



The Political Economy of Governance in the Euro-Mediterranean Partnership

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New Challenges: Domestic Reforms

Arab Mediterranean Countries facing the “second generation” of Reforms: A Political Economy Standpoint

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Christophe Laviolle

Laboratoire d'Économie d'Orléans – University of Orléans, France

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1. Abstract

The aim of this paper is to provide a general overview of the nature of domestic reforms that Mediterranean Partner Countries are facing today, and to cast new light on some of the obstacles affecting these economies in their attempt to conform to Euro-Mediterranean Partnership requirements and to turn what is nowadays a simple macroeconomic growth strategy into a real development process.

Our starting point will be to describe the EMP, in its economic component, as coming from the point of view of the reform trend, within a “second generation” of reforms. Following the structural adjustments which, during the 1980s and until the beginning of 1990s, focused on the re-absorption of the excess of global demand and on the stabilization of the main macroeconomic equilibriums, the goal is now to instigate supply, to improve potential growth and to lay the foundations of a real development process. It is then a matter of prolonging reforms of “first generation” (mainly intended to initiate the intrusion of market mechanisms into economies until then strongly regulated by state) by some reforms which go right through the heart of productive systems. This “second generation” reform has in fact the main goal of completing the diffusion of market mechanisms by setting up the institutional framework required for the functioning of capitalist economies. Therefore, these reforms, unlike the first one, directly affect not only the economic system, but the very way of functioning of the societies as a whole, and concern a high number of agents.

This deep difference of nature between the two stages of reforms explains why the present stage is so hard to improve. In this case, the obstacles must be researched, not only in a failure of the mode of governance, as it is regularly supposed, but in the dysfunction of the institutional area as a whole, notably in its ability to produce trust within the economic system. Then, the goal is in fact, behind the injunction to implement domestic reforms, and as the World Bank (2003) pointed out, to redefine a new social contract, breaking with the one prevailing since independence and until the end of 1970s. It is then a matter, not only of economics, but of political economy: which coalition of agents can emerge to sustain the process of institutional transformation?

2. Introduction

Generally conveyed traditional portrayals of Arab Countries describe deadlocked societies and economies, in which the failure to act on the behalf of the leaders would lead to violent and potentially dangerous convulsions. According to this viewpoint, the permanence of the clandestine migratory flux towards Europe would be at the same time a symptom of this crisis, and a signal addressed to the European countries.

The objective of this article is to widen, look further into, and make more complex our vision of these countries. It will be a question of identifying the obstacles met by these countries in the process of installation of the reforms. From that viewpoint, the Arab world does not constitute a homogeneous reality: Gulf countries, particularly, exhibit political, economic and social regulations deeply different from those of the Mediterranean Arab countries. In addition, the latter are also distinguished within the partners countries of the Barcelona Process. Therefore, the scope of our reflection is regional and focuses on the Arab Mediterranean Countries which are included in the Barcelona Process, and particularly, Morocco, Algeria, Tunisia, Egypt, Jordan, Lebanon, and Syria.

The aim of the paper is then to provide, concerning these countries, a general overview of the nature of domestic reforms that they are facing today, and to cast new light on some of the obstacles affecting these economies in their attempt to conform to Euro-Mediterranean Partnership requirements and to turn what is nowadays a simple macroeconomic growth strategy into a real development process.

Our starting point will be to describe the EMP, in its economic component, as coming, from the point of view of the reform trend, within a “second generation” reforms. Following the structural adjustments which, during the 1980s and until the beginning of 1990s, focused on the reduction of the global demand excess and on the stabilization of the main macroeconomic equilibriums, the stake is now to instigate supply, to improve potential growth and to lay the foundations of a real development process. It is then a matter of prolonging reforms of “first generation” (mainly intended to initiate the improving of market mechanisms into economies until then strongly regulated by state) by some reforms which go right through the heart of productive systems. This “second generation” of reforms has in fact the main goal to complete the diffusion of market mechanisms by setting up the institutional framework required for the functioning of capitalist economies. Therefore, these reforms, unlike the first one, directly affect, not only the economic system, but the very way of functioning of the societies as a whole.

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The present work leans on the research and the publications of the World Bank, notably upon that (2003c) about the need of a new social contract in Arab Mediterranean Countries, but also the works of Kaufman on Governance (Kaufman (2003, 2004 and 2005), Kaufmann & al (1999, 2002, 2005) and on the exploitation these works made of the WB's statistical indicators (World Development Indicators, Global Development Finance, Governance Indicators of World Bank Institute). The general problematic of the paper owes a lot to the work of Jacques Ould Aoudia (2006, 2007) (see also Meisel & Ould Aoudia (2006)) and the use he made of the MINEFI ¹Data Basis "Institutional Profiles" (see Berthelie & alii (2004)).

3. The Euro-Mediterranean partnership and the "second generation reforms" in MPC: from technical agenda to political challenge

A) From first to second generation reforms

Arab Mediterranean Countries have engaged, during the 1980s and 1990s, macroeconomic stabilization policies, framed by structural adjustment programs negotiated with international institutions. These programs were implemented when stating serious macro-economic imbalances that most of developing countries have experienced in the 1980s, in relation to problems in paying off their foreign debt.

¹ French "Ministère de l'économie et des finances"

These programs articulated two joint points: firstly the reduction of disequilibrium between global demand and aggregate supply; secondly, the setting up of a first set of reforms in order to frame this rebalancing.

- The adjustment between supply and demand goes through the reduction of deficits (public accounts and current accounts), a rigorous monitoring of fiscal policy, and finally a readjustment of the exchange rate, so as to diminishing what one could label an “artificial” capacity to import, created by the overvaluation of money. This macroeconomic adjustment finally takes the form of a systematic drop in demand, whose aim is to restore the capacity to pay off the foreign debt.
- The first set of reforms which goes together with this macroeconomic adjustment (and which could be label “first generation reforms”), aims to initiate the implementation of market mechanisms within economies until then strongly regulated by state: liberalization of prices (and particularly of interest rates), removal of administrative control over foreign trade and investment, privatization of public firms, and so on (Ould Aoudia, 1999).

After this first macroeconomic adjustment phase, the move has logically to be prolonged by an action on supply. The reasoning is here to raise the level of productive capacities, which implies deep structural reforms which enter within the heart of productive systems and of institutional compromises, aim to change the links between state and private sector, to reinforce the rule of Law in the relationships between citizens themselves and between them and the State.

The goal of these structural reforms, that one could label “second generation reforms”, is more generally nothing but the massive change of the mode of development of these countries. For that reason, they question the prevailing social contracts, and their historical and cultural roots.

B) The Euro-Mediterranean Partnership in the process of reforming MPC's economies: a theoretically relevant step

We know that, beyond its political dimension, the economic part of the EMP, as it was initiated in Barcelona in 1995, is focused on the progressive building of a free trade area, on the one hand between EU and every one of the MPC, on the over hand between these MPC themselves. This economic perspective is fitted into an accompaniment plan that offers to

these countries both a political anchorage and a financial help turned towards the support of institutional reforms (by the way of the MEDA program) and towards the financing of firms and infrastructures (by the way of European Investment Bank's loans and the FEMIP).

In terms of reform dynamic, the expected effects of the creation of a free trade area are, classically:

- In the short run, a stimulation of structural reforms, notably fiscal ones (because of the necessary compensation of losses of customs receipts due to tariff dismantling with the EU)
- In the long run, a stimulation of productive capacities by the way of the reallocation of productive factors induced by the modification of relative prices and the higher competitive pressure exerted by EU's products.

Beyond the fiscal area, reforms that must be initiated concern the financial system (increase domestic saving and make easier the financing of firms, notably the financing of the reallocation of productive factors induced by the increase of competitive pressure), the continuation of privatization plans and the implementation of private/public partnership for infrastructure, reforms of the labour market (notably in order to reduce the gap between a very protected formal market and a without-protection informal one), extension and reform of welfare systems, reform of educational systems, improving of health systems, and others.

In other terms, after having achieved the structural adjustments which were focused on the re-absorption of excess demand and the stabilization of main macroeconomic equilibriums, the goal is now to stimulate supply and potential growth, by the way of structural reforms and re-positioning of productive systems. It is then a matter of prolonging "first generation reforms", inferred by Structural Adjustment Plans negotiated with international institutions, by reforms that penetrate through the heart of productive systems.

From that standpoint, it is possible to say that **EMP may seem theoretically relevant** (Cling & Ould Aoudia, 2003): its aim is, by the way of introducing competitive pressure into the productive systems of MPC (particularly by the way of commercial opening), to fight against rents constituted under cover of customs protections, and so create a powerful leverage to make progress institutional transformations that must accompany factors reallocations.

C) The political challenge

To date, the first effects of EMP are measurable only in Tunisia and Morocco (Caupin, 2005). Indeed, the EMP seems to have started to make an impact in terms of stimulation of “second generation” structural reforms in Tunisia and, to a lesser extent, in Morocco, but the expected effects on the stimulation of productive capacities and the transformation of productive systems (stimulation of supply) are still to come (Ould Aoudia, 2006).

Finally, from the point of view of the reform dynamic in south and east Mediterranean countries, it stands out that these countries are still largely stamped with a self-centred development model, and consequently come up against grave difficulties implementing a new mode of functioning of their economies.

According to Massenet & Ould Aoudia (2000), it is then possible to classify these countries in three groups, regarding their engagement in the dynamics of the reforms:

- A first group is constituted by countries where reforms have largely progressed, and are supported and promoted by internal forces. In these countries (Israel, Cyprus², and, to a lesser extent, Turkey), the EMP doesn't appear as a primordial goal, because they do have their own strategy of insertion in world economy;
- A second group gathers together countries (Morocco, Tunisia, Egypt, Palestinian Territories, Jordan, Lebanon) that are, from our standpoint, in an intermediate position: reforms are begun there (to varying degrees) but come up against great resistance. In this group, the adhesion to EMP is strong, even for economic reasons (North Africa) or for political ones (Middle-East), but even when reforms are decided and officially adopted, they are not always applied and are sometimes diverted from their objectives.
- Finally, a third group is constituted by countries (Algeria, Syria) where, to date, both the dynamics of reforms and the adhesion to Euro-Mediterranean partnership are weak or null.

To conclude, it seems in fact that commercial opening cannot constitute, in itself, a development strategy (Fontagné & Guérin, 1997). It must be supported by a coherent set of internal reforms, whose implementation lies within the ability of these countries to find new

² But Cyprus is not any more a « partner country », because of its integration as a member state of the EU in 2004

political and social equilibriums able to constitute the base support for the reforms and the so-called “modernization” of societies.

Beyond the display of a very full agenda of reforms, the question is that of the coherence of this set of reforms (are they adapted to the existing institutional environment?), of the institutional complementarities likely to emerge (for instance between reforms engaged in the labour market, welfare systems and educational field, or between the institutional reconfiguration of productive systems and the modalities of State interventionism), and finally of the political and social support with which this agenda meets (which degree of appropriation of the movement of reforms can one expect on behalf of the citizens and of the society as a whole?)

4. The Institutional Complementarities in MPC: not very competing economies

Admittedly, the Arab MPCs have showed their capacity to implement the macro-economic adjustments and to engage, for almost all of them, in commercial opening within the framework of the EMP. But second generation reforms, that the EMP is supposed to cause, and which carry, through the heart of productive systems, transformations that shake up interests and traditions, are more hard to implement, and these countries showed here, as we have said before, have greater inertia.

In this section, we carry out an analysis in terms of **institutional complementarities**: firms and corporate governance, financial system, modes of state intervention into the economy. We show that strong complementarities exist, which define a particular model of mixed economy, a particular variety of “capitalism”³, both family-centred and paternalistic, in which the degree of competitive pressure is not very high.

A) The productive systems: a “family” capitalism

It stands out from different works (World Bank, 2003a et 2003c), Abed (2003), European Commission (2003)) that productive web of Arab MPC is still characterized by not very competing operation and defective corporate governance. Particularly, it is characterized by a

³ For a remarkable presentation of the “Varieties of Capitalism” Approach, cf. Hall & Soskice (2001) and, more recently Hancké, Rhodes & Thatcher (2007)

strong dualism between a limited number of large firms, narrowly overlapping with States, and thousands of small and very small companies, each of them taking part, at least partly, with the informal economy;

Large firms privilege rapid return activities by “horizontal” investments. Then they reinvest little in their own channel of production, which infers low technological and managerial know-how, a low long-term investment level (witnessing a high degree of aversion to risk), a weak investment in the qualification of their workers, or in the recruiting of a skilled workforce (whereas there exists a high level of unemployment amongst young graduates). Finally firms are characterized by their weak innovation capacities and even, taking into account the level of development of these countries, a weak appetite for imitation⁴ (Acemoglu & al, 2002).

Small companies, generally without access to external financing, remain at a personal or family stage of development, generally due to fear of unbalancing the structure of power within the company while opening to external competencies or contributions. It is also the weak level of transactions security which limits the growth of the size of these small companies. This weakness lies within of the predominant formal legal frameworks, but also, as we shall see later, in the narrowness of trust spaces between agents, which are generally reduced to those where personal links prevail. In this way, economic activity is spread neither in a climate of competition, nor in a space of co-operation (see below).

From the point of view of **corporate governance**, Arab MPCs share with developing countries as a whole an institutional form characterized by an extreme concentration of shareholding. In this way, the main potential conflict is not between owners and managers, but between insiders (owners as well as managers) and outsiders (minority shareholders and other investors). One understands that such an institutional configuration is a powerful brake on the opening of the capital to foreign investors.

⁴ For developments about the differentiation between “imitative” and “innovative” economies, cf. Acemoglu & alii (2002).

B) The financial systems

It is, finally, the weak dynamics of productive systems of Mediterranean Arab Countries which determine the main features of their financial systems. Broadly speaking, Firms don't call on external financing very much, whether it comes from banks or financial markets. They finance their activity mainly by self-financing. The financial systems are therefore primarily turned towards the financing of the State.

In terms of their structures, the financial systems of these countries, as is the case in almost all developing countries, are largely dominated by banks. Financial Markets play here a secondary role which, it should be noted, does not constitute in itself an obstacle in the way of economic development. Stock markets are tight (stock market capitalization is not very high taking into consideration the level of GDP, and the value of exchanged securities is very weak), bond markets are mainly turned towards the financing of public debt, and resale markets are quasi non-existent

As far as banks are concerned, with the "demand side factors" we have above mentioned, "supply side factors" are added to explain the low level of debt of the firms (BEI/FEMIP, 2004): low capacities of transformation; lack of training concerning the analysis of the risk; importance of doubtful debts; constraints weighing on the collateral, because of deficiencies in the definition of the property rights (particularly as regards property ownership); small degree of competition involving a lack of innovation; high asymmetries of information; and many others.

C) The modes of state intervention: a paternalistic capitalism

If the influence of the State on the economy decreases for some countries (notably in Morocco and in Jordan, and to a lesser extent in Tunisia), particularly as regards intervention on prices and interest rates, private sectors and states remain, everywhere, narrowly overlapping, which contributes to the not very competitive operation of the markets.

Such an overlap of private and public interests has been particularly studied in the case of transition economies, and more particularly in Russia (Hellman & Kaufmann, 2001). One can think that it constitutes a major obstacle to the dynamic development of productive systems

This pre-eminence of the State is, then, a strong feature of these societies, with historical roots. It lies within the heritage of independence, which made the public sector the main agent

of economic development in a context of both the priority granted to the constitution of the “State-Nation” and the weakness of the entrepreneurial class. It also lay with the “imports substitution” development strategy, admittedly now abandoned, but without a clear vision emerging of what could now be the possible new role of the State.

The idea generally advanced on this point is that State must now be the regulating agent of markets. But this prescription remains at a very general level, without any taking account of the contexts specific to each one of these countries, and particularly without any questioning about the very ability of them to adopt such a posture in view of the level of institutional development they have reached, and more precisely of the degree of rules formalization which they know.

Then, the unclear delimitation of public and private areas, combined with the weak level of trust between economic agents, that reduces the possible cooperation between firms, constitutes an institutional context which make difficult the adoption, by public authorities, of these new functions.

The control of privatizations brings another illustration of this phenomenon (BEI/FEMIP, 2004). In the absence of an adapted regulation framework they, until now, didn’t answer waiting in terms of making supply dynamic. However, this regulation effort needs in its turn a high level of development of formal institutions and the backing of a clearly stated and accepted public strategy.

Finally, the State, projected in its new role of regulator of markets, regardless of the capacities of societies to appropriate the new rules of the game, fails to play its role of supplying clear prospects in the medium and long term, and of coordinating expectations and individuals’ behaviour.

From that point of view, the real problem is not one of the sometimes authoritarian character of the State in the studied Countries. One knows now that the expected link between democratization and economic development is quite complex. For instance, economic takeoffs that East-Asian countries have experienced have been driven by authoritarian regimes (South Korea, Taiwan, China today). In a same way, among the MPCs, the abandonment of the “import substitution” development model in Turkey, which has inferred the beginning of the Turkish economy’s takeoff, has been promoted by a military regime.

Figure 1: Complementarities across sub-systems in the Arab Mediterranean Paternalistic Economies

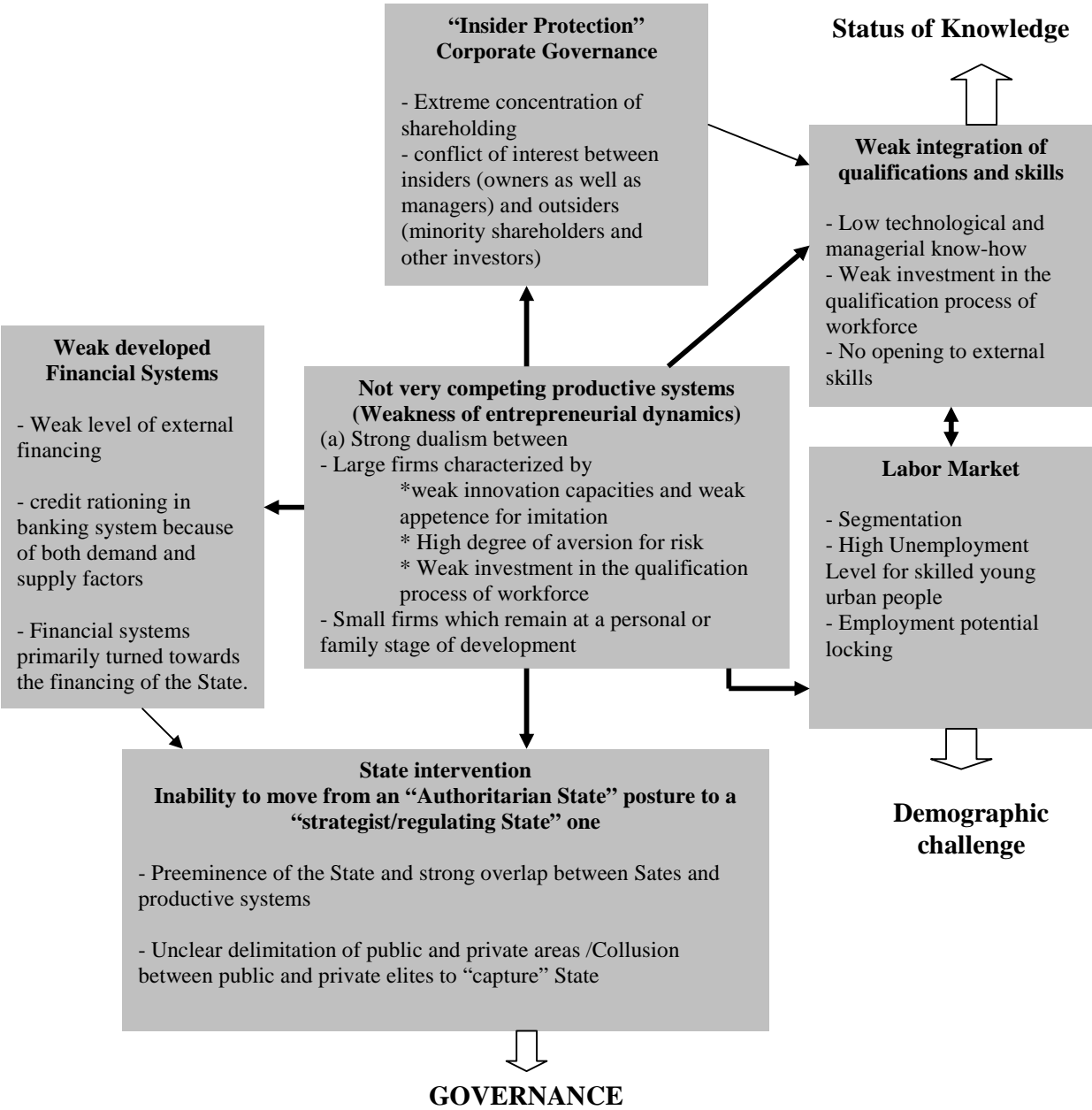


Fig.1 Complementarities across subsystems in the Arab Mediterranean paternalistic economies

The point is here that, if the disappearance of the State is not desirable (also it is now taken that the institution of a market economy has to go through the regulating capacity of public authorities), it is not enough to have a strong and authoritarian State. It also must be a strategist State, which polarizes private interests, coordinates behaviour, and makes credible the improvement of living conditions for all, while progressively and definitively using market forces as selection criteria.

In the countries we study, States have applied only the authoritarian dimension of the story. Without any strategic vision about the development of their countries, leaders seemed more worried about maintaining their position inside the State apparatus, and have constrained populations in their social requests (leaving them like loophole only strategies of “exit” or “voice” (radical protests), to paraphrase the terminology of Hirschman), instead of being based on their loyalty and capacities.

5. Beyond state governance, the institutional environment: not very cooperative economies

We show in this third section that the two main features of the type of mixed economy which characterizes MPCs are (1) the pre-eminence of the strength of “tie” over that of Law in the coordination of economic and social behaviours; (2) the primacy of security requirements (most often satisfied by way of public regulations or traditional family-centred solidarities) on individual freedoms. So the problem is not only a problem of state governance but more fundamentally lies in the not very cooperative character of these societies, which infer a low level of spontaneous trust between economic agents and turn out to be a major obstacle in the way of economic development.

A) The State governance

In the abundant literature on the weakness of growth in the Region and on the obstacles which one can locate in the way of economic development for these countries (FEMISE (1997, 2000, 2001), Abed & Davoodi (2003); Sala-i-Martin & Artadi (2003); Nunnenkamp (2003); Hakura (2004)), the existence of serious failures in the field of governance is regularly put forward. Authors underline the low efficacy of State Administration, high corruption, weak protection of property rights, high transaction costs, and so on.

However it seems, as Ould – Aoudia (2006) note, that the recent disposal of quantitative indicators evaluating the performances as regards governance (Kaufman & alii, 1999, 2002; Ould-Aoudia, 2003) strongly nuances this diagnosis.

- On 5 of the 6 indicators of Kaufman⁵, Arab Countries show relative performances (taking into account the level of their GDP) on average equal to, or slightly higher than, those of the other developing countries: as regards political stability, Government effectiveness, Regulatory quality, Rule of Law and control of corruption. Let us notice that these 5 indicators compose what is generally designed as the “business Climate”, regularly used to explain the attractiveness of a country for FDI.
- the Arab countries suffer from an important delay, compared to the whole of the other developing countries, only from the point of view of the indicator of democracy (Voice and Accountability), which synthesizes (i) the process by which government is designed, controlled and replaced, and (ii) the degree of civil freedoms.⁶ However, as far as “democracy” is concerned, as we mentioned it above in section 3, no unequivocal link between democracy and development was ever established by the literature, whether it is empirical or theoretical.

Therefore, if one makes a point of looking further into the study of the relationship between institutional characteristics and the level of economic development, we have to admit that institutional performances are not reduced to only performances concerned with governance (public institutions functioning, degree of voice and accountability). The institutional area also includes other major components: the propensity of a Society to invest in the future (by way of the investment in education and research for instance), capacities of coordination

⁵ The Worldwide Governance Indicators project defines governance as the set of traditions and institutions by which authority in a country is exercised. The political, economic, and institutional dimensions of governance are captured by six aggregate indicators: (1) Voice and Accountability (i.e. the extent to which a country’s citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media); (2) Political Stability and Absence of Violence (i.e. perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including domestic violence and terrorism); (3) Government effectiveness (i.e. the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government’s commitment to such policies); (4) Regulatory Quality (the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development); (5) Rule of Law (i.e. the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence); (6) Control of corruption (i.e. the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as “capture” of the state by elites and private interests).

⁶ Also confer to PNUD (2004) or EIU (2005)

between agents, corporate governance, social regulation (which type of social contract prevails?), the degree of segmentation of the labour market because of laws and traditions, openness to ideas, to flows of people, products, capital. In conclusion, the analysis of only governance can indicate only partially the institutional quality of an economy.

Therefore, it is within the institutional field “in the broad sense” that it is necessary to seek the origin of the chronic weakness of growth, and blockings of the economic and social development process.

B) The institutional environment

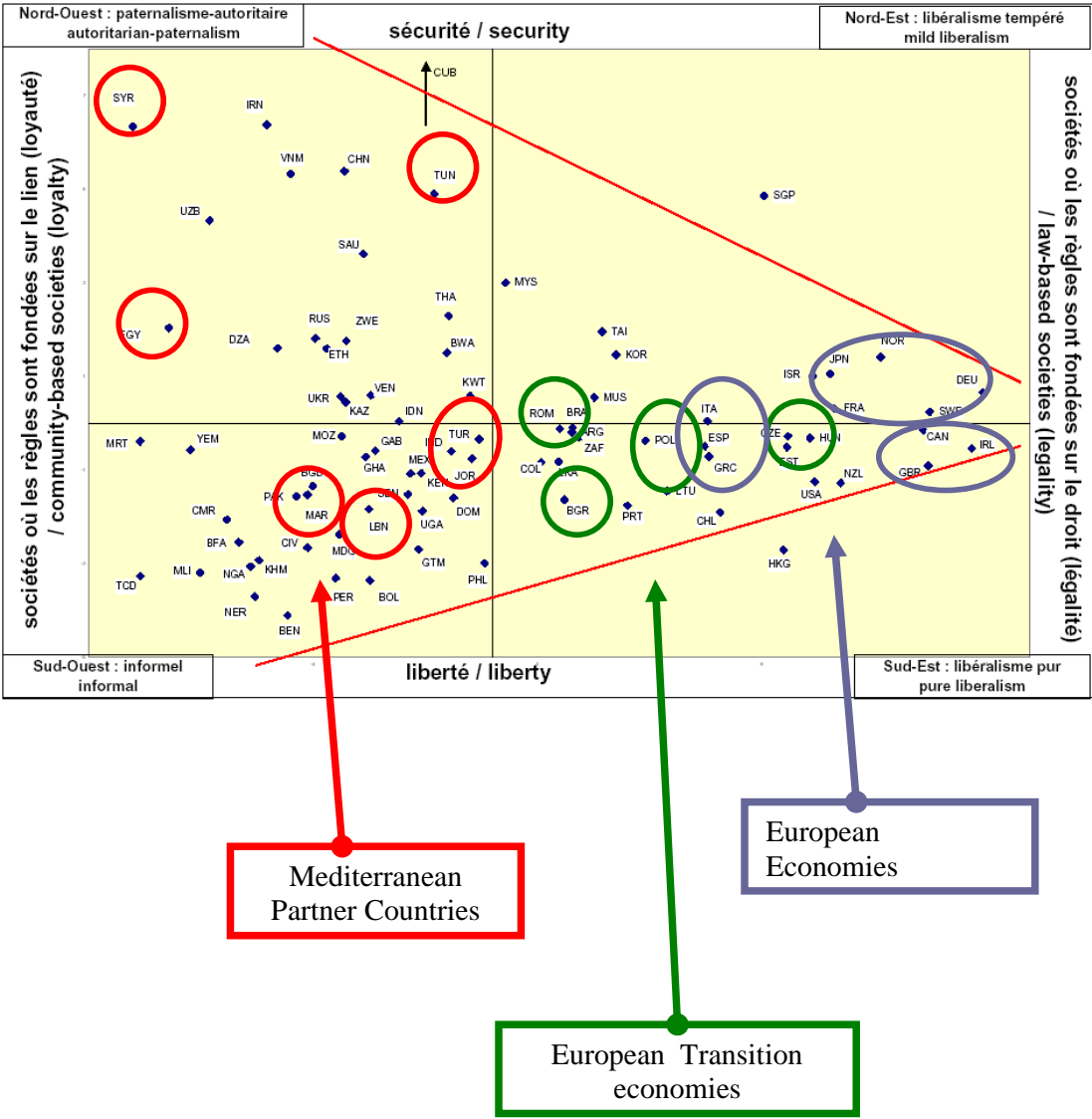
Here we take up the main results of the multi-criteria analysis of institutional characteristics of the Mediterranean Arab Countries made by Ould Aoudia (2006) based on use of the database “Profils Institutionnels” (see Bertheliet et al, 2004).

Such an analysis, firstly led without any economic inference (i.e. without prejudging an economic model on the relations between institutions and development) helps understand the complex character of the question of governance, because of its historical and cultural roots. At the same time, it helps one imagine the great difficulties involved in improving the quality of public governance “from outside”, without thinking about the political equilibriums and the social contract terms which sustain the present situation and may appear as many obstacles to the accomplishment of reforms.

The analysis opposes, along two axes,

- Countries in which resort to public regulations and security requirements prevail, on the other hand those where individual freedoms, “*Laissez faire, Laissez passer*” are the dominant values (vertical axis)
- Societies where rules are founded on community-based ties and those where they are exclusively based on Law (Horizontal Axis).

Figure 2: Topography of Institutional Characteristics



(Source: Meisel & Ould Aoudia (2006))

Three general remarks can be made about this representation.

On the horizontal axis, which represents countries depending on the degree they reach in the formalization of coordination rules, one may observe the strong correlation between this indicator and the level of development (developing countries are all on the left-hand side, developed ones on the right), which is confirmed by Figure 3.⁷

⁷ Cf. Annex. One could nevertheless observe that MPC (and particularly Arab MPC) show systematically a “relatively deteriorated” level of “good governance”, i.e. in comparison with their level of development.

The scatter of points is funnel-shaped: wide on the left-hand side, where informal rules (community-based developing societies) are prevailing; narrow on the right-hand side, where rules are formalized (law-based developed countries). It suggests a sort of convergence of the institutional systems the further the level of development improved. One may think that this convergence is realized in the direction of formalized rules systems which are elaborated by developed countries and diffused by the means, firstly of the constant economic relationships they keep going with developing ones, and secondly under the “pressure” of international institutions. Conversely, it shows the extreme diversity of institutional systems in developing countries from the point of view of the security/liberty requirements.

Finally, the crossing of these two axes logically delimits four great types of institutional systems:

- The “authoritarian / paternalistic” type gathers countries which, broadly speaking, are defined as ties-based societies, which on average privilege security requirements on freedoms;
- The “tempered liberal” type is constituted of Law-based societies, where recognition of the liberty requirement is balanced by concern for collective and individual securities, and the articulation between “*Laisser Faire*” and public regulations;
- The “pure liberal” type systematically privilege freedoms, in both economic and political areas; in Countries which enter this type, the improvement of law-based rules is a guarantee of good operating liberal system;
- Finally, the “informal” type gathers countries which combine the pre-eminence of ties with legal rule and Law, and liberty with security.

Most Arab Mediterranean Countries (Syria, Egypt, Tunisia, and Algeria) belong to the “authoritarian / paternalistic” type.

- They have socio-economic and institutional characteristics which combine the strength of traditions and the security for the citizens, with a public action whose efficacy is low, although the State is strong and the autonomy of civil society very restricted.
- On the economic plan, the State also controls the functioning of the markets, which remain not very open (see above). But it draws its legitimacy from other

sources of efficiency (for some of them, only from their capacity to redistribute oil revenues)

- The traditions weighs on social mobility

The others (Morocco, Jordan, Lebanon) belong to the informal type, and one could observe, if one compared results inferred by Ould Aoudia from the database “profils institutionnels” a move to the south part of the chart (along the vertical axis), i.e. a reduction of the authoritarian intervention of the state in these societies (particularly in Morocco), without that being accompanied by the installation of a systematic process of formalization of rules.

Therefore what still more differentiates the countries of the sample is the opposition between societies which base rules on formal devices and those where ties-based rules are prevailing. All Arab Mediterranean Countries belong clearly to these last ones.

- enrichment more often comes from the relation to the Power than from creativity and effort;
- recruitment more often depends on personal relations than on competence;
- the access to finance is due more to trust *ad hominem* with the banker than to real guarantees of the borrower;
- Finally, the production of trust, which gives security to transactions (see below) in economic relationships, is based on personal/community-based ties more than on legal and formal rights. In a word, trust is gained in a space of loyalty more than in a space of legality.

It is this primacy of informal ties which supports traditional solidarities vis-à-vis personal risks, and makes it possible to guarantee a certain social cohesion (to which testifies, for instance, the low level of monetary poverty in these countries). But this primacy tends also to ossify societies by discouraging social mobility (the transgression of law is accepted more than the transgression of family or community-based ties)

Finally, the coherence of this social contract is now weakened, at the same time by the process of the reforms, and social (and particularly demographic) evolution.

C) The production of trust in Arab Mediterranean Countries

A major obstacle to the implementation of an authentic development process can be found in the deficient production of trust within these economies. We indeed know that the capacity of an economy to produce trust may appear as a key element of long term growth (Meisel, 2004; Fukuyama, 1996; Zak et Knack, 2001)

The relationship between trust and growth follows two main channels. The first one is the reduction of transaction costs:

- Following North & Wallis (1986) we know that these transactions costs, according to their level, can inhibit or instigate the growth process: acting on these costs is thus a powerful lever on growth;
- However, the more the capital of trust between contracting partners is raised, the more the costs of information, of specification, and of control of the execution of contracts are reduced. The cooperative relations are facilitated, and individual engagements are more and more durable.

But the relationship between trust and growth follows a second channel: that of expectations. The decision to invest (for a firm or for a household) indeed supposes on behalf of the agents a reasonable reduction of uncertainties, in other words trust in the future.

Finally, as Meisel suggests it, one could define a “good institutional environment” as one which would be able to preserve trust durably, i.e. to pre-empt the potential factors of destruction of trust.

In countries where the main part of the contracts is based on formal Law, the existence of governance systems which are founded on a set of formal, impersonal and explicit rule ensures a high level of production of trust (within the framework of their normal functioning). The basic social function of these legal standards thus lies in their capacity to effectively channel individuals’ behaviour and expectations. The beneficial effects on growth are due to the credibility of these legal standards and their application.

The situation is quite different in developing countries, in which the force of the informal ties overrides that of formal rules. The simple recourse to legal and financial incentives is largely illusory there (opacity of the rules, very low level of information, devolution of the power locked).

In these countries, to which the Arab Mediterranean Countries belong, trust is produced and shared on the sole basis of personal relationships. The rules are there generally tacit, abstract, not written. Their respect is not easily verifiable by a third in position of neutrality.

A trust defect can result of this as soon as the transactions overflow of the narrow framework of personal or family relations. If this is the case, it is obviously an important obstacle for growth and development.

Ould Aoudia (2006) built, starting from the database “*Profils Institutionnels*”, four indicators of trust: two indicators of “static” trust (which apprehend the level of trust that each one, at a given time, seems to have in its relation with others or in the public institutions); and two indicators of “dynamic” trust (which express trust in the future).

- Concerning static trust in Public Institutions, Morocco and Tunisia are in an average position, taking into account their level of development (as it could be approximated by the level of GDP per capita). On the contrary, Algeria, Syria and Egypt suffer from a notable deficit of trust.
- Concerning the static trust between economic agents, only Tunisia approaches a relative position on average. In the four other countries (Morocco, Algeria, Syria, Egypt), trust between agents is weak taking into consideration their level of development
- Still more than for the variables of static trust, one notes the degraded situation of the Mediterranean Arab countries as dynamic trust is concerned. The degree of trust in the future is, on behalf of the economic agents, and taking into consideration the level of development, notably low.

Finally, the Arab Mediterranean Societies, probably because of their delay in the process of formalization of rules, seem to share a deep deficit of this basic element as a factor of growth which is trust, in its two dimensions (static and dynamic).

6. Conclusion: the political economy of reforms in the Arab Mediterranean Partner Countries. How to rebuild the social contract

A) The political Economy of reforms

It is thus understood, that in the implementation of the “second generation” reforms, it is less the superficial adoption of the reforms than their application which poses a problem. The main obstacle met by the reform process is not so much a failing system of governance, than an institutional environment, based itself on a historically and culturally rooted social contract, which appears today unsuited to the opening and the development of these economies and the societal transformations these countries know today.

From that point of view, the main defect of the engineering process of reforms is to have not checked, before their prescription and their financing, if they were well suited to the resources of the societies, in terms of institutional and political capacities.

To say it in another manner, it is necessary to wonder about “the political economy” of reforms which are, above all, institutional reforms.

Specifically, the first and the second generation reforms have very different political economies:

- Macroeconomic adjustment policies mobilize for their design and their implementation a restricted number of actors. They are clearly identified (essentially monetary and fiscal policies) and relatively easy to apply: the populations which support the weight of them are in general diffuse and poorly organized, while internal supporters of these reforms don't see their rents eroded by their implementation.
- Conversely, the second generation reforms, because it is in fact a policy of institutional development, is quite more complex and hard to conceive, to decide and to implement. Such a policy mobilizes a high number of actors. Its design, but also its fulfilment, requires, on behalf of the internal relays, either public or private, a high level of organisation. The reform is confronted with the culture of change and the weight of traditions within the societies which are concerned. It requires a culture of coordination and compromise because it often runs up against concentrated and organized interests. It is confronted with the paradox of having to

act with old tools to forge the new ones (for example to make apply anti-corruption devices by a corrupted administration). Finally it can be opposed to the interests of the elites which hitherto politically carried the reform process. It cannot thus rest on the same political equilibrium nor even on the same social contract.

B) The need for a new social contract

The “redistributive” social contract, which prevailed in MENA Countries since independence, does not operate anymore. This social contract could be summarized as following: (a) a widely redistributive welfare state; (b) strong state interventionism; (c) an import substitution – based mode of development, sheltered from competition pressure by the means of strong trading protections; (d) on the political side, a nationalist conception of the organic unity of the Nation, which did not leave any place for the expression of divergences and clashes of interests.

This particular type of social contract, which organized, on an authoritarian mode, the exchange between economic security and a low political participation of civil society, has obtained some results. But it began to fall apart during the 1980s, with the reduction of the redistributive capacity of states (because of the fall in oil prices for some of them, or because of the debt crisis). The attempt, by the states, to maintain, even in this new context, their ability to exchange political stability against a relative economic security has then inferred strong macroeconomic disequilibriums. The improvement of the structural adjustment plans and of the first generation reforms has then removed the above-mentioned levers which were available for states use. Now, the maintenance of economic equilibriums as well as the capacity of these economies to continue the process of their development prevent the return to a social regulation by the way of massive redistribution: the old social contract cannot function any more.

As World Bank (2003) notes, the most obvious demonstration of this blocking is the exceptionally high level of unemployment, particularly for young active workers, and the deepening of the dual character of labour market (see Figure 1).

A new social contract will have to balance on the first hand (a) the continuation of the opening process of these economies, (b) the transformation of an authoritarian type of state interventionism into a strategist/regulating one (and not simply a privatization and a reduction of the role of state), and, in a corollary way, (c) the progressive and systematic substitution of

the authority of the formal rules and the law to the influence of the informal, family or personal-based ties; with, on the other hand, the participation of people in the benefits of the economic growth, in order to form political support for the movement of the reforms.

The central goal is now to identify the main stumbling block to overcome in the way of re-founding the social contract. Contrary to what is often asserted, the public interests are not the only factors of resistance. It is the whole of the private and public elites who, by the determining influence which they have on the State (and because of the positions of rents which they constituted and which they want to maintain), block the social, economic and political evolutions in these countries [(Hibou (1999); Kaufmann (2003, 2004, 2005); Nabli (2005); Ould Aoudia, 2006)]. The question is then now to go round this obstacle, and to find a way to contest the authority and the influence of these elites.

C) The stumbling block: the emergence of civil society and political support for the reforms process

From that point of view, the UNDP, through the various reports about human development in the Arab world which it initiated in 2002, open new tracks [UNDP (2002, 2003, and 2005)]. Indeed, according to the authors of these reports, the development process of Arab countries is inhibited by three main fundamental factors, which affect the whole societies in this Region. These three factors are (1) as we have already noted, the lack of political freedom and the relative absence of participation of the populations in political power; (2) the weak involvement of women in the social and political life; (3) the statute of knowledge, which leads in particular to a weak diffusion of critical knowledge, inhibiting creativity and the spirit of responsibility, and supporting the behaviours of submission.

Concerning this last point, particularly, the second report of the UNDP (UNDP, 2003), underlines the delay taken by the Arab world as regards knowledge: the context of these countries is not very favourable with the production of ideas, creativity, and the exercise of the critical thought. The reforming thought appears there curbed, as are the technical, social and cultural innovation processes.

7. Conclusion

Elites, public and private, of the Mediterranean Arab countries, knew to carry out important reforms to restore macro-economic equilibriums and to maintain them. On the other hand, “second generation” reforms, because they are deeper, insofar as they penetrate in the heart of the productive systems and of the institutional complementarities of these societies, are facing major obstacles. These come both from the confused resistance of these elites, who benefit now by the status quo which maintains their rent positions in the State/productive system, and from the absence of political support on behalf of the populations, which do not feel a partner of the reforms process, and still less a beneficiary of it.

The political economy of the two waves of reforms is then quite different. Further thought about the possibility of starting, in these countries, an institutional development policy (because this is in fact the major issue: to be able to recompose the institutional complementarities), finally leads, as we underlined it, to wonder about the bases of the rules of the social game in these countries. The stake is indeed, from now on, to redefine the social contract, the structuring social compromises, the old ones having made from now on the proof of their decay, while the new ones remain to be invented and negotiated.

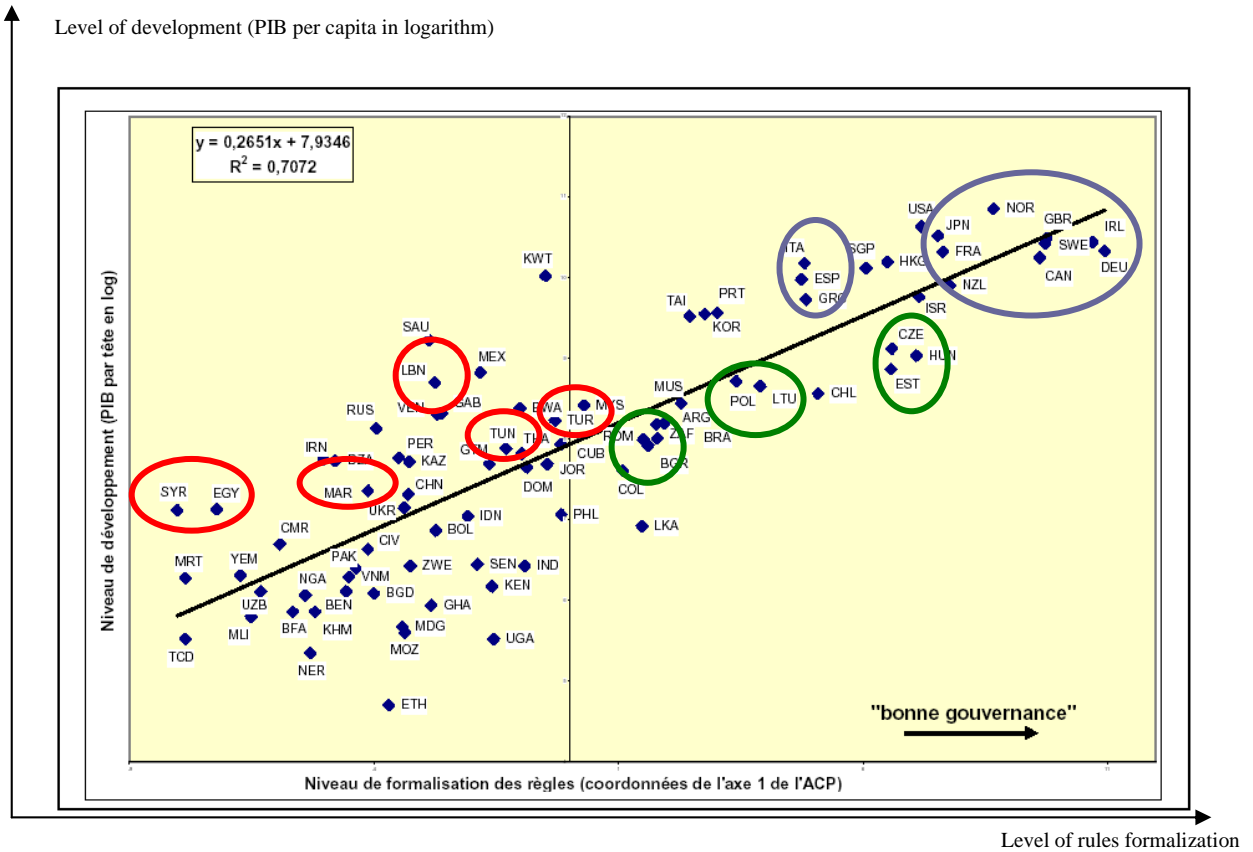
The challenge is then to reduce the sole injunction of democracy carried in the region by the western powers. Not only is such an injunction simplifying the problem, but it strongly risks generating deep resistances in these societies. Finally the solution seems to lie within the internal capacity of these societies to make emerge a powerful civil society, which could be the political support of the reforms and the way of skirting obstacles. This passes by the possibility of making the populations economically benefit from the process of the reforms. That obviously passes by an increase in public freedoms, and larger political participation of the populations, in particular of women. That finally also passes by a release of critical thought and a rejuvenation of the status of knowledge.

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9. Annex:

Figure 3: Good governance and the level of development



(Source: Meisel & Ould Aoudia (2006))