expenditures to improve the efficiency of public investments and for the decrease of expenditures in commercially feasible areas to ensure a space for the private sector (World Bank, 1991). Due to these measures decline in 1987 mainly contributed to the fall in total investment as a share of GDP from 23.5% in 1986 to 20.3% in 1987 and 18.8% in 1988 (World Bank, 1991, p. 5). Another aspect of fiscal reforms was the lowering of the expenditures for subsidies. Subsidies used up almost 11% of overall budgetary resources and accounted for 3.5% of GDP (World Bank, 1993, p. 22). Under the SAL, it was agreed to reduce the subsidies and raised prices primarily on the less sensitive consumer items, such as fertilizer subsidies, barley and soya (World Bank, 1993, p. 22).

For mobilization of resources of revenues, the government improved collection of direct taxes, VAT, as well as raised sales taxes on alcoholic beverages and tobacco (World Bank, 1992). By fiscal measures, reforms of the indirect and direct tax systems were introduced. The VAT was established in 1988 to replace three turnover taxes- a multiplicity of rates (13 different rates), and a group of excise taxes (45 different tax rates) (World Bank, 1993, p. 19). In contrast, the new VAT now had only three rates; the principal rate was at 17%, but basic consumption items and professional services would pay 6% and luxuries would be levied a rate of 29% (World Bank, 1993, p. 20). So, the new system was much simpler with an incidence of the tax enlarged and the marginal rate of taxation reduced (World Bank, 1993). Next year the reduced rate of taxation was applied to wholesale trade, excluding foodstuffs. As to direct tax reform, it affected both personal and corporate incomes, which put all these taxes under a unified direct tax, eliminating the double taxation of dividend income (World Bank, 1993, p. 22). It took effect for personal incomes earned in 1990 by setting the highest marginal tax rate on personal incomes at 35%, and extended to corporations in 1991 based on a normal rate of 35% and a low rate of 10% for agriculture, small enterprises, and special ventures, such as retail cooperatives (World Bank, 1993, p. 22). The revenue from direct taxes increased by 15% from 1990 to 1991 (World Bank, 1993, p. 22).



By introducing wage and salary policy, the government intended to control the rapid rise of wages initially through a wage freeze policy, and then, allow nominal wage increases with productivity growth (World Bank, 1993). The purpose was to bring real wages in line with economic reality. Real average salaries declined by 2.9% in 1987 and rose by only 1.2% in 1988 (World Bank, 1991, p. 5).

The efforts directed to stabilize macroeconomic environment were satisfactory as the policies for reduction of budget imbalances gave the desired results. A positive real interest rate and a reduction in the fiscal deficit contributed to a rise in gross domestic savings from 19.5 % in 1986 to 21.9 % in 1994 (World Bank, 2004).

The prudent credit and monetary policies kept inflation contained at 7.2% in 1987 and further lowered it to 6.3% in 1988, and already in 1995, it was 5.8% (World Bank, 1988).

### **5.2.2 First phase of structural adjustment program: 1987- 94**

Simultaneously with stabilization plan, liberalization policies were launched. The peculiarity of Tunisian industrial enterprises was in the preferential treatment of export producers vs. domestic market producers. One group producing for export market exempted from import duties and benefitted from a very favorable fiscal treatment and a group of domestic market producers was heavily protected by import duties and non-tariff barriers (World Bank, 1992). According to the World Bank Report, in 1988 over 90 % of domestic agricultural and manufacturing production was protected by non-tariff restrictions on imports (World Bank, 1991). First of all, producer prices were decontrolled for a group of well-established industries (World Bank, 1991, p. 6). The important step was the reduction of high import tariffs and the elimination of disparities in effective protection levels between various sectors of the economy (World Bank, 1987). The government prepared the gradual tariff reductions policy with an aim to achieve a lower and reasonably uniform effective protection rate of about 25% (World Bank, 1991, p. 6). Tariffs were compressed from a range of 5%-235% to a range of 15%-50% in 1987 and 15%-41% in 1988, and all other import taxes were eliminated or incorporated in tariffs (World Bank, 1991, p. 6).

The government phased out quantitative restrictions to improve incentives for export production, except for capital goods (World Bank, 1987, p.12). Liberalization started with spare parts essential for use in industry, agriculture, hotels, hospitals, raw materials for production pharmaceutical items and semi-finished products for enterprises that export at least 25% of their output, and capital goods for new investment projects (World Bank, 1987, p.12). In agriculture sector in compliance with the ASAL, the adjustment of producer and input prices were set, distribution margins for fertilizer were liberalized and interest rates for agricultural credit were raised (World Bank, 1988, p.26). In 1986, as an additional incentive for exports, firms exporting more than 25% of their turnover were allowed to import all of the inputs they needed freely, and this policy was extended to firms exporting a minimum of 15% of their turnover in 1987 (World Bank, 1991, p. 6). Imports of capital goods and the remaining semi-finished were liberalized in 1988, and as a result, about 75% of all imports liberalized by the end of 1988 (World Bank, 1987, p.12). Remaining quantitative restrictions, mainly those on consumer goods abolished already in 1989-90 (World Bank, 1992). The share of imports subject to quantitative import restrictions was reduced to 74% of the output value of the agricultural, fishery and manufacturing sectors by February 1991 (World Bank, 1992, p. 13).

The strategy of the government over price control abolition was conducted in all other industries with the exception of a few specific investment and agricultural products the prices must remain regulated for social reasons (World Bank, 1993). Despite the measures implemented towards price liberalization, a considerable degree of price controls remained within the economy, specifically commodities subject to monopoly enterprises of products (World Bank, 1993). By 1991, the percentage of products' prices had been decontrolled by 60% (World Bank, 1993).

As a part of SAP, the Tunisian government adhered to financial liberalization and the implementation of the relevant reforms. An essential part of implemented reforms was the liberalization of the banking sector. Tunisia was previously pursuing the economic development strategy focusing on the strong role and control of the state over various sectors of the economy and the financial sector was under the state strict direct control. According to Cook and Hababou and Roberts (2001) “one of the foremost functions of the

financial sector was to collect savings at low cost and redirect them to government and PEs, as well as to priority business sectors.” (p.2). The state intervention was also significant in regulating credit allocation and interest rates, limiting foreign presence in the financial sector (Cook et al., 2001). The government ensured its presence in the banks appointing its representatives to boards of the most banks, thus getting control over banking regulations (Cook et al., 2001). Moreover, non-performing loans (NPL) were a significant portion of bank assets (20%) in government bonds and banks were under pressure to lend to priority sectors at concessional rates of interest and the resultant accumulation of loans to highly leveraged borrowers (World Bank, 1988, p. 19). Foreign investment was quite restrictive and required authorities’ approval, which means that capital flows were tightly regulated (Cook et al., 2001). Following the recommendations of IMF, the government had to reform the commercial banks’ system to create competition and make sure to have an efficient allocation of resources. In 1987 interest rates were liberalized and banks were allowed to make their own credit allocation decisions, as well as in 1988, the requirement for prior authorization by the central bank for credit decisions was eliminated and in 1990 bank financing for some PEs at preferential rates ceased (Cook et al., 2001). The new system of loan classification was established and the requirement of prior Central Bank approval for bank loans was removed above a certain size (World Bank, 1988, p.18). The important step implemented regarding Treasury bills to make it more attractive for insurance companies and other non-financial institutions. Treasury bills redesigned to make them more liquid, and in 1991, the Treasury stopped issuing low-interest, long-term government bonds and Treasury bills had been sold through an auction system since 1989, making gradually accessible also for the general public in 1995 (Cook et al., 2001). Restriction upon foreign participation was abolished to increase outside competition, thus opening banks’ capital to foreign participation and in 1994 the establishment of interbank foreign exchange markets in Tunisia signaled the beginning of decentralizing of the management of foreign exchange (Cook et al., 2001). Though under new Banking Law of 1994 adopted measures significantly strengthened the portfolios of banks, the financial markets remained dominated by public institutions (World Bank, 2004).

One of the main strategies of the Tunisian government was to ensure economic growth, to return to export-driven growth and to change the system of incentives. As a part of liberalization program and as a condition of ITPAL, the new investment code was presented in 1987 to support export promotion which would replace the old insufficient and too complex system of incentives (World Bank, 1991). By the new investment code, the government eliminated the need for authorization for all investments except those seeking special incentives available to no more than an estimated 25-30% of all new investments (World Bank, 1991). All other investments not requesting or not eligible for such incentives could be implemented without any prior government approval (World Bank, 1991). The new code also improved the transparency and consistency of all incentives available for foreign and domestic (World Bank, 1991).

Privatization of SOEs tended to enhance the productivity of ill-performing PEs being a burden on the government budget. However, the process of privatization was not so fast and smooth at the beginning when it was initiated in 1987. It only accelerated in 1989 by Law no.89-9 and had quite extended process till 2008.

The highest number of SOEs was in the sectors of transportation, industry, and banking, but during the first period, privatizations of hotels, textile companies and smaller holdings were completed (World Bank, 1989). From the end-1990 to end-1991, the government sold US\$40 million of its assets in PEs, accounting for less than 0.3% of total assets of PEs as of end-1987; at the end of 1991, after four years of privatizations, only about 1% of the assets of PEs had been divested (World Bank, 1995). The Stock Exchange was privatized in 1994 (World Bank, 1995).

From 1987 to 1994 48 SOEs had been privatized and still, a few hundred remained in the state's portfolio leaving Tunisia with one of the largest public sectors in the world (Guislain, 1997).

The first phase of SAP was considered quite successful by the World Bank experts as liberalization allowed to improve the market environment. One of the significant features of the first phase was the decline of government subsidies and expenditures directed to cover the budget deficit. The strategies directed to export-led ensure growth. A significant feature of the Tunisian export economy was the establishment of the off-shore sector designed to

offset the anti-export bias of the protected domestic economy (World Bank, 2004). The volume of manufactured exports increased on average by more than 8 % per year and total exports by 5 % annually in real terms between 1989 and 1994 (World Bank, 2004). Exports of goods and services rose from 30 % of GDP in 1986 to 43% in 1994 (World Bank, 2004). In parallel, the rise in unemployment reaching 15 % of the labor force in 1990 was a concern urging appropriate measures (World Bank, 2004).

Despite the progress done in overall macroeconomic environment and trade and price liberalization, the implemented policies were incomplete and the steps were required toward the continuation of targeted sectors' improvement.

### **5.2.3 Continued structural adjustments: 1995–2005**

Maintaining sound macroeconomic and fiscal frameworks progress was crucial. Tunisian government development number one priority for the next years was to continue the structural reforms, gradually opening the economy. The government had still a dominant role in the economy and the World Bank and IMF recommendations on export-oriented reforms were in correspondence to the Development Plans of the government to open up the economy to competition while maintaining macroeconomic stability (World Bank, 2004).

The Economic Competitiveness Adjustment Loans (ECAL 1996, 1999, 2001, 2007) aimed at accelerating the pace of structural reforms, particularly in the areas of trade liberalization, enhancing the enabling environment for investment, opening investment activities to the private sector, and reforming the financial sector (World Bank, 2004).

Though the external debt to GDP ratio improved considerably declining from 58 % in 1995 to 54 % in 1997, the domestic macroeconomic achievements were less impressive (World Bank, 1998). The fiscal deficit improved but the difference was small, at 3.4 % of GDP, in 1997 over the 1996 level of 4.0 % (World Bank, 1998). The inflation rate fluctuation and the projected level proved that there was a space to reduce it further as it remained high. The government continued its prudent monetary and fiscal policies. The monetary policy aimed to preserve the internal and external value of the TD, by maintaining low inflation

and keeping the external balance (World Bank, 2004). Monetary policy was tightened in 2001, and the Central Bank drastically cut its refinancing to commercial banks to keep under control the growth of domestic demand (World Bank, 2004).

Despite macroeconomic and structural reforms, Tunisia's growth had relied more on public investment, and private investment remained compressed at around 14 % of GDP (World Bank, 2004). It was required to continue tariff dismantling policies to develop more dynamic and open private sector. In July 1995 Tunisia signed an Association Agreement with the European Union (EU) entailing trade liberalization by a gradual phasing out of tariffs as a part of trade liberalization and directed into deeper trade integration in the global economy (World Bank, 1998). Under the Agreement, tariffs on the import of goods (excluding agricultural products) would be progressively eliminated over a 12-year period (1996-2007), starting with those on capital and intermediate goods (World Bank, 1998). Another negotiation with World Trade Organization ended up with an agreement to complete elimination of quantitative import restrictions (mainly on cars) by 2001 (World Bank, 1998). In 1996, the government adopted Finance Law which included a reduction in tariffs on equipment (World Bank, 2004). In 2000s Tunisia signed the Greater Arab Free Trade Area (GAFTA), the Arab-Mediterranean Free Trade Agreement, as well as agreements with the European Free Trade Association and the Union du Maghreb Arab and various bilateral agreements (AfDB & OECD, 2006).

Price liberalization remained a priority for the government due to a lot of inconsistencies with the strategy aimed to lead Tunisia to the export-led growth economy. Trade protection was still high because of high Most Favored Nation tariffs and specifically in manufacturing (World Bank, 2004). Most Favored Nation tariffs applied in 2005 were 32 %, compared to 33 % in 2004 (AfDB & OECD, 2006, p. 80). At the same time, average duties on agricultural products were 67 %, while the average for non-agricultural products was 23 % (AfDB & OECD, 2006, p. 80).

The reduction in customs duties, as well as other duties and taxes for local products and imports, was implemented according to the trade agreements signed by the authorities. In 2004, a reform of technical inspection procedures for imports was initiated aiming to reduce customs clearance times (AfDB & OECD, 2006, p. 500). Capital accounts

liberalization was also applied. In 2005 non-residents were allowed to purchase up to 5% of Treasury bonds denominated in foreign currency, exporting companies were allowed to make higher level transfers, as well as the right of non-exporting companies was extended to make investments abroad to finance their foreign activities (AfDB & OECD, 2006, p. 500).

The efforts were directed to continue rather a slow process of privatization which would reduce the state control. In 1998, the privatization of large and profitable companies started. The presented agenda of liberalization related to telecommunication sector. However, privatization of public monopoly Tunisie Telecom began only in 2002 and extended till 2008 when the main transaction for the sale of Tunisie Telecom (35% of its shares) took place (World Bank Privatization Database, 2015). Ten companies belonging to four fields of activity privatized and in 1998 alone, privatization yielded revenue of 435 million TD for the budget and balance of payments also greatly benefited from privatization in the form of increased FDI (World Bank, 1998). The government could raise its cumulative privatization receipts since 1987 from 400 million TD to over 830 million within a year (World Bank, 1998). However, the process of privatization declined and in 2005, only four companies were privatized bringing in revenues 2.39 billion TD (about €1.43 billion), of which 74 % from foreign investors (AfDB & OECD, 2006, p. 501).

Private FDI continued to rise in 2002 due to privatizations in telecommunication and banks (World Bank, 2004). Under ECAL the largest insurance company (Tunisian Lloyds) was privatized and another one (ElIttihad) was restructured (World Bank, 2004).

Though some improvements made in the banking system, there was still a problem with NPLs, the banking system was under control of the government and the issue of competitiveness and efficiency of banking sector needed to be addressed.

At the beginning of 1998, the financial sector of Tunisia consisted of the 13 commercial banks and state-controlled banks, eight development banks and eight offshore banks and two merchant banks, at the same time the state was controlling three largest banks and more than half of the banking system's assets (World Bank, 2004). According to Tunisian laws, a bank is public if the government holds 34% or more of its capital (World Bank, 2004). Four commercial banks remained in the public domain (with combined assets that represent 45

% of the entire banking system) to serve “strategic” sectors (i.e., agriculture, housing, tourism, and micro-credit), development banks mostly had suffered from high levels of NPLs and offshore banks provided financial service to enterprises in offshores (World Bank, 2004, p. 12). Actions had been taken to reduce NPLs about 19 % of bank assets in 2001, from over 30 % in 1993, but it again increased to above 22 % since 2002 (World Bank, 2004, p.8). Steps undertook to increase tax deductibility of provisions for NPLs, two government-controlled banks were privatized, and some private banks were recapitalized by owners leading to the financial soundness of a number of banks and significant decline of NPLs ration in 2005 (IMF, 2006). The state-owned banks were still the subject of state interference and the banking system had still limited financial freedom.

As to improvements in the investment environment, FDI reached €488 million in 2004, down 5.3% in 2003 and 44 % on 2002 (AfDB & OECD, 2006, p. 500). Between 2004 and 2005, Tunisia’s trade deficit decreased from 8.6 to 7.8 % (AfDB & OECD, 2006, p. 500). In 2005, the increase in the value of exports was partly the result of the appreciation of the euro (AfDB & OECD, 2006, p. 500). Inflation continued to decline and in 2003 it was 2 % (World Bank, 2004). The satisfactory results were registered in poverty reduction. The incidence of poverty fell from 13 % in 1980-85 to 4 % in 2000 (World Bank, 2004). The same positive dynamic could not be registered for unemployment, particularly among the youth and external debt level. As Harrigan and El-Said mention, one of the reasons for high unemployment rates (15%) was likely to be the extremely rigid labor market legislation making it almost impossible to lay off workers (Harrigan & El-Said, 2010). Another reason they mention was the low investment levels, despite the registered improvements and the wide gap between employment places’ creation in urban as compared to rural areas (El-Said & Harrigan, 2010).

External debt level increased from 69.9 % in 2003 to 71.1 % in 2004 (AfDB & OECD, 2006, p. 500). Despite this increase, the debt service coefficient stayed at an acceptable level of 14.1 % in 2004, against 13.1 % in 2003 (AfDB & OECD, 2006, p. 500).



#### **5.2.4 Improvements after 2005**

After completion of the main packages of structural adjustment reforms in 2005, the loans of World Bank and IMF continued to improve the macroeconomic framework and strengthen the implemented structural reforms. Under the fourth Economic Competitiveness Development Policy Loan provided by the World Bank, the government strengthened the medium fiscal framework. Budget deficit continued to decrease and Finance Act of 2007 reduced it to 3.1%, growth reached 5.3 %, but inflation increased from 2% in 2005 to 4.5% in 2006 mainly due to the significant rise of oil price (World Bank, 2007, p. 11).

The private investment climate had been improved for the development of private sector and the delays in granting the authorizations were reduced.

At the revenue level, the 2006 Finance Act included an increase from 25 to 35 % in VAT credits for companies and customs duties reduced for a new list of raw materials and capital equipment (World Bank, 2007, p. 11). Moreover, the Fiscal law of 2006 re-balanced the rate of VATs to 6%, 12% and 18% for the standard rate, addressing the reform of the taxation system (World Bank, 2007, p. 11).

In 2007 the government cut the taxes but the income and corporate tax rates remained quite heavy. While tariff dismantling led to a decrease in tariff revenues, any losses were compensated for by more burdensome tax rates for onshore companies (BTI, 2010, p.14). The government set top income tax rate at 35% and the top corporate tax rate at 30% for onshore companies (BTI, 2010, p.14).

In the banking sector, three state-owned banks controlled 38.7% of total assets, 43.5% of loans and 36.5% of total deposits at the end of 2009, hence about one-third of the Tunisian banking system (AfDB, 2012). The banking sector was strengthened by increasing the level of tax-exempts provisioning to 100% to improve the level of provisioning of NPLs, banks with the insufficient level of provisioning were mandated to affect 100% of their benefit to improve their provisioning (World Bank, 2007, p. 11). All banks had been required to reach a provisioning ratio of 70 % by 2009, up from 46.4 % at end-2005 (IMF, 2006, p. 4). Despite this improvements, Tunisian banking system could not improve the performance

keeping high levels of NPLs at 13% at the end of 2010, a low provisioning rate at 58% at the end of 2010, and low capital adequacy rate at 12.4% (AfDB, 2012).

The exchange rates and capital accounts were still under the strict control of the Central Bank, even though exceptions were accorded to export-related activities (AfDB, 2012). The insurance sector was strengthened by restructuring two major insurance companies the Societe Tunisienne d'Assurance et de Reassurance (STAR) and le Groupe d'Assurances Mutuelles (MGA), thus allowing the foreign investors being majority owners in the capital of insurance companies (AfDB, 2012). While the measures applied for the improvement of the business environment in offshore sector to develop export-oriented industries and the sector was relatively free and competitive, the domestic private sector still was well behind with burdensome regulations and controls of the public sector. The public sector dominated all the strategic sectors in the economy such as energy, transport, telecommunications, pharmacy, collection and trade of basic food, and basic commodities prices were controlled by the government as well, not to mention that nine largest firms of the country are SOEs (AfDB, 2012).

Tunisia's private investment share was still under 60% of total investment and less than 15% of GDP and especially in the onshore sector, there is a significant gap between rules and practices (AfDB, 2012). In parallel, foreign investors were not allowed to have majority ownership of Tunisian companies without government approval and domestic trading was granted only to Tunisians (nationality and majority of capital) (AfDB, 2012). Moreover, foreigners could not own agricultural lands and investments in non-tourism onshore companies with a capital share larger than 49% require government authorization (BTI, 2010).

To fix the problem existing between regulations in offshore and onshore fields it was necessary to reform the incentives system. In 2007 the government revised the Investment code by reducing restrictions to majority capital ownership by foreign investors (World Bank, 2004).

As to privatization processes, the government sold Tunisair in 2006 which allowed to generate proceeds from privatization and reduce the budget deficit to 2.1 % of GDP (AfDB & OECD, 2006).

To ensure macroeconomic stability and liberalize the economy, Tunisia decided to turn to the IFIs. SAPs included trade and price liberalization, privatization of SOEs, financial sector reforms, taxation, devaluation of the national currency and restrictive monetary policy. Neoliberal package of reforms considered successfully implemented in Tunisia, nevertheless, recorded a lot of shortcomings. While reforms in Tunisia's foreign trade regime supported to the liberalization and to the process of dismantling trade barriers in 2008 as a result of an agreement with the EU, but foreign trade regime was still heavily regulated, public sector dominance over private sector was tremendous not mentioning the problems related to corruption and transparency. Pricing was almost free except the cases when the state can set prices for subsidized commodities and influence on prices through regulation and state-owned utilities and enterprises and monopolies (BTI, 2010). In general, Tunisian authorities were reluctant to follow the recommendations regarding monopolies and prices subject to monopoly enterprises of products remained unchanged.

In the financial sector, despite the reforms, the banking sector and capital market were still considered heavily regulated, and financial regulations had political influence as elite had direct control. Although the state sold its stakes in two banks in 2002 and 2005, respectively, the country remained the controlling shareholder in at least four other banks with 50% of their assets (BTI, 2010, p. 16). The interference of the state was presented in direct control of financial flows, as well as with the presence of elites' representatives in top positions of banks' regulating bodies.

Neoliberal reform of foreign investment remained restrictive with the required approval which allowed tightly regulating the capital flows. The slow process of privatization directed to reduce the state control was much rooted in a bad organization of the divestiture. Here again, World Bank and IMF promoted a neoliberal model of development putting the accent on economic growth which would eventually combat increased unemployment and poverty.

In parallel with the liberalization of the economy, Zine al-Abidine Ben Ali's seizure of power in November 1987 was a signal that more pluralistic political system would be developed in Tunisia (BTI, 2010). As such, since 1999 Tunisia hold, in formal terms, pluralistic presidential elections, following with Constitutional amendments made in 2002

which allowed the President in coming presidential elections of 2004 and 2009 to run for a fourth and fifth mandate (BTI, 2010). The President could adopt his power based on the ruling party and the opposition parties that could resist were banned and even legalized opposition parties did not influence ruling party. All branches of power were under the direct executive control of the President.

Hence significant transformation shortcomings and resistance in liberalization process of the economy and the continued state interference and control of economy were also the reflections of the autocratic political reality of Tunisia. The political turmoil of 2010 leading to the revolution ended up with the resignation of Ben Ali.

Despite the improvements in liberalization policies, high unemployment rate, poor living conditions, widespread corruption and lack of political freedoms reflected in the struggle for political regime change.

### **5.3 Results of Neoliberal policies in Tunisia and Morocco**

The package of Washington Consensus policies in the form of the structural reforms aimed to decrease the role of state intervention in the economy and diminish protectionist policies in various sectors of the economy. The comprehensive package of Washington Consensus principles with harsh methods imposed on Morocco and Tunisia to overcome the critical crisis. The institutionalization of neoliberalism by IFIs and the promotion of Washington Consensus agenda with a focus on the importance of SAPs are considered as a backbone for developing countries. Neoliberalism which turned to emerge as a useful tool to reduce state control on the economy and to ensure economic efficiency, on the contrary, became merely an instrument in the hands of the World Bank and IFM to rapidly transform Morocco and Tunisia into the models of growth. Growth promoted by World Bank and IMF was considered as an essential element for market-oriented economy and the imposed SAPs were implemented in the context of development. As Stiglitz (2002, 2008) emphasizes the concept of growth for developing countries has been summarized as liberalization, stabilization and privatization (as cited in Babb, 2013, p. 270). SAPs had been developed within these three pillars and promoted as merely an economic agenda and

imposed by World Bank as a universalistic approach without accounting the particularities of the countries. Rapid transformation into the models of growth turned to be the prolonged implementation of deep structural reforms. Washington Consensus agenda dogmatically promoted the prescriptions whereas the governments in Morocco and Tunisia could not find the balance between the concept of withdrawal of state from the market and its capacities for the institutional development of the markets.

Morocco and Tunisia, as one of the client countries, became a laboratory for the implementation of economic policies promoting theory of neoliberalism intertwined with Washington Consensus policy instruments. The theory, which favors a reduced role of the state in the market, but as a development prescription institutionalized by IFIs, pushed forward a set of conditions on client countries to receive international assistance. In case of Morocco and Tunisia, these prescriptions in the form of SAPs transformed the ideological and political background of neoliberalism to severe neoliberal model for development. The imposed aggressive neoliberal policies had been implemented ignoring the political and institutional context of the both client countries. IMF and World Bank's SAPs enforced "free market fundamentalism" neglecting the weak institutional capacity and the presence of autocratic regimes. The applied severe neoliberal model in Morocco and Tunisia was not just the rejection of the previous economic model but rather a "dogmatic laissez-faire attitude" without ensuring the framework within which the competitive market could flourish. According to the World Bank reports the results of the macroeconomic measures and structural reforms were assessed as sufficient in the context of enhancing the business environment and improving the competitiveness of the economy. However, neoliberalization in Morocco and Tunisia has not been very effective in regard to the market consistencies. The problems of establishment of effective markets also were conditioned with approaches of structural reforms' speed of implementation recommended by the World Bank. The chosen approaches to adjustment mostly conditioned by the deep destabilized financial and economic situation in Morocco. The applied faster macroeconomic stabilization policies and gradual implementation of other structural reforms created a distortion. Tunisia started a more liberal approach to the economy and adopted a premarket strategy of liberalization earlier than Morocco. Adhered to gradual

approach of reform implementation, Tunisia was much quicker to adjust to the new environment due to also its mixed economy character in the 1970s encouraging FDI. Both countries' economies characterized by strong state domination and interventionism but their starting points of economic development were diverse to some extent. Morocco and Tunisia could gain relatively macroeconomic stabilized environment, but the reforms, considered to adjust the economic structure of the countries, were propagated by IFIs as the main panacea to ensure growth. The strategy to increase growth and keep inflation under control, transformed neoliberal reforms implementation into a "checklist" by authorities inducing opposition entirely to follow the forced recommendations. The resistance showed up specifically in sectors where the state was reluctant to follow the policies directed on reducing the central control on decision-making.

Morocco and Tunisia required setting an economic agenda that would promote not just the withdrawal of the state from the market but to help in the separation of the economic power from the political influence.

## **6. Roots and Evolution of crony capitalism**

### **6.1 Morocco**

The political history of Morocco is characterized by the authoritative rule of the King and his centralized use of power (Biygautane & Lahouel, 2011). Though it is a “constitutional monarchy,” the King’s supreme power gives another picture of political reality in Morocco. He is the head of the state and the Supreme Representative of the Nation, he appoints the Cabinet members, the Prime Minister, and has the authority to dismiss them and even can dissolve the legislature on his initiative (Biygautane & Lahouel, 2011, p. 6). Despite the existence of a bicameral Parliament, the real decision maker is the King and the government approves whatever decisions are made by the King (Biygautane & Lahouel, 2011). Desrues and Moyano state that while the Kingdom has a multi-party system, the political parties are marginalized which allowed King Hassan II (1961–99) to be the only supreme representative of the nation, as well as he monopolized relations between the different interest groups in Moroccan society (Desrues & Moyano, 2001). During decolonization from French protectorate, the King’s makhzen (royal household) could acquire settler property and distribute it to its strategic clients (Cammatt, 2007). Saadi considers that a “critical juncture” in the making of Moroccan crony capitalism was “Moroccanization.”(Saadi, 2016). The King took over some richest lands and became one of the largest landowners and with nationalization “Moroccanization” of industrial and commercial properties in 1973, most of the enterprises went to the groups of private entrepreneurs who were the part of makhzen (Cammatt, 2007).

Proclaiming nationalization allowed officially transfer the majority ownership of French-owned companies to Moroccan business groups and a preferential treatment enabled the economic elite to strengthen its assets through its closeness to the makhzen (Biygautane & Lahouel, 2011).

Moroccan King became a central actor in the process of Moroccanization when he took over important foreign companies, particularly the French group called “Omnium Nord-Africain” (ONA) and Unigral Cristal (Saadi, 2016). Specifically, financial sector shows the domination of Moroccan private elites, as the control of main banking companies provides

with a considerable profit and economic influence. Other important holding families perform the same strategy, such as Lamrani family (SAFARI-SOFIPAR group) with close ties with makhzen (Oubenal, 2016).

The initiated neoliberal reforms aimed to reduce the strong role of the state and eradicate the existing system of cronyism and in this context, it is essential to understand the way privatization was processed which can be very useful to explain whether the network of makhzen was extended or not. As a neoliberal policy and in the framework of Washington Consensus, privatization is considered to lessen the pressure on the government budget, as well as private industry is managed more efficiently than SOEs. Moreover, at the same time, it has also the objective to stimulate the participation of middle-income population which will also help to extend property ownership (Kim, 2005).

Under the SAL I Agreement Morocco obliged to implement the first phase of privatization. Though King Hassan announced about the necessity of privatization in 1986, the process began only in 1993. Morocco's Privatization Law 39-89 presented the list of 112 SOEs (later increased to 114) to be privatized (World Bank, 1995). The target enterprises should meet the particular criteria including (actually or potentially) profitable operations, the absence of serious overstaffing, no public service responsibilities, a significant share of state ownership, and a role in regional development (World Bank, 1995). Najem emphasizes that the criteria established by the authorities regarding identifying preferred buyers tended to favor the traditional Moroccan elites (Najem, 2001, p. 63). 37 of the companies on the original list were hotels, 43 manufacturing enterprises, four main banks, insurance companies, finance companies and service companies, as well as big industrial businesses (particularly in the cement, steel, petrol, phosphate and mining sectors), in the area of public services such as post and telecommunications, transport, state-owned water and electricity companies (World Bank, 1995). The Law specified method of sale for Moroccan companies. The companies to be privatized by initial public offering on the Casablanca Stock Exchange could be acquired through direct negotiations if the potential buyer demonstrated that he was the most logical potential purchaser and the existing majority shareholder (World Bank, 1995, Ernst, Edwards, Gladstone, Gregory, & Holt. 1999). Employees might also be permitted to buy up to 10% of the share capital of the



company, or 20% of the State holding (World Bank, 1995, Ernst et al., 1999). The principal methods of privatization through competitive bidding are the sale of assets or shares through public auction or tender, and the public offering of shares through a stock exchange (World Bank, n.d., p.7). According to legal guidelines of the World Bank "except in the case of pre-existing contractual rights such as pre-emptive options to purchase held by existing private shareholders, a direct negotiated sale to a single buyer should be avoided" (World Bank, n.d., p.7). Hence, it is desirable to use the public auction or tender and public offering through the stock exchange than the direct sale (private contract) for privatization which is a conventional method but due to its complexity and lack of means ensure proper transparency may be considered a source of corruption, specifically in transition economies.

Most of the companies had been presented for privatization through first bidding but then purchased by direct sale (World Bank Privatization Database, 2015). According to Najem (2001) "the favored type of divestiture tended to involve at least a partial sale of a given privatizable asset to a *noyau dur* (or hardcore) of investors before it was listed on the stock market. These cores of investors tend to be comprised of elements with strong links to the regime."(p. 61). Hence, in that case, a hardcore of investors would prefer the sale of companies through direct negotiations allowing generating more revenue instead through open tender or the stock market. So, giving preference to *noyau dur* form, we conclude that the regime tended to use the privatization program to continue its traditional tactics to secure and extend the cronyistic links within the elite by linking it with the private sector. The choice of *noyau dur* complicated the situation with transparency which is crucial in case of privatization as in case of sale on the stock market the concerns regarding transparency will not be debated during the bidding process. As Mansouri et al. (2005) mentioned "the 'cake' of privatization seems to be mainly profitable for the bigger local and foreign capital" (p. 34). Employees' participation and acquisition of shares in the bidding process was not tangible, as according to Privatization Law allocation of shares to employees was not considerable. Moreover, average Moroccan employees, including the middle-income population did not have enough income to acquire a large number of shares. Whereas as Najem mentions the traditional economic elites were the only who could have

the capital to offer for shares in state holdings (Najem, 2001). Thus, the objective of privatization to bring the middle-income population into the privatization process and in that way to help to extend property ownership to broader segments of the society could be considered as failed.

As a part of the privatization program, foreign investors were invited to bid as strategic investors (part of the *noyau dur*) (Ernst et al., 1999). The participation of foreign investors was significant as a part of the liberalization implemented in FDI under SAL I in 1983 and 1988 and Sectoral Adjustment agricultural loan, and the acquired share of assets by foreign investors was registered as a significant step forward, but Moroccan companies or individuals purchased the majority of companies. The data shows that by the end of 1994, based on the initial privatization list, the privatization transactions registered from the following countries: Morocco 62.7%, Switzerland 11.9 %, UK 8.5 %, France 8.7 %, USA 4.2 %, Others 4.0% (World, 1995, p.12).

If we consider that one of the primary objectives of the privatization was the reduction of budget expenditure by selling loss-making companies, the list of the companies for privatization must be composed of these companies. But the Table 1 below shows that according to the audit implemented by the World Bank, the giant companies with the negative profile (net profits) or with less profit were not on the privatization list. We based on the World Bank report on the summary of the data available on significant PEs.

Table 1. Data on major public enterprises

Public enterprise name	Year	State share	Net profits (million)
ONE	1994	100	-819
ONEP	1994	100	-81
ONCF	1994	100	-744
ONPT	1994	100	209
ONDA	1992	100	-124
RAM	1994	93,82	101
COMANAV	1994	68,62	4,4
ODEP	1994	100	30,5
BRPM	1994	100	-0,2

*Source: World Bank Privatization, 2015 and Ministry of Economy and Finance of the Kingdom of Morocco, 2010*

Though these are only the part of massive PE because of the lack of data, it shows that the companies have not been included on the initial list for the privatization. Undoubtedly there can be various explanations why the government did not present first the loss-making PE for privatization. Najem states that the logic behind is the difficulty in selling loss-making companies but the regime was also concerned with using the sell-offs as a form of patronage to secure and extend their already strong links with the Moroccan private sector elements that were most likely have both the interest and the capital to buy into the traditionally state-run industries (Najem, 2001, p. 59). Thus, on the initial list, a lot of companies were among the profitable ones. Another indicative was the sale of two largest companies ICOZ and SIMEF to Moroccan-International Consortium at a meager price (1.2 \$ million, 10 million in MDH), through the direct sale with share of 97,44% (World Bank Privatization Database, 2015).

Catusse emphasizes that based on examination of privatization operations it is obvious that just a few groups were regularly presented during offers and purchase of the companies (Catusse, 2009, p.9).

When presenting the roots of cronyism in Morocco, we referred to several groups of Moroccan private elites that dominated in the financial sector during Moroccanization. Catusse discusses the case of Omnium Nord Africain (ONA), the private holdings of the royal family, which became the principal national winner from the privatization (Catusse, 2009, p.9).

During the second phase of privatization launched under the SAL II covering broad specter of state enterprises in various economic sectors, Group ONA purchased the enterprises in mining mostly through direct sale (World Bank Privatization Database, 2015). As Catusse mentions, for ONA it was the occasion to deploy a “multi-sectoral strategy” (Catusse, 2009, p.10). In their works, Catusse and Denoux mention that the royal family is the primary shareholder in Morocco's largest private conglomerate, ONA-SNI (Catusse, 2009, Denoux, 2007). In the privatization dataset of the World Bank Database, the Group ONA listed as the purchaser of SNI (Societe Nationale d'Investissement) a public holding with large stakes in manufacturing, mining, commerce, and services and sugar production as well (World Bank Privatization Database, 2015).

Already in 1994 and 1995 with the help of FMDL, the privatization was also implemented regarding the financial sector and ten financial institutions (banks, insurance companies, and a large financial holding) were privatized (World Bank, 1995, p. 7). ONA-SNI conglomerate, behind the name of the Consortium of Moroccan financial institutions, privatized a lot of enterprises not only in mining but also banking sector, insurance, real estate, agribusiness, and communication. The King Mohammed VI of Morocco inherited a 35% stake in SNI (formerly ONA-SNI, formerly ONA) and significantly developed it (Lhomme, Benchemsi & Davet, 2016). Since then it is the ruling family's main source of wealth controlling, often with majority shares, 34 companies, and covering a dozen major economic sectors with stakes in the country's largest bank, Attijariwafa, mining company Managem Group, sugar producer Cosumar, and dairy firm Centrale Danone (Lhomme, Benchemsi & Davet, 2016). Oubenal emphasizes that the control of financial sector, mainly banking companies by the monarchy and its surrounding were conditioned by the fact that it was a very profitable sector and during the 2000s the value-added of financial activities was higher than industrial sectors as well as the concentration of capital specifically of bank companies was also significant (Oubenal, 2016). He refers to the listed three main banks on Casablanca Stock Exchange (Attijariwafa bank, BCP and BMCE Bank) with the concentration around 65% of assets, deposits, and loans (Oubenal, 2016, p.6). Catusse notes that together with a few other big groups (Benjelloun family, Kettani, Akhannouch, etc.), this conglomerate "reinforce their acquired positions and diversify in all directions" (Catusse, 2009, p.10). Benjelloun family is the owner of BMCE Bank which is one of Morocco's largest banks and has activities in more than 15 African countries, not mentioning that through his company FinanceCom, Othman Benjelloun, the 81-year-old businessman, has investments in banking, insurance, and telecom in Morocco (Allilou, 2014). It should be mentioned the name of Moulay Hafid Elalamy as a political figure to understand the interconnection between various big groups regarding business and their position. He owns an estimated 83% of Saham Group, which operates CNIA Saada, one of Morocco's biggest insurance companies (Salako, 2015). In June 2015, Moulay Hafid Elalamy formed a joint venture with FinanceCom, owned by another Moroccan billionaire Othman Benjelloun, to broaden the insurance and other financial products market

throughout Africa (Salako, 2015). At the same time, Elalamy also had occupied the position of Secretary General of the group, and General Manager of the insurance subsidiary (Ministry of Industry, Investment, Trade and Digital Economy, n.d.). At present, he is Morocco's Minister of Industry and Commerce (Ministry of Industry, Investment, Trade and Digital Economy, n.d.).

Aziz Akhannouch is one of the representatives of the families in this big group of business. He has stakes in Akwa Group, a multi-billion-dollar Moroccan conglomerate with interests in petroleum, gas, and chemicals through its publicly-traded subsidiaries Afriquia Gas and Maghreb Oxygene, as well as in media, real estate development and hotels (Allilou, 2014). In parallel, he is also the Minister of Agriculture and Marine Fishing, as well as administrator of BMCE-Bank (Ministry of Agriculture and Fisheries, n.d.).

According to Oubenal, Lamrani family (SAFARI-SOFIPAR group) became a shareholder in different commercial and industrial companies and the principal shareholder of the bank Credit du Maroc (Oubenal, 2016). In general, Lamrani family's economic extraction and linkage with political power can be traced during Moroccanization period when the Prime Minister of 12th and 13th governments of Morocco was Mohamed Karim Lamrani, (August 6, 1971) (12 April 1972) (Ministry of Culture and Communication of Morocco, n.d.). Lamrani was the Prime Minister of during 19th, 20th, 21st, and 22d governments implementing SAPs and during the privatization as well (Ministry of Culture and Communication of Morocco, n.d.).

We already discussed the deal type of privatization and that the majority of deals were conducted through direct negotiations. However, we assume that it cannot be the only indicator that elites and groups who already held concentrations of considerable capital used this deal type to reinforce the economic power. It should be mentioned that the bidding process regarding the financial sector and specifically banks and insurance companies were also implemented through tender or public offering in the stock market (World Bank Database, 2015; Ministry of Economy and Finance of the Kingdom of Morocco, 2010). But the purchaser of companies in the banking sector and insurance was predominantly Consortium d'institutions financières marocaines which also was the buyer of SNI as a part of Group ONA conglomerate.

Though the process of privatization boosted foreign investment participation, it is noteworthy to mention that before SAPs the Moroccan elites had been implementing the restrictive policies of foreign ownership of certain economic sectors which was mostly conditioned with the reduction of the French businesses dominant role in the Moroccan economy. During the 1990s, under FMDL directed to address FDI as a neoliberal policy, the new investment code was adopted in 1995 tending to improve the investment conditions and promoting FDI flows (World Bank, 1995). Morocco reduced the level of restrictions. However, the investment code prohibits foreigners to have ownerships predominantly in the agricultural sector, monopolies on phosphate and applies discretionary right to limit all foreign majority stakes in the capital of large national banks (World Bank, 1995). Investing Across Borders indicators measuring FDI regulation show that despite the banking system is quite competitive, there are limits on foreign capital stakes in the large established banks. Moroccan central bank (Bank Al Maghrib) may use regulatory discretion in issuing authorization for the establishment of domestic and foreign-owned banks as well (Bureau of Economic and Business Affairs, 2017).

Regardless of the liberalization reforms, the case of privatization was likely to serve as a mechanism for the influential families to keep their domination in the spheres where they have control and ensure the influence of monarchy over the multiple essential sectors of the Kingdom. If market-oriented neoliberal policies directed to lessen the role of the state and to abstain from using the political control to intervene in market regulations, in case of Morocco, we can see that cronies not to lose the real advantages, tried to use the reforms to protect their interests and to consolidate their economic power. Moroccan regime could channel the privatization in a way benefiting the elites which was also conditioned with the fact that other stakeholders did not possess enough financial resources to privatize the enterprises and in this context the royal family and closest surrounding reinforced its economic positions almost in all sectors of the economy. We provided here with the process of privatization to show that even with the determined objectives of the market-oriented policies, the elites tried to serve the reform for redistribution of the economic power and enlarge the existing ties between state and small interest groups. The state interventionism though reduced but was still strong enough to grant economic opportunities

to the higher echelon of the elite who used privatization in the process of restructuring of power to institutionalize cronyism. Hence, the interpersonal and cultural phenomena of cronyism developed into the systematic and structural feature: crony capitalism.

## **6.2 Tunisia**

Tunisia is a unitary semi-presidential representative country which after gaining the independent from France was ruled by the President Bourguiba leading the state to a highly centralized system of governance and authoritarianism (Biygautane and Lahouel, 2011). In 1987, Zine Abidin Bin Ali, a military figure overthrown Bourguiba in a coup, initially paving the way for democracy, but he could consolidate the power and became more repressive head of state than Bourguiba (Biygautane and Lahouel, 2011). The Parliament was one of the weakest institutions in the political system of the country and though the opposition had seats in the Parliament the decision making was monopolized by the President (Biygautane and Lahouel, 2011). The centralized form of the political structure of Tunisia had its influence on the economic orientation of the country. State interventionism was practicing as a model since decolonization when French private companies transferred to the state. As Pfeifer states, under Bourguiba, the state took control of natural sources, notably phosphates and hydrocarbons, finance and banking (Pfeifer 1999). Under Bourguiba, the preferential treatment was a common practice specifically for clans coming from regions which doubled the wealth at the expense of other parts of the country. It indicates that Tunisia' regions developed disproportionally as business clans ran the most privileged ones. Moreover, Bourguiba's government inherited and acquired facilities of the infrastructure like transportation, railways, ports, telecommunications, and banking (Biygautane and Lahouel, 2011). Cammett (2007) indicates that "unlike in Morocco, where the big groups had stakes throughout the economy, Tunisian business owners tended to confine their holdings to a single sector, focusing either on manufacturing, banking, or mining"(p. 77).

With neoliberal economic reforms introduced during the 1980s and 1990s, the level state interventionism should be reduced and in this context, the use of privatization methods applied in Tunisia will be helpful understand what the dynamics in Tunisia were.

Tunisia obliged to reform its vast public sector and launched its privatization reform under Public enterprises restructuring Loan (PERL) which was the part of single SAL lasting from 1987-1991. The mission of PERL was to improve management and competitiveness of PEs, support private sector development through privatization and support the financial/technical recovery of certain enterprises in need (World Bank, 1995). Law 87-47 was the first document proclaiming to restructure the public sector in 1987 and to create a commission which would decide on the list of enterprises to be privatized. However, the process of organization and implementation of privatization was a complicated one in Tunisia because Tunisian executive body had unlimited power and leverage to keep away from the active participation of other stakeholders in the policy-making process of privatization.

According to Belev even the word ‘privatization,’ was rarely mentioned and instead, the ‘participation in public enterprises’ and ‘restructuring’ phrasing was mentioned not to involve the potential stakeholders in the process (Belev, 2001). However, the organization of privatization process extended with similar arrangements in 1989 in the framework of public sector reform under PERL aiming to entirely or partially liquidate state-owned companies or transfer the responsibilities to non-state shareholders.

Only in 1994 with Law 94-102, the scope of the framework was defined including the intention to privatize also banks and insurance companies. ECAL of 1996 aimed at accelerating the pace of structural reforms and privatization of large companies as a part of conditionality continued in 1998, particularly the large and profitable companies in telecommunication and banks. Between 1997 and 2003, ten companies belonging to four fields of activity were privatized (World Bank, 1999). In comparison with Morocco, the peculiarity of Tunisian government during the process of privatization was the absence of particular plans and the exact list of enterprises targeted for divestiture. In comparison with Morocco, where the target enterprises should meet the defined criteria regarding identifying preferred buyers, Tunisian Decree on Privatization had set only the general concepts and



listed the bodies responsible in the process of privatization. The selection criteria, regulations, and scope of methods to be used for privatization were not included in Law, only the list of public companies that must not be privatized, such as strategic ones (Sagir, 1993). Even the World Bank's Privatization database does not sufficiently provide the list of targeted enterprises, sector and deal types of privatization due to the lack of information from the state authorities. We assume that the designed Law allowed the corresponding state agencies in charge of privatization to maneuver on open space with unlimited discretion. Belev considers that regarding the privatization the government permitted the information in only one way, from the top down, and little feedback was asked for (Belev, 2001). Belev emphasizes that while initially it was decided to privatize the loss-making enterprises, the situation had been changed already in 1994 when it was extended to profit-making enterprises and even the ones considered being strategic ones (Belev, 2001).

On the contrary to Morocco, among the multiple methods of privatization with the level of state involvement in the process of implementation, Tunisia mostly adhered to the privatization through the sale of assets or shares through public auction or tender, and the initial public offering of shares through a stock exchange selling. Though there were the cases when the enterprises privatized through direct negotiations or distribution of vouchers and applying liquidation or merger for several loss-making enterprises, predominantly the government chose the mentioned methods as a basis for competitive bidding. Moreover, the government declared that the employees of SOEs would have given the priority in acquiring shares in the enterprises. Belev notes that the government could reduce potential opposition from labor providing priority to employees and also facilitated to apply the methods of divestiture which would limit the number of players involved in the transactions (Belev, 2001).

By using the strategy of selling shares on the Tunisian Stock exchange the ruling elite tried to broaden its ownership through privatization. The problem was that those deals related to the small investor transactions. The Tunis Bourse set the standards for companies which many of the listed ones could not meet. The government also used "a golden share" concept regarding the privatization of several sensitive companies which allow to veto and keep control rights over the company to be privatized, including the sale of one or more assets

(Belev, 2001). Marquardt and Clark (1994) mention that the “Golden Share was never a real shareholding but rather a protectionist legal facility that gave the government added control over the eventual ownership of its newly privatized companies”(p. 417).

The portfolio of the Tunisian public sector was quite extensive. Though the real wave of privatization started in 1995, since 1988 the government tried to sell the companies in the service sector and some agricultural enterprises. The deal type of these transactions is not indicated in the World Bank Privatization dataset, and only the transactions of enterprises since 1995 are noted in the database. So far, the majority of these transactions have been carried out through a sale of assets to strategic investors (World Bank Database, 2015). Here, again we face the problem that Najem raised regarding privatization process in Morocco having the similarities in Tunisia privatization program. The choice of strategic investor or a hardcore (a noyau dur) could shed lights on the transparent process of privatization. Belev indicates ‘spin-off’ (cession) or ‘merger’ (fusion) was used to cover sale of a part or an entire enterprise to a strategic investor (Belev, 2001).

Under ECAL of 2007, the government obliged to revise the Investment code in 2007 by reducing restrictions to majority capital ownership by foreign investors (World Bank, 2007). The new Investment code allowed foreign investors to participate in privatization and to purchase Tunisian companies. However, most of the enterprises were sold to Tunisians.

The reforms implemented must support the reduction of control of central government, but in the context of privatization, the government behaved the opposite way utterly. Privatization cannot be transparent and to coincide with its stated objectives if the government does not ensure active participation of other stakeholders, such as public sector managers, private sector investors and unions in the process of privatization. Starting from the declaration about PE restructuring and later vague interpretation of the corresponding Law and limiting the debate around the privatization program were the signals that the state control over the process of privatization would likely be implemented in a protectionism way of the essential sectors. The small private sector was still under the process of development and had no sufficient financial resources to acquire shares. Another problem was that business environment was unable to operate without the support of the public

sector and the subsidies provided by the state. At the same time, big enterprises were mostly controlling the key sectors of the economy. This reality created the inability for the small private sector to be fully participating in the privatization. Pfeifer mentions that many big enterprises were owned by the elite which increased the probability of protectionism and unfair competition and the possibility of the unequal distribution of benefits of the market-oriented reform process (Pfeifer, 1999). If one of the main points of privatization is the abolition of state monopoly, in Tunisia it turned to be a private monopoly and the state mechanism was used to secure it, thus limiting the competition and consolidating the economic power. Cammett (2007) emphasizes that “prominent families – usually those with close connections to Ben Ali and his family – expanded their holdings significantly across diverse sectors” (p. 78). Among the examples was the won a public auction in 2000 by Marouane Mabrouk, one of Mr. Ben Ali's sons-in-law, to acquire a controlling stake in Le Moteur, a state company that distributes Mercedes cars in Tunisia (Gauthier-Villars, 2011). He also won a government license to set up Tunisia's first broadband-cellphone network (Gauthier-Villars, 2011).

Another example of the widened network of cronies is Sakher El Materi business activity, the other son-in-law of Ben Ali who controlled the Princess Holding of Tunisia, the largest conglomerate in Tunisia which held various companies in the industry sector (Wigglesworth, England & Parker, 2016). He first made money by investing in and reselling companies that were being privatized (Gauthier-Villars, 2011). In 2006, he bought a 41% stake from state-controlled Banque Nationale Agricole SA for 3.6 million TD, in the Tunisian unit of Swiss food group Nestlé SA by using some of the proceeds (Gauthier-Villars, 2011).

Mr. El Materi founded a Bank Zeytouna, Tunisia's first Islamic Bank, bought a 25% stake in Tunisia's second-largest telecom operator, got elected to parliament and acquired a media group, Radio Zitouna (“Banque Zitouna - Tunisia Opens,” 2010; Gauthier-Villars, 2011).

It is only the top of the iceberg of crony capitalism network cherished and promoted by Ben Ali. The system of privileges and network of cronies is not a new phenomenon in Tunisia, as it has already functioned during French Protectorate and enlarged after independence. Nevertheless, with the launch of a privatization program, it expanded with new wave within

the frames of neoliberal reforms. Cammett argues that notable shifts took place in a system renowned for crony capitalist ties between the state and small elite that controls vast holdings across the multiple sectors of the economy (Cammett, 2007, p. 6). As Freund et al. emphasize interventionism became increasingly directed by the country's elite for their benefit (Freund et al., 2014). After the revolution, when Ben Ali had to flee Tunisia, the new government issued a Declaration listing the names of Ben Ali and his wife family links that owned hundreds of companies. The network of cronies from Ben Ali and Trabelsi family counted 112 people subjected to international prosecution and their companies were confiscation with the assets freeze abroad (Décret-Loi n° 2011-13). In the context of privatization, the President and his family could group close associates expanding their crony activities which allowed them not only to survive but also to develop their firms' opportunities using state intervention policies regarding competition. The non-democratic nature of the regime promoted the potential development of cronyism making it structural. What differentiates Tunisia from Morocco in the context of privatization is that the privatization process was faster, deeper and more transparent concerning openness of information published about privatization. In Tunisia, it had the more decentralized picture, with creation and cancelation of various committees responsible for privatization which also influenced on the organizational structure of privatization. If Morocco, since SAPs, had already big economic groups with stakes throughout the whole economy, the peculiarity of the Tunisian business groups was the concentration on the single sector. As Cammett mentions, the elite could expand its holdings across diverse sectors (Cammett, 2007). If privatization in Morocco was not a challenge for makhzen as the sectors were already distributed and based on strong ties between the King and elites, in Tunisia the redistribution of assets and the necessary enlargement of cronyism required rearrangement of the economic domain between the groups which came to power with Ben Ali. Moreover, makhzen as a mode of controlling the economy had strong roots and the interest groups used the process of reforms to turn into reality their economic objectives through political control of the Monarchy.

### **6.3 Concluding results on crony capitalism**

According to the neoliberal principles, the reduction of big government involvement in the economy was considered to be the most effective way of controlling cronyism. The neoliberal reforms package is linked with idea promoted by World Bank and the IMF on combat of corruption. According to World Bank (1997) "economic policy reform should be the main pillar of anticorruption strategy" and "deregulation and the expansion of markets are powerful tools for controlling corruption and promoting economic growth" (World Bank, 1997, p. 35). So, the market tools must decrease the level of corruption. Among other main neoliberal objectives, Williamson envisaged the Washington Consensus, as the opportunity to minimize the potential for corruption. In this study, we departed from the idea that under non-democratic regimes neoliberal policies will likely support the evolution of crony capitalism.

Examining the Tunisian and Moroccan path to market economy, in the context of the relationship of the implemented neoliberal reforms and the evolution of crony capitalism we can conclude that "laissez-faire" in Morocco and Tunisia had been performed without the robust institutional framework which would ensure the fair competitive market allowing the cronies support state interventions mechanism for their benefits.

In our analysis of the relationship between neoliberal policies and crony capitalism, we based first of all on examination of roots of cronyism before the reform period, and we found that deep roots of business-state relations and well-developed network of cronies was an inherent part of both countries. Morocco's elite was consolidated around makhzen and the Monarchy's business relations with economic groups were the inherited practice since French protectorate. Moreover, business interests were introduced directly in the government and high officials of the government were represented in big enterprises. Tunisia's cronyistic roots were in the practice of the preferential treatment specifically for clans coming from regions. The strong executive power of the President institute helped the new President who came to power with strong business groups to consolidate economic power around him and his family.

Detecting the privatization as a mechanism, we traced and analyzed the openness of process and the applied methods of privatization. Privatization of enterprises was not a mere process of transferring the SOEs to the private sector. Analysis of the process showed that in both states the delegation of power and the issue of accountability was a matter of question. Based on the study of the Laws, we found that the issue of accountability and transparency was a challenge and the governments were reluctant to ensure regulatory oversight and audit. The specific political and institutional settings were not appropriately organized to provide the flow of operations transparently.

Examining the process of privatization of Tunisia, we found that the government did not have the particular plan and the list of enterprises for privatizations, as well as certain criteria concerning identifying preferred buyers, regulations, and scope of methods to be used for privatization were lacking in the law. Even the process of privatization was called the process of restructuring of SOEs. Mainly, we found that the government did not ensure active participation of other stakeholders in the process of privatization.

Examining the reforms on Investment code, we analyzed the restrictive policies for foreign ownership of certain economic sectors. In case of Morocco, we found that most of the restrictions on foreign ownership in certain sectors were lifted and foreign firms could have equity participation of more than 49 %. However, Moroccanization aimed to reduce French firms involvement in Moroccan economy had predominantly influenced on the political and economic behavior of the elites during the reform period, and Moroccan capital shares mostly handed over to Moroccans. It was illustrated in the process of privatization when most of the enterprises were sold to Moroccans.

Though the World Bank dataset on Tunisia' privatization did not sufficiently provide the transaction type but based on findings in documents about privatization, it was revealed that Tunisia used the strategy of selling shares on the Tunisian Stock exchange. These findings outlined that those deals related to the small investor transactions and many of the listed companies in the Bourse could not meet the declared set of standards by Tunis Bourse. The analysis of Public enterprises restructuring Loan (PERL) for Tunisia, SAPs I and II for Morocco regarding private sector development demonstrated that while the reforms aimed to increase the capacities of the private sector, most of the companies depended on the

support of public sector subsidies. The small private sector was not adequately addressed in reforms and moreover, it had no sufficient resources to participate in privatization.

Exploring privatized companies from World Bank Privatization dataset and the list of companies from the Moroccan corresponding state agency, we outlined the regular presence of few well-known Moroccan business groups in the principal operations during purchase. These groups purchased profitable companies mainly in banking, insurance, telecommunication, as well as mining and agribusiness. By analyzing the Law on Privatization in Morocco, we concluded that though the employees had a right to participate in privatization allocation of shares it was not considerable which allowed other influential stakeholders to acquire the large part of the shares. Predominantly, examining the results of reforms in financial sector under FMDL Loan and crosschecking with Privatization dataset we found that ten financial institutions, contributed about 30% of total value added of the sector, were privatized by financial conglomerates, such as ONA-SNI where Benjelloun, Kettani, Akhannouch families have a significant share of assets.

In combination with data from the national and World Bank Privatization dataset, we found that methods of divestiture and specifically golden share and noyau dur used as one of the core types of acquiring assets in both countries. The analysis of golden share allows us to state that through golden share as a legal method, the elites added control over the ownership of the newly privatized companies, as according to the concept of a golden share the government is allowed to veto and keep control rights over the company to be privatized. Based on Privatization database, noyau dur (or hardcore) of investors used in Morocco for privatization we found that direct negotiations were the preferred type of divestiture. A hardcore of investors favored this type allowing generating more revenue instead through open tender or the stock market.

Deriving from our findings, we conclude that the organization of privatization process, the methods and type of operations of divestiture and the scope of defined restrictions for local and foreign participation, outlined the consolidation of economic power of elites and ensured an open space for maneuver of cronies to reset their interest and expand the network through the whole economy. In parallel, the absence of political liberalization of the system did not allow to entirely creating fair market rules and regulations.

The process of privatization showed that the greater involvement of the state in economic decision making was not diminished, as upper classes neglected the alleged objective of neoliberalism and restructured their economic power consolidating their profits and capital and re-establishing the conditions in new economic realities.

The study of neoliberal policies' influence on the possible evolution of crony capitalism under non-democratic regimes showed that the neoliberalism directed to the reduction of state involvement in market regulations and creation of less state concept as a means to combat cronyism served to the evolution of the cronyism bringing it to a higher level: crony capitalism in Morocco and Tunisia.



## 7. Conclusion

The goal of this study was to examine whether crony capitalism has been developed in Morocco and Tunisia during the implementation of neoliberal reforms. We have started with the examination of SAPs within the framework of Washington Consensus Agenda and imposed by the IFIs on Morocco and Tunisia for macroeconomic stabilization measures and structural reforms and compare the outcomes taking into account also the starting points of economic development models for both countries and the chosen approaches for the transition. We concluded that while stabilization measures were mostly supported to the economic improvement and main market liberalization objectives were met to some extent, but, SAPs had been developed within three pillars of liberalization, stabilization, and privatization and imposed by World Bank as a universalistic approach without accounting the particularities of the countries. Washington Consensus agenda dogmatically promoted the prescriptions whereas the governments in Morocco and Tunisia could not find the balance between the concept of withdrawal of the state from the market and its capacities for the institutional development of the markets. The state had to adjust to the new economic opportunities.

In our analysis of the relationship between neoliberal policies and crony capitalism, we based first of all on examination of roots of cronyism before pre-reform period, and we found that deep roots of business-state ties and well-developed network of cronies were an inherent part of both countries. By examining the possible evolution of crony capitalism in the context of privatization, we concluded that privatization was implemented for the benefit of the most favored sectors of the economy. The organization of privatization process in a non-transparent way, the preferential treatment of the methods of privatization securing advantages position of elite groups, the poor developed private sector as well as the dominance of big businesses and proved that the unfair market competition only supported to the enlargement of the cronies' assets across diverse sectors of the economy. The analysis of various aspects of neoliberal reforms showed that the old system of cronies had not been weakened impacted by new adjustments but on the contrary, the cronies were

capable of consolidating themselves in certain areas of economic importance and even re-engineered the methods to develop crony capitalism.

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