THE ECONOMIC AND POLITICS DETERMINANTS OF IMF AND WORLD BANK LENDING IN THE MIDDLE EAST AND NORTH AFRICA

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SUMMARY

This paper assesses the economic and political determinants of IMF and World Bank program loans to the Middle East and North Africa. First we assess what is already known about the geo-political influences on aid flows to the MENA region and the potential for this to operate via the IMF and World Bank. From this we conclude that there is scope for IMF and World Bank lending in the region to respond to the political interests of their major shareholders, particularly the U.S. We support these arguments with both a qualitative and a quantitative analysis of the determinants of World Bank and IMF program lending to the region, focusing on both economic need in the MENA countries and the politics of donor interest before concluding.

KEY WORDS: IMF, World Bank, Middle East and North Africa, Aid Allocation.

1. INTRODUCTION

The Middle East and North Africa (MENA) consists of the predominately Islamic cultures of the Gulf Arab countries, the Levant, the countries of North Africa, plus Iran and the more industrialized country of Israel[i]. MENA assumes both political and economic significance. Politically, it is arguably the epicenter of world crisis, chronically war-prone and the site of the world's most protracted conflicts (HinnebU.S.ch 2003: p1); economically, it owns the bulk of the world's oil reserves and as such serves as the petrol tank of the world economy, driving in particular the U.S.A economic engine. In light of the region's geo-politically and economically strategic position in the world economy it is clear that economic and political factors are inextricably linked when it comes to the manner in which the West, particularly the U.S.A, responds to the region's needs.

There is a long and rich theoretical and empirical literature on the determinants of the geographical allocation of foreign aid[ii]. It is generally accepted that this allocation is influenced by both recipient need and donor interest and that multilateral aid is less susceptible to donor interest than bilateral aid (Maizels and Nissanke 1984; Rodrik 1995). In the past donor interest has often reflected the geopolitics of the Cold War, with pro-western regimes, regardless of economic need and their record on human rights, being large recipients of western aid[iii]. However, even before the collapse of Communism in the late 1980s and early 1990s, a new theory was emerging to the effect that 'Islam [is] the new Communism and [hence represents] a grave threat to Western civilization' (Niva 1998, p. 27). Consequently, 'rogue states' were isolated whilst pro-western regimes, particularly if they were threatened by Islamists, were rewarded for serving Western interests (Hubbell 1998, p.9). Hence, the end of the Cold War replaced the old dichotomy in the Arab World between conservative pro-Western and socialist pro-Communist Arab regimes with a new and less covert formula based on 'friends or allies, or good or bad' regimes (Perthes 1998, p. 30).

In the light of the above it is possible that past aid allocations to MENA have been influenced by U.S. interests in the region. We assess whether this has affected the flow of funds from the IMF and World Bank. It is often argued, particularly by the anti-globalization movement, that the two Washington-based multilaterals are strongly influenced by the economic and political needs of their major western shareholders, especially the U.S. This influence can take two forms - determining the geographical flow of funds i.e. who gets what from the IMF and the World Bank; and influencing the conditionality attached to such funds i.e. program loan[iv] recipients are expected to undertake economic liberalization programs, which help to open up their economies to the global economy and thereby extend the reach of western pro-capitalist and pro-globalization ideology.

In addition, we can speculate that if there is evidence that past financial flows into pro-western MENA countries have responded to donor interest rather than recipient need, then, given the post 9/11 foreign policy concerns of the west, this may well intensify in the future. For example, post 9/11 the U.S.A has been increasingly forthright in suggesting that the War on Terror and U.S. security are important reasons for foreign aid (www.U.S.aid.gov/fani/overview p. 2). Likewise, when President G.W. Bush proposed the first significant increase in U.S. development assistance in a decade, he offered the following justification when speaking at the United Nations Financing for Development meeting in Monterrey, Mexico in March 2002: 'We fight poverty because hope is an answer to terror.'

This has two important implications, which go beyond the scope of this chapter. Firstly, the allocation of aid funds according to donor interest rather than recipient need is likely to reduce the developmental impact of aid - the most needy countries or those that can use aid to the best of effect will not receive their due share.

Secondly, the politically motivated flow of funds to MENA may well backfire. The flows of program aid funds from the IMF and World Bank almost always have economic liberalization conditions attached to them. Such reform conditions may well have negative social ramifications in the recipients. For example, reforms such as privatization, removal of state subsidies on foodstuffs, devaluation, and trade liberalization can potentially increase unemployment and income inequality as well as reduce real incomes of the poor. This, in turn, may lead to the growth of anti-reform movements challenging incumbent regimes. There is already ample anecdotal evidence that this has occurred. The 1990s and the first four years of the 21st century have witnessed a rise in the number and forms of distributive conflicts in the Arab World, including riots, demonstrations, strikes, violence, assassinations, clashes with labor unions and university students in addition to an increase in crime rate (Ayubi, 1995; Richards and Waterbury, 1996; El-Ghonemy 1998; Shafiq 1998; Economist, September 5, 2002). Quite often this unrest has an explicitly anti-western and anti-IMF focus, for example, the IMF-induced lifting of price supports sparked rioting in Jordan in April 1989 and August 1996.

Many such opposition movements have centered on Islamic-based political parties. Political Islam and Islamic fundamentalism should not be confused. But a vicious cycle of declining social welfare caused by possible effects of economic liberalization, increased domestic opposition to pro-western local regimes implementing such programs, and repression of such opposition by the same regimes is likely to force frustrated religiously-based political groups into increasingly extremist responses as well as enhancing their appeal to impoverished and disaffected members of society.

The remainder of this paper is divided up as follows. In the next section we assess what is already known about the geo-political influences on aid flows to the MENA region and the potential for this to operate via the IMF and World Bank. From this we conclude that there is scope for IMF and World Bank lending in the region to respond to the political interests of their major shareholders, particularly the U.S. We support these arguments with both a qualitative and a quantitative analysis of the determinants of World Bank and IMF program lending to the region, focusing on both economic need in the MENA countries and the politics of donor interest before concluding.

2. POLITICS, AID AND MENA - WHAT DO WE ALREADY KNOW?

Three facts are already established in the literature - bilateral aid flows are influenced by donor political interest; flows into MENA, most notably Egypt and Israel, are partly politically determined; and the U.S.A wields considerable power and influence in the IMF and World Bank.

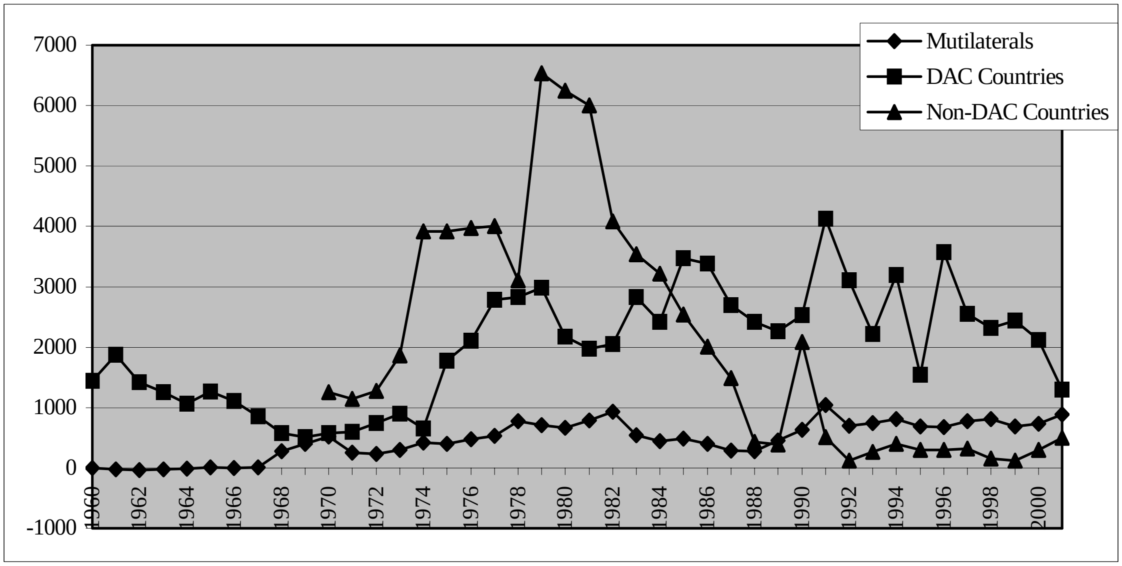
The MENA region has been the second largest regional recipient of aid in the period since 1960. From 1960 to 2001, the MENA region received nearly $329 billion of aid (in 2000 prices), which only its poor neighbor sub-Saharan Africa exceeds by a large margin[v]. In terms of the importance of different donors to the region, the U.S.A championed MENA in the 1960s, 1980s and 1990s, whilst the GCC was the largest donor in the 1970s (see Figure 5.1). The multilateral donors have been less important to the region than the bilaterals and although the World Bank is the largest multilateral donor its role pales into insignificance compared to that of the U.S.A, as shown in Table 5.1. The same is true of the IMF (Appendix Tables 1 and 2 provide details of all IMF and World Bank program loans to MENA countries).

Table 1 U.S. Aid and World Bank Aid to MENA

	U.S.	U.S. share	WB	WB Share	Total
		Africa – North of Sahara			
60-69	9995.95	39%	-49.3		25610
70-79	7545.67	16%	1051.4	2%	48466
80-89	16303.53	42%	1191.7	3%	39084
90-99	13785.49	34%	308.2	1%	41105
2000	629.13	29%	22.8	1%	2184
2001	586.09	24%	-1.0		2403
		Middle East			
60-69	5056.72	42%	-76.4		11969
70-79	11554.3	22%	582.0	1%	51540
80-89	19787.32	33%	691.3	1%	60860
90-99	17554.76	44%	606.7	2%	39739
2000	1216.42	39%	47.3	2%	3141
2001	500.46	19%	57.9	2%	2674

Data Source: DAC online database (in U.S $ million).

Figure 1 The Source of Net ODA disbursement (US $ million-2000 price)



*Data Sourc*e: DAC on-line Database

Donor interest seems to play a significant role in aid allocation to the MENA region. Many aid allocation studies based on models which incorporate variables representing both donor interest[vi] and/or recipient need have reached the conclusion that donor interest is an important determinant of the geographic allocation of aid, especially on the part of bilateral donors (Jalée 1968; Frank 1969; Hayter 1971, 1981; Hensman 1971;McKinlay and Little 1977, 1978; 1979, Maizels and Nissanke 1984, McGillivray 2003; Feeny and McGillivray 2002; Berthelmy and Tichit 2003). Our own recent study, based on a mathematical model of the aid allocation process and employing a fixed effects model with panel data produced a similar result (Harrigan and Wang 2004 forthcoming)[vii].

A number of the aid allocation studies also introduce dummies to reflect specific strategic links between donors and certain recipients. This is most common in the context of MENA, where dummies are often introduced for Egypt and Israel when the database includes these two countries. Many of these studies find these dummies to be positive and significant e.g. Alesina and Dollar (2002); Berthelemy and Tichit (2002); Feeny and McGillivray (2002) among many others[viii]. The Egypt and Israel dummies reflect that fact that these two countries are key strategic allies to the West, especially the U.S.A, such that donor interest is likely to have a positive influence on aid allocations. According to Feeny and McGillivray (2002 p. 14) 'Israel's relationship with the United States is arguably one of the most intense between a donor and a recipient'.

Our own work (Harrigan and Wang 2004 forthcoming) has enabled U.S. to go beyond simple dummies for Egypt and Israel and to make more country specific observations regarding the influence of donor interest in aid allocations to MENA countries. In our base regression, we have applied a fixed effects model to panel data to analyze the determinants of aid allocations by various class of donor (with 2484 observations covering 32 years and 138 recipients). The donor-recipient fixed effect coefficients for MENA countries are reported in Table 5.2. These coefficients capture donor-recipient specific effects i.e. they show the linkages between donor and specific recipients, which include long term strategic relations, economic linkages, colonial ties, etc. As can be seen from Table 5.2, donor interest, as represented by the fixed effects coefficient, has a strong positive effect in the allocation of U.S. aid

(LU.S.MPC) to Israel and Jordan, two of the most strategically important U.S. allies in the region, and a strong negative effect on U.S. aid allocation to Iran, Sudan, and Yemen, countries traditionally hostile to U.S. foreign policy in the region. As expected, the fixed effects coefficients for multilateral aid (LMULTMPC) are much smaller, although links between multilateral aid and Egypt, as well as Jordan and Lebanon, are evident. Interestingly, Israel is not favored by the multilaterals, in contrast to its special relationship with the U.S.

Table 2 Donor-recipients Fixed Effects Coefficients for MENA Countries

Country	USA	Non-USA	Multilateral
Egypt	0.87	1.56	0.72
Iran	-1.61	-0.21	-0.83
Israel	6.03	1.4	-1.22
Jordan	2.41	0.85	0.67
Lebanon	0.91	0	0.72
Morocco	0.35	1.23	0.25
Sudan	-1.9	-0.24	0.18
Syria	-0.34	-1.45	-0.49
Tunisia	0.65	1.34	0.39
Turkey	-0.6	1.46	0.15
Yemen	-2.24	-0.55	-0.23

Source: Harrigan and Wang (2004 forthcoming)

Another recent study of aid allocation, which enables conclusions specific to some of the MENA countries is that of Collier and Dollar (2002). In their paper they compare the actual allocation of aid with an optimal poverty-efficient allocation of aid, with the latter assumed to depend on each recipient's level of poverty, the elasticity of poverty with respect to income, and the quality of its policies. Comparing actual 1996 aid allocations with the optimum they find that a large number of middle-income countries with poor policy receive excessive amounts of aid. The significance of their results in the context of MENA is that all of the MENA countries in their sample of 59 developing countries should not receive any aid on the poverty-efficient criteria. Table 5.3 compares this optimal allocation with the actual aid receipts of such countries in 1996. Jordan in particular stands out as a country receiving aid equivalent to 3.26 per cent of its GDP as opposed to 0 per cent under the optimal Collier and Dollar allocation.

Table 3 Optimal versus actual 1996 aid allocation in selected MENA countries

Country	Poverty-efficient allocation	Actual aid
Jordan	0.0	3.26
Egypt	0.0	1.31
Morocco	0.0	0.70
Tunisia	0.0	0.29
Algeria	0.0	0.22

Source: Collier and Dollar 2002 Table 3 (in per cent of GDP)

The above types of studies have led to the general conclusion that MENA is over-aided. In the words of DFID:

'In comparison with other regions, it (MENA) receives substantially more aid per poor person … but poverty reduction is not the primary motivation for many donors' assistance to MENA…aid allocations are substantially influenced by donors' domestic political considerations, including commercial advantage and foreign policy objectives such as migration and terrorism'.

(DFID 2003, p.11)

Although there seems to be ample evidence that bilateral aid flows to the MENA region are influenced by donor interest, a common view is that flows from multilaterals such as the IMF and World Bank are less likely to be influenced in this way since they do not represent the interests of any particular country. Indeed, the Bank and Fund Articles of Agreement explicitly state that lending decisions should not be influenced by political factors[ix]. However, in reality, it seems that this has only reduced the level of politicization in their actions rather than removed it altogether. Therefore, it is possible that IMF and World Bank lending provide donors with another arms length instrument to pursue their own interests.

Donors can employ multilateral lending to complement their own foreign aid strategy in several ways. The immense power of the IMF and World Bank, especially the former, means that their ability to influence developing countries is considerable.

For example, an IMF agreement is the key to access to the international capital market for many developing countries - it is required for debt relief from the Paris Club and may facilitate the flow of funds from other official and commercial sources. Because the IMF can impose punishments or rewards which are much wider in scope than those which any single donor country can impose, western donors may well try to influence the IMF stance in a particular country to consolidate or reinforce the existing commercial, strategic and political alignments which have already been pursued by their own bilateral aid policy.

Secondly, the conditionality attached to multilateral lending can serve a donor's objective of altering the behavior of recipient governments. For example IMF and World Bank economic reform conditions encourage developing countries to adopt western-style capitalism and open up their economies to the global economy and western investors. Indeed, the acceptability of such extensive multilateral conditionality derives partly from the perception that the World Bank and the IMF operate somewhat autonomously from policy makers in western capitals and in a relative non-political manner (Rodrik, 1995).

Analysis of the voting power of the U.S.A in the IMF and World Bank clearly shows that the U.S.A has the capacity to exercise leverage in these two institutions. Indeed, a common criticism of the operation of IMF and World Bank is that their decision making process is dominated by the G-7 countries, especially the U.S. The Bretton Woods institutions have systems of governance based on weighted voting. Each member possesses a number of votes, which depends on its quota allocation and which must be cast as a bloc. This leads to a problem of democratic legitimacy since a member's influence or voting power within such a decision-making system does not in general correspond to its voting weight.

Using voting power analysis[x], Dennis Leech and Robert Leech (2003) and Denis Leech (2002) show that the U.S.A possesses considerably more power than voting weight in relation to ordinary decisions requiring a simple majority. They conclude 'Weighted voting tends to further enhance the power of the United States at the expense of all other members in both the board of Governors and the Executive board' (Leech and Leech 2003 Abstract) and 'Our principal result is that the voting power of the U.S.A turns out to be far greater than its quota would warrant' (ibid. p.3).

Given America's voting power advantage in the IMF and World Bank, Mckeown et al 1999 have argued that there is no reason why American policy makers would not be expected to use this power in order to promote adherence to U.S. alliances; to secure the strengthening of a regime friendly to the U.S. or to weaken a hostile regime by removing a source of support; and to win trade or investment concessions. Conteh-Morgan 1990 and Zimmerman 1993 have made a similar argument. The influence of the U.S. government is further evidenced by the fact that the American Executive Director 'is ordered by law to clear his or her decision with the Secretary of the Treasury' (Swedberg, 1986, p.379) and each major decision must have the approval of the U.S. Senate and Congress (Smith 1984).

A number of empirical studies have attempted to provide more rigor to the above analysis by trying to identify and quantify the specific determinants of IMF lending[xi]. Joyce (1992), Conway (1994), and Knight and Santaella (1997) concentrated on economic determinants. Some consensus has emerged with respect to key economic variables, though there are not always measured in the same manner. Declines in export earnings, high debt service ratios, and the presence of arrears on debts, as well as histories of other financial problems are all associated with a higher likelihood of an IMF agreement being signed. Many other economic measures, such as GDP per capita and the balance of payments have inconsistent effects across the different studies.

Based on a simple macroeconomic model, Thacker (1999) conducted a test on whether IMF lending is politicized by introducing variables of political proximity (UN voting pattern, similarity between U.S.A and recipient) and political movement (the shift of recipient's voting pattern towards U.S.A voting pattern). His results show that movement toward the United States within a defined international political space can significantly increase a country's chances of receiving a loan from the IMF. The results from similar studies (e.g. Rowlands 1995; Barro and Lee 2001; and Bird and Rowlands 2001) are generally consistent with Thacker’s findings, but divergent at the level of U.S.A influence intensity. For example, Rowlands (1995) concludes that the evidence for systematic U.S. influence is less strong than that commonly expected.

It is not just the receipt of a loan that may be influenced by western countries; the terms of the loan might also be affected. A series of case studies conducted for a project by Killick (1995, p118-119) reveals that at least one-third of seventeen countries studied secured favorable loan terms on their IMF programs due to the intervention of major shareholding countries on their behalf.

Regarding World Bank lending, Fleck and Kilby (2001) used panel data to examine the geographic distribution of the World Bank lending from 1968 to 1992 and conclude ‘Countries with strong U.S. trade ties received a significant share of the World Bank lending than comparable countries with weak ties; Countries which the U.S. favored with bilateral aid received a disproportionate share of the World Bank funds as well’ and such effects ‘vary across U.S. presidential administrations’ (Fleck and Kilby 2001 p.16). In a more qualitative analysis of the World Bank, Schoultz (1982) has documented that the World Bank’s ‘interests’ in a given loan or aid package are often influenced by the U.S. Executive and Congress.

IMF lending may also be influenced by political conditions in recipient countries, such as democratization or elections. Dreher and Vaubel (2002) conduct a formal test of the political business cycles using regression analysis. They found IMF credits in the more democratic recipient countries are larger in pre-election and post-election years, while the credits in more authoritarian regimes are marginal smaller in post-election years.

The above literature review has indicted that donor influence, including strategic geo-political interests, influence aid allocations, especially allocations in the MENA region, and that the IMF and World Bank are not immune from the influences of their major shareholders, particularly the U.S. We now turn to look more specifically at the determinants of IMF and World Bank program lending in MENA in order to assess to what extent it has been determined by recipient need and to what extent by donor interests. We adopt two approaches – a qualitative analysis of the timing of Bank and Fund loans and a more formal quantitative analysis of IMF lending based on a Probit model.

3. THE TIMING OF IMF AND WORLD BANK PROGRAMS IN KEY MENA RECIPIENTS: A QUALITATIVE ANALYSIS

(a) Recipient Economic Need

Although IMF and World Bank program loans have only been a small percentage of total aid flows into the MENA region they nevertheless have the capacity to profoundly influence the recipient economies via the loan conditionality. In the past such conditionality has brought with it economic reform via structural adjustment and stabilization programs. A cursory glance at economic performance in the region makes it clear that reform was indeed needed in many MENA countries in the post-1980 period.

In order to fully understand economic performance in the region and the need for both financial support and economic reform from the mid-1980s onwards (and hence a role for the IMF and World Bank) it is necessary to divide performance into sub-periods. During the 1973-81 period, the region's wealth and industrial structure was concentrated on oil. During this period the region as a whole also enjoyed substantial inflows of so called Official Development Assistance (ODA) from DAC bilateral donors, non-DAC bilateral donors and multilateral donors. As shown in Table 5.4, the 1970s was a golden period for the MENA region. GDP growth averaged over 6 per cent per annum, gross domestic savings and capital formation were a respectable 37 per cent and 29 per cent of GDP respectively and both export and import coefficients were high. On the back of this wealth public expenditure expanded with a strengthening of both state welfarism and state economic activity.

Table 4 Selected economic indicators of the MENA 1975-2000

Year	75-79	80-84	85-89	90-94	95-99	2000
GDP growth (%)	6.2	2.3	1.3	4.4	2.96	3.9
GDP per capita (constant 1995 US$)	1908.5	1882.3	1759.1	1842.7	1909.1	1983.1
Gross domestic savings (% of GDP)	36.7	28.7	18.7	22.2	23.1	30.5
Gross capital formation (% of GDP)	29.5	27.4	23.6	24.6	21.7	20.4
Export (% of GDP)	42.0	36.2	23.9	32.0	30.7	37.9
Import (% of GDP)	34.8	35.0	30.1	34.5	29.3	27.9

Data Source: WDI 2002 CD-ROM

However, when oil prices softened in the 1980s, the structural weaknesses of the economies in the region, especially the over-reliance on oil, became apparent[xii]. As can be seen from Table 5.4, growth declined and per capita GDP decreased by an average 1.0 per cent per year in the 1980s, a rate worse than any other developing region, except sub-Saharan Africa. Other economic indicators also pointed in the same direction: the saving rate and investment rate dropped in the late 1980s and the export/GDP and import/GDP ratios also declined.

The disappointing economic performance of the MENA region in the 1980s can be attributed to a number of factors. Internally, a high population growth rate, poor economic management, corruption, and prolonged heavy protection led to high unemployment and economic inefficiency. It is also worth noting that during the oil boom years, despite having high domestic saving rates and high inflows of foreign aid, investment in the MENA region was well below the saving capacities. Consequently, resources were mostly diverted towards consumption as well as non-productive investment.

The extent of crisis can be seen when we look at key macroeconomic indicators for countries in the region who were to become major recipients of IMF and World Bank program loans, namely, Egypt, Jordan, Morocco, Tunisia and Algeria[xiii]. Details of the IMF and the Bank programs implemented in the above countries are listed in Appendix Tables 5.1 and 5.2 respectively. Macroeconomic indicators for the above five countries indicate that inflation and current account imbalances were built up in 1970s and persisted throughout the 1980s, the central government debt and total debt service ratio were also high in the 1970s and became even worse in the 1980s. With the rising debt and high inflation, gross capital formation started to decline from the early 1980s and never looked like bouncing back to the peak level of late 1970s. In light of this fall in investment, the decline in

GDP per capita growth witnessed in all five countries during the 1980s seems inevitable.

However, a more nuanced analysis, which looks at the specific timing of loans and corresponding macroeconomic indicators in each recipient suggests that the determinants of lending often do not reflect recipient economic need. Table 5.5 provides macroeconomic data for each of the five countries for the year in which each received its first IMF loan and for the previous five years (Egypt received two distinct phases of loans and so is represented twice)[xiv]. By looking at the macroeconomic variables for the year in which each country received the first of its series of IMF loans and comparing them with the previous period we can see if there is evidence that the granting of the first loan coincided with severe macroeconomic distress. The results are surprising.

(i) Algeria

Algeria received its first IMF Standby Loan in 1989. Comparing 1989 with the previous five years it does not seem that Algeria was in exceptional distress in terms of inflation, the current account balance, gross capital formation or GDP growth. Indeed, GDP growth had bounced back after three years of negative growth. The only variable that shows any sign of significant deterioration is the debt service ratio, which had doubled compared to 1984. However, in the year in which Algeria was granted its first IMF program the debt service ratio was already beginning to improve. This cursory glance at the type of macro economic variables that the IMF

Table 5 Macroeconomic indicators for selected countries

Algeria						
	1984	1985	1986	1987	1988	1989
Inflation, consumer prices	8.1	10.5	12.4	7.4	5.9	9.3
Current account balance	0.1	1.8	-3.5	0.2	-3.5	-1.9
Central government debt,						
Total debt service	36.8	35.6	56.4	53.4	76.6	66.8
Gross capital formation	35.2	34.6	33.6	27.6	27.6	30.1
GDP per capita growth	2.2	0.5	-2.4	-3.5	-3.6	1.8
Egypt						
	1971	1972	1973	1974	1975	1976
Inflation, consumer prices	3.1	2.1	5.1	10.0	9.7	10.3
Current account balance	-5.7	-5.3	-5.8	-17.7	-21.2	-10.2
Central government debt,						
Total debt service	21.8	32.5	31.1	11.9	10.3	6.4
Gross capital formation	13.2	12.3	13.1	22.5	33.4	28.4
GDP per capita growth	1.6	0.2	-1.1	0.5	6.8	12.2
Egypt						
	1982	1983	1984	19857	19868	1987
Inflation, consumer prices	14.8	16.1	17.0	12.1	23.9	19.7
Current account balance	-9.9	-5.4	-8.2	-9.3	-9.4	-2.3
Central government debt,					0.0	0.0
Total debt service	19.3	20.1	21.4	25.8	27.0	17.9
Gross capital formation	30.1	28.7	27.5	26.7	23.7	26.1
GDP per capita growth	7.1	4.6	3.4	3.9	0.1	0.0
Jordan						
	1984	1985	1986	1987	1988	1989
Inflation, consumer prices	3.8	3.0	0.0	-0.2	6.6	25.7
Current account balance	-5.3	-4.9	-0.7	-5.4	-4.6	4.4
Central government debt,	49.6	56.4	59.0	70.1	100.1	126.1
Total debt service	13.0	17.2	19.7	24.0	30.9	19.7
Gross capital formation	28.8	20.5	20.5	23.3	23.5	23.7
GDP per capita growth	4.6	-0.2	3.1	-0.8	-5.2	-16.5
Morocco						
	1978	1979	1980	1981	1982	1983
Inflation, consumer prices	9.7	8.3	9.4	12.5	10.5	6.2
Current account balance	-9.9	-9.4	-7.5	-12.0	-12.1	-6.4
Central government debt,	38.2	39.8	41.7	53.4	58.4	73.2
Total debt service	22.9	26.6	33.4	38.4	45.4	40.3
Gross capital formation	25.4	24.5	24.2	26.1	28.2	24.0
GDP per capita growth	0.0	2.5	1.3	-4.9	7.2	-2.7

Table 5 Continued

Tunisia	1981	1982	1983	1984	1985	1986
Inflation, consumer prices				8.9	7.3	6.2
Current account balance	-5.4	-8.1	-6.8	-9.3	-6.9	-6.7
Central government debt,	35.1	38.2	41.5	42.3	45.5	56.5
Total debt service	15.2	16.2	19.3	22.7	25.0	28.4
Gross capital formation	32.3	31.7	33.5	35.9	30.2	26.6
GDP per capita growth	2.8	-3.1	2.0	3.7	2.5	-4.5

Data Source: GDI 2002

Note: Inflation, consumer prices (annual %); Current account balance (% of GDP); Central government debt, total (% of GDP); Total debt service (% of exports of goods and service); Gross capital formation(% of GDP); GDP per capita growth (annual %).

usually considers when deciding whether a country is in need of a loan seems to suggest that Algeria's first IMF loan in 1989 cannot be explained by the standard analysis of recipient need. As will be argued below, it is possible that important changes in Algeria's domestic politics and foreign policy provide an alternative explanation of the timing of the 1989 loan.

(ii) Egypt

Egypt received its first IMF loan in 1976 followed by a new phase of loans that commenced in 1987. The first 1976 loan does seem to coincide with a period of increased inflation and deterioration in the current account, although debt service, gross capital formation and GDP growth were not problematic. However, given that inflation and the current account are often regarded as critical indicators by the IMF it would seem that the 1976 loan reflects a degree of recipient need. The picture, however, is very different for the 1987 loan. There is no indication of macroeconomic instability in 1987. Indeed, all variables apart from the GDP growth rate were improving in 1987. Although some of the improvement may be due to the IMF program itself, given that the loan was signed in May, the previous year's data, apart from inflation, do not suggest any increase in macroeconomic distress immediately prior to the loan. Again, it seems we must look for other factors, which go beyond recipient need to help explain the 1987 IMF loan.

(iii) Jordan

Jordan's IMF programs began in 1989. In this case there is much more evidence of macroeconomic crisis. Inflation, the build up of central government debt and GDP growth all registered a significant deterioration in 1989. The previous two years had also seem escalation in the debt service ratio. However, as we will argue below, the 1989 economic crisis in Jordan was inextricably linked with changes in domestic politics and foreign policy, both of which may also have played a part in loan timing.

(iv) Morocco

Morocco commenced her IMF programs in 1983 but on the macroeconomic data contained in Table 5.5 would not seem to be an obvious candidate for such programs. Inflation, the current account and debt service ratio all improved in 1983 and this cannot be ascribed to the IMF program itself, as the loan was not signed until September. The only variable that worsened dramatically in 1983 was the GDP growth rate, which is not a variable IMF programs traditionally responded to in the 1980s.

(v) Tunisia

Tunisia became an IMF Standby recipient in 1986. As with Morocco, there is little sign of recipient need in terms of the standard variables of concern to the IMF. Inflation, the current account and debt indicators were showing no notable deterioration. Again, evidence of need is limited, and it seems, as with Morocco and Egypt in the 1980s, the only obvious indicator of need contained in Table 5.5 is the decline in GDP per capita growth.

In summary, the 1980s, when most IMF programs in the MENA region commenced, was a period of generally deteriorating economic performance for the region as a whole. There was a clear need for both external finance to help with growing debt burdens as well as a program of economic reform to restructure many of the economies in the region and generate sustainable economic growth. Hence, the stage was set for entry of the IMF and World Bank with their stabilization and structural adjustment loans and we cannot deny the element of recipient need in this respect. However, an analysis of the exact timing of the first IMF loan in the five major recipients provides only limited evidence that economic need, as illustrated by key macroeconomic variables, was a determinant. Although it seems that Egypt's loan of 1976 and Jordan's loan of 1989 were a response to clear macroeconomic difficulties the evidence for Algeria, Morocco and Tunisia's as well as Egypt's 1987 loan is much less clear cut. Indeed, if anything, in Morocco, Egypt and Tunisia it seems that the IMF was responding to the growth rate variable, which was not one of the standard macroeconomic variables one usually associates with IMF programs in the 1980s[xv]. This would suggest that in many instances other factors might well have influenced the decision as to when a country is eligible to commence a series of IMF and World Bank programs. It is to this issue that we now turn.

(b) Donor interest and the influence of the U.S.A

We have argued in an earlier section that there are reasons to suspect that the political interests of their major shareholders, particularly the U.S.A, may well influence the flow of funds from the IMF and World Bank. Hence, in this section we present a qualitative analysis of the timing of the signing of World Bank and IMF program loans in the major MENA recipients in order to see whether there is any evidence that political factors have been influential.

(i) Jordan

While the 1989 agreement with the IMF and World Bank largely reflected dire domestic economic conditions, Jordan's experience with both bilateral and multilateral aid, before and after 1989, presents an excellent example of the subjection of such flows to the political interests of and pressure from major western donors. Following the 1973 Arab-Israeli War and an Arab oil embargo against the U.S.A, Washington increased pressure on the late King Hussein to sign an individual peace treaty with Israel. But with more than half of his population being of Palestinian origin, and without tacit support, if not direct participation, of the PLO[xvi], a separate peace treaty with Israel would have been tantamount to political suicide. The U.S. 'frustration with King Hussein' led to the suspension of American aid to

Jordan in 1978[xvii] (Shultz, 1993, p.454). During this period, Jordan was neither favored by the IMF or the World Bank.

Although U.S. pressure on Jordan to join Egypt and sign a peace treaty with Israel intensified in the early 1980s, particularly following President Reagan's 1982 proposed Peace Plan[xviii], which placed Jordan in the position of representing the Palestinian people, Hussein continued to develop closer relations with the PLO[xix]. However, in the second half of the 1980s tension between Hussein and Arafat led to a rift on who should really represent the Palestinians in any peace settlement with Israel. Hussein consequently reverted to an old and by now well documented approach of continuing secret cooperation with the Israeli state, further intensified following the collapse of negations with the PLO in 1985 (Dallas, 1999). Hussein's refusal to allow Arafat to gain ground in the West Bank and Gaza Strip (WBG) led to a hastily and ill thought out plan in 1988, when Jordan severed all economic and administrative ties with the WBG. With Jordan's Palestinians dominating the private sector, severing ties with the WBG created uncertainty with regard to their political future and presence in Jordan. They thus engaged in extensive capital flight and curtailed their investment and economic activities in the country, leading to Jordan's first real banking and financial crisis in 1989. Within the space of six months, the Jordanian Dinar lost almost 50 percent of its nominal value, Jordan's external debt reached unsustainable levels and per capita income was almost halved (Kanovsky, 1989). Subsequent riots resulted in a tactical move by King Hussein; he restored parliamentary elections in 1989 (suspended since the 1976 war), and within a span of two years abolished martial law, legalized political parties and sanctioned greater freedom of press. In July 1989, the IMF granted Jordan an SDR 60 million Standby Agreement and the World Bank provided a U.S.$ 160 million SECAL for the industrial and trade sector. It seems that a complex interaction of the stance towards Israel and the WBG, the ensuing economic crisis and the attempted panacea in the form of political liberalization, all played a role in qualifying Jordan for IMF and World Bank support in 1989.

With strong domestic opposition to foreign intervention in the region, Jordan took a neutral stand in the 1990-91 Gulf War and refused to openly support U.S.-led attacks against Iraq. This led to a complete halting of aid flows to Jordan from the U.S. and its Arab allies in the Gulf and the temporary suspension of the IMF and World Bank agreements with two thirds of the IMF Standby funds not being drawn. Squeezed financially, isolated internationally and ostracized regionally the U.S. led pressure had the desired effect of prompting an 'alliance shift' (Brand 1994 p.20). Hussein soon criticized Saddam Hussein and openly talked about regime change in Iraq, and went further by hosting Iraqi opposition leaders. Following this revised stance, a new SDR 44.4 million Stand-By Agreement was signed with the IMF in February 1992.

Since the mid-1990s Jordan has been further rewarded for her peace overtures to Israel. In 1993, Jordan started direct negotiations with Israel under the Oslo Accord of 1991-2, leading in October to a Common Agenda agreement on issues related to territory and water, refugees, and arms control. In the same month, the

World Bank granted Jordan a second U.S.$ 80 million SECAL for the energy sector. This was followed in May 1994 by a SDR 130 million IMF Extended Fund Facility. In 1994, Jordan formally signed a peace treaty with Israel in *Wadi Araba*, formally ending the 46-year-old state of war between the two countries. Since then, Jordan has not only become one of the largest recipients of U.S. aid in the world, but also the recipient of a further six World Bank loans and three IMF loans. The political timing of many of these loans deserves attention. The third World Bank U.S.$ 80 million SECAL for the agricultural sector came only three months after the *Wadi Araba* Agreement was signed. In the same year, the U.S. wrote off U.S.$ 833 million of Jordan's debt and began providing Jordan with advanced weaponry. The fourth SECAL for the same amount came in October 1995, less than a month after Jordan's support for the OSLO II Accord under which Israel agreed to a partial withdrawal from the West Bank with administrative powers to be given to the Palestinian Authority.

In light of the above analysis, it would seem that the timing of at least seven of the fourteen program loans that Jordan has received from the Bank and the Fund since 1989 may well have been influenced by Jordan's stance on Middle East affairs.

(ii) Algeria

Throughout the 1970s and 1980s Algeria was considered a rogue state by the non-communist west. In 1974 the country firmly rejected the 'open door policy' (infitah) adopted by Egypt and much of the Arab world which involved a shift in the balance of domestic economic power to the private sector, opening up to western investment and accepting the hegemony of the U.S. Instead, in 1976 President Boumedienne adopted a new socialist constitution and Islamic state, with the Islamist movement further promoted by his successor President Chadli Benjedid. During this period, which witnessed rapid industrialization and the successful development of domestic oil and gas, the west remained hostile to Algeria's anti-American regime (Swearingen 1996; Pfeifer 1996). In 1980, Algeria embarked on a successful liberalization program designed to overcome the inefficiencies created by the previous import substituting industrialization strategy. Although the program was not dissimilar to a standard IMF and World Bank package, Algeria, unlike its Western friendly neighbors Morocco and Tunisia, received little assistance. Whilst Morocco and Tunisia had more than a third of their annual external debt on concessional terms, Algeria was forced to finance its reform program in the early and mid-1980s with market-based loans with only 3 per cent of her debt on concessional terms.

But reforms, associated with external borrowing on unfavorable terms, induced a ballooning in foreign debt. The collapse of oil and gas prices in 1986 followed by a large devaluation in 1988 led to escalating inflation and unemployment, which triggered strikes, riots and growing domestic opposition to the regime. The economic and political crisis prompted a shift in both domestic and international policy. In 1988 a new constitution restricting the military and allowing opposition parties was introduced. In early 1989, Algeria joined the new Arab Maghreb Union (UMA), which was committed to preventing the spread of radical Islam and fostering closer links between the Maghreb and the European Union. As in

Jordan, Algeria's new pro-western stance combined with domestic political liberalization was a signal for the arrival of the World Bank and IMF. In May 1989 the Fund granted a SDR 156 million Standby followed in August 1989 by a U.S.$ 300 million Structural Adjustment Loan from the World Bank. In total between 1989 and 1999 Algeria received four IMF stabilization loans (as well as a Compensatory Financing Facility) and four World Bank adjustment loans. The timing of several of these, as argued below, is noteworthy.

President Benjedid's political liberalization backfired producing unexpected support for the Islamic opposition. The Bank and the Fund responded in June 1991 by offering the embattled regime a SDR 300 million Standby and a U.S.$ 350 million Structural Adjustment Loan (the largest ever Bank program loan to any country in the MENA region). The army, shaken by the Islamists' overwhelming victory in local elections, stepped in on January 1992, deposed Bendjedid himself and cancelled the elections. A retired army general, Liamine Zeroul, was appointed by the army as the head of the state in January 1994, and confirmed President after the 1995 elections. The disposition of Benjedid and cancellation of elections ushered in a new and bloody era in Algeria's history, characterized by two main features. First, brutal repression of Islamists and other opposition in what became known as the 'dirty war'. Second, the growth of a radical opposition Islamic movement coincided with the new post-Cold War American view of Islam as the new communism. Therefore, the new Algerian military-backed regime used the so-called War on Terror to build closer relations and links with the U.S. In March 1993, Algeria broke off diplomatic relations with Iran, after years of cultivating relations with Tehran, which it now blamed for exporting Islamic revolutions to the Arab World. At the same time, Algeria withdrew its ambassador from Sudan, another country described by the U.S. officials as a rogue and anti-western state (EIU, 2001, p.14-15). In May 1994, Algeria was rewarded with a SDR 457 million IMF Stand-By Arrangement.

In late 1994, Algeria also vigorously supported, along with Egypt, an anti-terrorist code of conduct at the Casablanca Islamic Summit. A few months later in January 1995, Algeria received a U.S.$ 150 million World Bank Economic Rehabilitation Support Loan, followed in May 1995 by the largest ever IMF Extended Fund Facility in the region of SDR 1.2 billion. The latter came to an end in May 1998, and was associated with unexpected macroeconomic success, mostly caused by improved global prices and demand for gas.

In late 1998, President Zeroual announced that he would stand down and that elections would be brought forward to early 1999. One day before the voting began in the delayed April 1999 elections, all candidates, except Mr. Abdelaziz Bouteflika, pulled out due to credibility problems. This left Mr. Bouteflika, who is supported by a pro-western, anti-Islamist powerful coterie of senior army officers and state officials, to become Algeria's seventh President. His first years of rule were marked by intensified violence and further crackdown on Islamists. To help bolster Mr. Bouteflika's position, particularly following the decline in oil prices in late 1998 and the rise of debt service ratio to 46 percent, the IMF extended a Compensatory and Contingency Financing Facility of SDR 223.5 million in May 1999.

(iii) Egypt

Egypt was the first Arab state to sign a peace treaty with Israel in 1978, hence formally ending the state of war between the two countries. Since then, Egypt has become a favored recipient of U.S. aid, despite its appalling human rights record. Although Egypt has had relatively few Bank and Fund program loans[xx], what is noteworthy is that Egypt has continued to receive such loans despite the disappointing pace and quality of reform which falls significantly short of that in Morocco and Tunisia as well as in Jordan after 1999. In addition, the timing of two of these loans was undoubtedly influenced by political factors. Without Egypt, there would have been no Arab stance supportive of the U.S.-led coalition in the 1990-91 war against Iraq. Egypt mobilized Arab support for the war and held an emergency Arab Summit for that purpose in 1990. Unlike Jordan, Egypt also sent troops to fight alongside the American forces in liberating Kuwait. Three months after the war ended in May 1991, Egypt was rewarded with a SDR 234 million IMF Standby Loan and a U.S.$ 300 million Bank Structural Adjustment Loan. Egypt also received more than $15 billion of debt write-off from the west for its efforts and strong support for the allies during the 1990-1 war, the highest level of debt forgiveness in the history of MENA.

(iv) Tunisia and Morocco

Tunisia, like Morocco, has long been regarded as a friendly pro-Western regime within MENA. Consequently, both Morocco and Tunisia have been treated favorably first by the EU, and later, by the IMF and World Bank. Between 1982-

2003, Morocco had six debt rescheduling agreements with the Paris Club and three with private international banks, received fifteen World Bank Structural and Sectoral Adjustment Loans and seven Stand-by and Extended Facilities from the IMF. Morocco has also long been the recipient of generous American military support. Over the same period, Tunisia received nine World Bank Structural and Sectoral Adjustment loans in addition to five years of continuous IMF financial support. Such treatment compares very favorably with their less America-friendly neighbors such as Algeria in the1980s and Libya in the 1980s and 1990s.

It has been argued that Washington not only used its influence inside international financial institutions to soften IMF and World Bank conditionality as well as the WTO's entry requirements, but also, along with the EU and Japan, 'repeatedly and generously lubricated' their reform efforts by 'financial assistance to ease the pain and political costs to the regime of early austerity phases' (Pfeifer, 1999, p.23 and 25-26). It would seem that in these MENA countries U.S. officials hoped, by providing friendly regimes with financial and military support and by developing them into regional showpieces of globalization, that this would stabilize the regimes of their Arab allies (Alexander 1996; Waterbury 1998).

Morocco has been such a massive and continuous recipient of Bank and Fund program loans that it is difficult to link key domestic and international political events to the timing of such loans. However, its efforts in supporting the 1991 Gulf war, including sending 1,200 of her troops, was rewarded handsomely with more than U$ 5 billion in debt forgiveness from the U.S. and Arab oil-rich states. Political liberalization in late 1997 and early 1998, with parliamentary elections resulting in the first change over of political power in the Kingdom's history, was followed by three World Bank loans over the next year totaling U.S.$ 450 million.

Tunisia has long pursued a pragmatic pro-Western foreign policy (Murphy 2002). However, a significant shift in domestic politics occurred in late 1987 with the coming to power of General Zine Ben Ali. Ben Ali's new regime, claiming an attempted Islamic coup, rapidly cracked down on the Islamic movement, arresting the head of the main opposition the Movement de la Tendance Islamique. In early 1989 the regime signaled a further shift against Islamic politics in favor of a pro-western stance by joining the Arab Maghreb Union designed to prevent the spread of radical Islam and foster closer links with the EU. The response of the Washington-based international financial institutions mirrors that in Algeria. The crackdown on Islam was followed by both a Bank and Fund loan the following year, whilst joining the Maghreb Union was followed within four months by two further Bank Sectoral Adjustment Loans.

4. LOAN TIMING: A MORE FORMAL QUANTITATIVE ANALYSIS

The above has provided a simple descriptive analysis of the timing of IMF and World Bank program loans to MENA recipients in order to try and isolate the influence of both economic need and key domestic and international political events. The results suggest that although in some cases recipient economic need, as signaled by a deterioration in key macroeconomic variables, is a determinant of the start of

IMF (and usually World Bank) lending, such loans also seem to be influenced by political events in the recipients that curry favor with U.S. policy in the region. However, so far the analysis lacks rigor. In order to strengthen and advance our argument we now use a more formal quantitative approach.

In this section, we employ a Probit model to investigate what factors influence IMF loans to MENA countries[xxi]. The dependent variable is IMF coded either 1 if a country signed an agreement (including SAF, ESAF and PRGF) in year t, or 0 otherwise. Based on the previous discussion, three sets of variables are included in the regression: economic need, U.S influence and domestic political factors. Independent variables representing economic need consist of GDP per capita, GDP growth rate, debt service ratio, short-term debt as percentage of total debt, balance of payments and changes in national reserves. U.S. influence is captured by the dummy variable PEACE, which indicates whether a country signed a peace treaty with Israel or not. Two variables are used to capture the domestic political factors: DEM-the democracy index (ranging from 1 to 7, 1 is the highest level of democracy, 7 the lowest), and DELEC – the legislative election year.

The estimation is conducted in a pooled sample with 11 countries from 1975 to 2000. The detailed variable definition, data sources and the country list are reported in Appendix Table 5.3. Following the standard procedure, the sample was limited to years in which a country was not under a previously agreed IMF program, and the explanatory variables - LGDPPC, GDPG, CAB, TDEBTS and SDEBT are lagged by one year to avoid simultaneity bias.

The first stage of the analysis focuses only on the economic variables, which may reflect the presence of a financial or macroeconomic problem that might prompt the government to approach the IMF for resources and which may be used by the IMF to decide on loan eligibility. The results for the corresponding economic model are reported in Table 5.6. The coefficients on GDP per capita (LGDPPC[-1]), total debt service ratio (TDEBTS[-1]) and changes in net reserves (D(RES/GDP)) are all significant and with the expected signs indicating that a MENA country with low GDP per capita, high debt service ratio and experiencing a sharp decline in reserves is likely to receive IMF assistance. The coefficient on the current account balance (CAB[-1]) is not significant and the coefficients on GDP growth (GDPG[-1]) and short-term debt (SDEBT[-1]) are significant but with unexpected signs.

Although the above economic approach provides some useful insights into the determinants of IMF programs, it suffers from specification error due to the omission of relevant variables (e.g. variables that capture political factors which we know from our above literature review and qualitative analysis are likely to be important). Consequently the economic model has low explanatory power (measured by an R Square of 0.194) and a low correct prediction ratio. As can be seen from the bottom of Table 5.6 the number of observations for receipt of a loan is 23 but our economic model only correctly predicts 5 of these[xxii].

Table 6 Probit Analysis of the Determinants of IMF Agreements

Variables	Economic Model		Supplemented Model	
LGDPPC[-1]	-0.659		-0.337	
	(0.279)**		(0.445)	
GDPG[-1]	0.058		0.042	
	(0.033)*		(0.045)	
CAB[-1]	-0.015		0.038	
	(0.023)		(0.037)	
TDEBTS[-1]	0.039		0.033	
	(0.013)***		(0.017)**	
SDEBT[-1]	-0.060		-0.065	
	(0.023)***		(0.037)*	
D(RES/GDP)	-5.731		-6.972	
	(3.46)*		(4.426)†	
DEM[-1]			-1.008	
			(0.445)*	
DELEC[-1]			0.6000	
			(0.535)	
DELEC			0.694	
			(0.601)	
DELEC[+1]			0.832	
			(0.505)*	
PEACE			1.052	
			(0.481)**	
Constant	3.197		5.804	
	(1.941)*		(3.089)**	
Number of Observation	165		154	
	Predicated		Predicated	
	0	1	0	1
Actual 0	139	3	125	6
Actual 1	18	5	7	16
Log Likelihood	-48.8***		-31.4***	
Chi squared	35.6***		67.1***	
R Squared (ML)	0.194		0.353	

1. Standard errors are in parentheses, and values of degrees of freedom are in square brackets.
2. ***, **, * and † indicate that the coefficient is significantly different from zero at the 1%, 5%,10% and 15% levels respectively.

In order to try and improve the model the two sets of political variables are added into regression. The results for corresponding supplemented model are reported in the third column of Table 5.6. The coefficients on GDP per capita (LGDPPC[-1])[xxiii] and GDP growth (GDPG[-1]) are no longer significant; the coefficient on the current account balance (CAB[-1]) is still insignificant; and the coefficients on short term debt (SDEBT[-1])[xxiv] and the change in reserves (D(RES/GDP)) changed slightly in terms of magnitude. For those political variables, the dummy PEACE is positive and significant, the democracy index DEM is negative and significant and the dummy for the year after a legislative election DELEC[+1] is positive and significant. This suggests that MENA countries who have signed a peace treaty with Israel, which have just had a legislative election and are democratic are likely to receive an IMF loan. In the supplemented model, the R square statistic is much higher at 0.353 and correct prediction ratio of the positive value (sign an agreement with IMF) is 16 out of 23, which is a big improvement, compared to the economic model.[xxv]

The above results clearly show that in trying to predict when the IMF will sign a loan agreement with a MENA country the model which incorporates both political and economic variables is superior to a purely economic model. Our supplemented model indicates that whether a country receives an IMF program is influenced by both economic and political factors, particularly the latter. The only economic variables in the supplemented model that have the predicted sign and are significant are the change in foreign reserves and total debt service – a decline in reserves or a high debt service ratio are good predictors of an IMF program. This finding can be further supported by the fact that 20 out of 28 IMF programs in MENA were accompanied by a Paris Club debt relief or reschedule agreement. Hence, IMF programs seem to clearly coincide with debt problems and the need to save foreign reserves. Along with the two economic variables, signing a peace treaty with Israel and improving democracy also increase the likelihood of reaching an agreement with the IMF. The existence of political business cycle also plays its part in that we have found that MENA governments are more likely to enter into an agreement with the IMF in the year after the legislative election.

The formal results from the Probit model lend support to our more qualitative analysis. They show that economic need alone does not really explain the timing of IMF loans. However, political liberalization, which often sees the incumbent regimes challenged by Islamic opposition, seems to have an influence as shown by the significance of the democracy and election variables. Likewise a change in foreign policy stance represented by signing a peace treaty with Israel is a good predictor of IMF loans.

6. CONCLUSION

Our qualitative and quantitative analysis enable U.S. to conclude that both recipient need and donor interest influence the granting of IMF and World Bank program loans to countries of the MENA region. This is not surprising given that our literature review indicated that most empirical studies of aid allocation find that donor interest, including geo-political interest, influences who gets what in terms of aid. The generally accepted view is that donor interest plays a more important role in bilateral aid allocation than in multilateral aid allocation. This may be so, but we have identified important reasons why the major western shareholders might seek to influence the flow of funds from the two major Washington-based multilaterals. Given its voting power in both the Bank and the Fund, the U.S.A is in a particularly influential position.

Our qualitative analysis focused on the five major MENA recipients of IMF and World Bank program loans - Algeria, Jordan, Morocco, Tunisia and Egypt. Looking at each country's macroeconomic performance in the year in which they commenced their first of a phase of program loans we see very little evidence of economic need. Only in the case of Jordan in the late 1980s and Egypt in its first phase of loans during the mid-1970s do we see any clear sign of recipient economic need in terms of a significant deterioration in the macroeconomic indicators the IMF is usually concerned with. It seems therefore that we must look to other factors to explain the IMF and World Bank engagement with Egypt in the 1980s and with Morocco, Tunisia and Algeria. In all cases a cursory political analysis would indicate that a shift towards a pro-western foreign policy, peace overtures to Israel, domestic political liberalization and the often related challenge to the regime by Islamic opposition prompt an inflow of funds not just from the U.S.A but also from the Bank and Fund. Even in the case of Jordan, who became a recipient of such loans in 1989, the severe economic crisis of that year was inextricably linked with such foreign policy and domestic political events.

The above findings are further supported by our more formal qualitative analysis. Using a Probit model to estimate the determinants of IMF lending in the region we found that a model that only includes variables representing recipient need performs very poorly. However, once we include foreign policy and political variables the model performs extremely well. In this supplemented model the only economic variables that help to predict whether a MENA country will be granted an IMF loan are a change in foreign reserves and total debt service – a decline in reserves or a high debt service ratio are good predictors of an IMF program. Signing a peace treaty with Israel improves a country's chance of a loan as does improving democracy. Related to the latter, we also found that holding an election is likely to be followed by an IMF loan in the post-election year.

The above findings are important, not just because they add to an already large body of empirical work on the determinants of aid allocation, but also because they have important policy implications. The fact that IMF and World Bank lending in MENA seems to be orientated towards pro-western regimes that introduce western-style democracy, and adhere to U.S. foreign policy interests in the region suggest that factors other than recipient need are influencing global aid allocations. This may well reduce the developmental impact of a scare resource, namely aid. As Collier and Dollar have argued (2002) a more poverty-efficient allocation of aid has the potential to double the number of people lifted out poverty from 10 to 20 million.

Secondly, IMF and World Bank loans to MENA countries do not just provide finance, they also bring with them an extensive package of economic reform and liberalization. Many of these reforms, if correctly implemented, have the ability to bring tremendous gains to the region. Nevertheless, economic liberalization also brings risks and costs. Unemployment may increase, at least in the short term, income inequality may worsen and certain vulnerable groups, if not caught by social safety nets, will be harmed. In light of this there is the serious risk that U.S. foreign policy in the region, including the encouragement of IMF and World Bank lending to pro-western regimes, could catastrophically backfire. Economic and political liberalization by western-supported MENA regimes, if it brings with it adverse social welfare effects combined with a backlash in the form of a crack down on often legitimate opposition groups, is likely to fuel the already growing unrest in such countries. Increasingly, such unrest is directed not just at incumbent regimes but also has anti-western and more specifically anti-American and anti-globalization overtones. In some instances, such as in the case of past riots in Jordan prompted by the IMF-induced lifting of price supports, the IMF and the World Bank have been viewed by many of the opponents of reform as synonymous with the American presence and interests in the region. If this persists, the very regimes that America and the west are trying to support with funding and reform packages may well not survive. The welfare effects of IMF and World Bank programs in MENA countries as well as local perceptions of these two institutions is hence an area that deserves further research.

Appendix 1: History of IMF Lending Arrangements in MENA

Algeria	Date of Arrangement	Date of Cancellation	Amount Agreed	Amount Drawn	Amount Outstanding
Extended Fund Facility	May 22, 1995	May 21, 1998	1,169,280	1,169,280	525,487
Standby Arrangement	May 27, 1994	May 22, 1995	457,200	385,200	0
Standby Arrangement	Jun 03, 1991	Mar 31, 1992	300,000	225,000	0
Standby Arrangement	May 31, 1989	May 30, 1990	155,700	155,700	0
Egypt					
Standby Arrangement	Oct 11, 1996	Sep 30, 1998	271,400	0	0
Extended Fund Facility	Sep 20, 1993	Sep 19, 1996	400,000	0	0
Standby Arrangement	May 17, 1991	May 31, 1993	234,400	147,200	0
Standby Arrangement	May 15, 1987	Nov 30, 1988	250,000	116,000	0
Jordan					
Standby Arrangement	Jul 03, 2002	Jul 02, 2004	85,280	10,660	10,660
Extended Fund Facility	Apr 15, 1999	May 31, 2002	127,880	127,880	127,880
Extended Fund Facility	Feb 09, 1996	Feb 08, 1999	238,040	202,520	113,738
Extended Fund Facility	May 25, 1994	Feb 09, 1996	189,300	130,320	35,205
Standby Arrangement	Feb 26, 1992	Feb 25, 1994	44,400	44,400	0
Standby Arrangement	Jul 14, 1989	Jan 13, 1991	60,000	26,800	0
Morocco					
Standby Arrangement	Jan 31, 1992	Mar 31, 1993	91,980	18,396	0
Standby Arrangement	Jul 20, 1990	Mar 31, 1991	100,000	48,000	0
Standby Arrangement	Aug 30, 1988	Dec 31, 1989	210,000	210,000	0
Standby Arrangement	Dec 16, 1986	Apr 30, 1988	230,000	230,000	0
Standby Arrangement	Sep 12, 1985	Dec 15, 1986	200,000	10,000	0
Standby Arrangement	Nov 15, 1959	Mar 15, 1985	833,250	0	0
Standby Arrangement	Sep 16, 1983	Mar 15, 1985	300,000	300,000	0
Tunisia					
Extended Fund Facility	Jul 25, 1988	Jul 24, 1992	207,300	207,300	0
Standby Arrangement	Nov 04, 1986	May 31, 1988	103,650	91,000	0

Source: IMF (Amount in thousands of SDR)

Note: Seven cases are not reported here: Djibouti, 1996 SAF and 1999 PRGF; Yemen 1996 SAF and 1997 PRGF and ESAF; Egypt 1976, SAL and Morocco, 1980 SAL; and the date for Morocco second Arrangement seems to be wrong in IMF Web-page.

Appendix 2: History of World Bank Lending Arrangements in MENA

Project name	Commitment US $ Million	Country	Date of Approval
Economic Reform Support Loan	300	Algeria	31-Aug-89
Enterprise & Financial Sector Adjustment Loan	350	Algeria	21-Jun-91
Economic Rehabilitation Support Loan	150	Algeria	12-Jan-95
Structural Adjustment Loan	300	Algeria	25-Apr-96
Agricultural Industrial Imports	70	Egypt	03-Dec-74
Agricultural Industrial Imports (02)	70	Egypt	14-Jun-77
Structural Adjustment Loan	300	Egypt	21-Jun-91
Industry & Trade Policy Adjustment Loan	150	Jordan	14-Dec-89
Energy Sector Adjustment Loan	80	Jordan	07-Oct-93
Agriculture Sector Adjustment Loan	80	Jordan	08-Dec-94
Economic Reform & Development Loan	80	Jordan	24-Oct-95
Economic Reform & Development Loan (02)	120	Jordan	11-Dec-96
Economic Reform & Development Loan (03)	120	Jordan	01-Jun-99
Public Sector Reform Adjustment Loan	120	Jordan	21-Jun-01
Public Sector Reform Adjustment Loan (02)	120	Jordan	02-Jul-02
Industrial and Trade Policy Adjustment Loan	150.4	Morocco	31-Jan-84
Agricultural Sector Adjustment Loan	100	Morocco	20-Jun-85
Industrial and Trade Policy Adjustment Loan (02)	200	Morocco	16-Jul-85
Education Sector Reform Program	150	Morocco	20-Mar-86
Public Enterprise Rationalization Loan	240	Morocco	26-May-87
Agricultural Sector Adjustment Loan (02)	225	Morocco	24-Nov-87
Structural Adjustment Loan	200	Morocco	01-Dec-88
Financial Sector Development	235	Morocco	25-Jun-91
Structural Adjustment Loan (02)	275	Morocco	30-Apr-92
Financial Markets Development Loan	250	Morocco	27-Jul-95
Contractual Savings Development Loan	100	Morocco	09-Jun-98
Post Information Technology	101	Morocco	06-May99
Policy Reform Support Loan (PRSL)	250	Morocco	01-Jun-99
Information Infrastructure Loan	65	Morocco	31-May-01
Asset Management Reform Loan	45	Morocco	05-Jun-03
Agricultural Sector Adjustment Loan	150	Tunisia	18-Sep-86
Industrial and Trade Policy Adjustment Loan	150	Tunisia	24-Feb-87
Structural Adjustment Loan	150	Tunisia	16-Jun-88
Agricultural Sector Adjustment Loan (02)	84	Tunisia	01-Jun-89
Public Enterprise Reform Loan	130	Tunisia	11-Jul-89
Economic & Financial Reforms Support Loan	250	Tunisia	12-Dec-91
Economic Competitiveness Adjustment Loan	75	Tunisia	25-Jul-96
Economic Competitiveness Adjustment Loan (02)	159	Tunisia	20-Apr-99
Economic Competitiveness Adjustment Loan (03)	252.5	Tunisia	20-Dec-01

Source: World Bank Project Database.
Note: Six cases are not reported here: Iran, 1957 SAL; Lebanon, 1977 SAL; Djibouti, 2001 SAL; Yemen, 1996, 97, 99 SAL.

Appendix 3: Variable Definition and Data Source

D(RES/GDP)	Changes in net reserves (BoP, current US$)/GDP(current US$)
CAB	Current account balance (% of GDP)
TDEBTS	Total debt service (% of exports of goods and services)
GDPG	GDP growth (annual %)
LGDPPC	Log[GDP per capita (constant 1995 US$)]
SDEBT	Short-term debt (% of total external debt)

(World Development Indicator 2002 CD-ROM)

DEM Democracy index (1-7)

(Freedomhouse: www.freedomhouse.org)

DELEC Dummy, is there a legislative election? (1 if yes)

(World Bank DPI database: Beck, et al (2001), the World Bank Economic Review)

PEACE Dummy, the year that a country under peace treaty with Israel (1 if yes)

Country List: Algeria, Djibouti, Egypt, Iran, Jordan, Libya, Morocco, Oman, Syrian, Tunisia and Yemen.

Years covered: 1975-2000

ENDNOTES

[i] The World Bank definition of MENA includes: Algeria, Djibouti, Egypt, Iran, Iraq, Jordan, Lebanon, Libya, Malta, Morocco, Oman, Palestine, Saudi Arabia, Syria, Tunisia, and Yemen. It does not include the high-income countries of the Gulf, nor Israel, nor Sudan and Mauritania which although predominantly Arab countries face challenges more typical of sub-Saharan Africa. In our general discussions of aid allocation we use the same country grouping as the Bank, although also include reference to Israel, a major recipient of U.S. aid.

[ii] For an excellent survey and methodological critique of this work see McGillivray and White (1993).

[iii] Western aid to Mobuto's Zaire or Marcos's Philippines designed to bolster anti-communist pro-western regimes are good examples.

[iv] Program loans divorce development finance from specific investment projects in the recipient and instead provide general support for the balance of payments and/or government budget in return for which the recipient agrees to undertake various economic reforms, which can often be far reaching. See Mosley, Harrigan and Toye 1995.

[v] In terms of destination of aid in the MENA region, DAC aid is quite concentrated. Between 1961-2001 Egypt and Israel accounted for over 60 per cent of DAC aid into the region, followed by Morocco 8.0 per cent, Jordan 5.3 per cent and Tunisia 4.5 per cent.

[vi] Donor interest includes pursuit of commercial interests via the promotion of donor trade or investment opportunities by allocating aid to countries most likely to absorb donor exports and investment. It also includes the pursuit of political, diplomatic and strategic objectives in order to create an international environment, which favors the donor. According to Feeny and McGillivray 2002 p. 3: ‘This can involve allocating aid to countries which are in a strategic geographic location or which have particularly close diplomatic ties with the donor. It can even involve rewarding countries for particular actions with increased aid or punishing others with reduced or continually low or zero levels of aid’.

[vii] We ran our regressions for three dependent variables - U.S. aid, bilateral aid excluding the U.S., and multilateral aid and found that donor interest has the strongest effect on the allocation of U.S. aid, and also that non-U.S. bilateral aid responded more to donor interest that did multilateral aid.

[viii] The U.S.-Egypt dummy parameter in Berthelemy and Tichit's study was particularly large in the 1980s sub-period following the Camp David Peace Accord with Israel and the analysis suggested the privileged assistance enjoyed by Egypt from the United States translated into an aid bonus of U.S.$49 per capita.

[ix] IBRD Articles of Agreement IV: operations, section 10; IDA Articles of Agreement V: operations, section 6.

[x] A country's voting power is not the same as its voting weight: it's power is its ability to decide the issue when a vote is taken whereas its weight is just the number of votes

it has the right to cast. Voting power is calculated by analyzing all the voting outcomes that can occur, and in each case investigating the ability of every member to be decisive - that is to be the one member who can decide whether the vote leads to a decision or not.

[xi] The bulk of the studies have concentrated on the determinants of IMF rather than World Bank lending. The reason seems to be two-fold. Firstly, an IMF agreement is usually a pre-requisite for a Bank program loan and most IMF agreements are followed by such a loan. Hence, many of the determinants of an IMF agreement will also be determinants of the Bank's activities. Secondly, the aspects of recipient need that the IMF is meant to respond to, namely inflation, balance of payments and budget deficits are much easier to measure than the more medium term supply side determinants of World Bank program loans (structural imbalance, developmental indicators etc). Hence, from a methodological standpoint it is much easier to construct the independent variables in an equation estimating the determinants of IMF loans than those that would need to enter such an equation for World Bank program loans.

[xii] Reliance on oil took two forms, direct and indirect. Direct reliance refers to the oil export countries include OPEC countries in the region, along with Egypt and Yemen. Indirect reliance refers to those countries, especially Jordan, Egypt and Yemen, who received large remittances from the oil rich GCC countries.

[xiii] In the period since 1981 Egypt received one program loan from the Bank and four from the Fund, Jordan received eight from the Bank and six from the Fund, Morocco eleven from the Bank and seven from the Fund and Tunisia nine from the Bank and two from the Fund. More recently from 1989 onwards Algeria has received four from the Bank and four from the Fund. In addition, Djibouti received a SAL in 2001, Lebanon in 1977, and Yemen received three between 1996-99.

[xiv] We look at IMF loans rather than World Bank program loans because the former are almost always a prerequisite for the latter.

[xv] The traditional division of labor in the 1980s was that the IMF would take care of balance of payments problems whilst medium term growth would be the concern of the World Bank (Mosley, Harrigan and Toye 1995 vol. 1 pp51-56).

[xvi] In the 1974 Arab Summit in Rabat, Morocco, the PLO was declared as the 'sole representative of the Palestinian people', a fact, which further weakened King Hussein's hand in negotiating a separate peace settlement with Israel.

[xvii] Lost aid from the U.S. was more than compensated by the 1979 Arab Summit in Baghdad, which allocated U$1.25 million in annual grants to Jordan from oil-rich Arab states. This obviously weakened the U.S.'s bargaining position in persuading King Hussein to sign a separate peace treaty with Israel and at the same time marked the beginning of stronger and long-lasting relations between Jordan and Iraq's Saddam Hussein. However, with the collapse of international oil prices in the early 1980s, Arab aid to Jordan was drying up. Only Saudi Arabia was able to continue to

provide Jordan with grants over the ten-year period agreed upon during the 1979 Arab summit (See Brand, 1994).

[xviii] This plan was based on the principle of peace for land formula, including the establishment of a self-governing authority in the West Bank and Gaza Strip (WBG) in association with Jordan, since the U.S. was strongly opposed to the idea of recognizing or negotiating with the PLO so long as the latter did not recognize Israel's right to exist (Lukacs, 1997).

[xix] This culminated in what became known as the Amman Accord in 1985. The Accord called for Israeli withdrawal from the occupied territories, the resolution of the refugee problem and a Palestinian self-determination within a Jordanian-Palestinian confederation.

[xx] Egypt received only three World Bank SALs (two of which were in the 1970s) and four IMF program loans.

[xxi] Again only IMF programs are considered here due to the fact that the World Bank's SALs or SECALs are generally preceded by an IMF program. The Probit model can be used to determine the eligibility of receiving aid as opposed to the amount received. Hence the dependent variable takes the value of 1 or 0 depending on whether each country in the sample receives aid in a give year or not. In our case we use the Probit model to predict whether a country receives an IMF loan.

[xxii] The actual number of observations for no IMF loan is 142 and of these the economic model correctly predicts 139 (and incorrectly predicts 3). But it should be noted that most Probit model analysis scores highly on predicting the zeros in the observations of the dependent variable.

[xxiii] The coefficient on LGDPPC[-1] is sensitive to whether we include a constant or not. When the constant is excluded, the coefficient is negative and significant.

[xxiv] Short-term debt as percentage of total debt has a negative impact on receiving an IMF loan, which is not expected. However, when we checked the debt structure of MENA countries, we find short-term debt has been in decline since the early 1980s, and more than two thirds of their long-term external debt is from official sources. If the government's desire to sign an agreement with IMF is designed to help initiate the process of long term debt relief from major donors this would explain the negative coefficient on short-term debt. The smaller the percentage of short-term debt (and hence the larger the percentage of official long-term debt) the more likely it becomes that an IMF agreement will be signed.

[xxv] Given this study is based on a relative small sample, those figures are very respectable. Bird and Rowlands (2003) have shown that a common feature of this genre of research is its arguably low explanatory power overall. Although the percentage of correct prediction was often 80 and 90 percent, it has to be recalled that these numbers corresponded roughly to the percentage of countries without agreements.

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