

MIDDLE EAST INITIATIVE

# Rewriting the Arab Social Contract

## Toward Inclusive Development and Politics in the Arab World

Hedi Larbi  
Kuwait Foundation  
Visiting Scholar



HARVARD Kennedy School

**BELFER CENTER**

for Science and International Affairs

STUDY GROUP REPORT

MAY 2016

## **Middle East Initiative**

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# Biographies

## **Hedi Larbi**, Kuwait Foundation Visiting Scholar, Middle East Initiative

### Lead Author and Editor

Former Minister Hedi Larbi is the 2015-2016 Kuwait Foundation Visiting Scholar at the Belfer Center's Middle East Initiative. He most recently served as Advisor to the MENA Vice President at the World Bank, and from January 2014 to February 2015 served as both the Minister of Economic Infrastructure and Sustainable Development and the Economic Advisor to the Prime Minister, Tunisia. Mr. Larbi has over 35 years of professional experience in economic and social development as both a policy advisor and policy maker, with more than two decades of high level work in the World Bank Group, the private sector (in Europe and Middle East and North Africa), and the Tunisian transition government. Mr. Larbi also has substantial expertise in the areas of public policy, economic and sectoral development strategies, private sector development, infrastructure services, human capital development, public finance and macroeconomic management, infrastructure (transport, water, energy, and urban services), social sectors (education, health, social protection), and more. He has developed, negotiated and supervised major economic and institutional development programs, and public and private investment operations in various social and economic sectors including major infrastructure projects and economic reforms. Mr. Larbi has an excellent knowledge of the economic, institutional, political and social challenges of the MENA region as well as of many Sub-Saharan countries. To a lesser extent, his regional experience extends to Latin American Countries and East and Central European Countries in the context of cross-support and policy advice to governments and World Bank teams. Mr. Larbi holds an MSc in Civil Engineering from the Ecole des Mines de Paris, and an Executive MBA from Harvard Business School.

## Session 1:

### **Paul Salem**, Vice President for Policy and Research, Middle East Institute

Paul Salem is vice president for policy and research at The Middle East Institute in Washington, D.C. He focuses on issues of political change, transition, and conflict as well as the regional and international relations of the Middle East. He has a particular emphasis on the countries of the Levant and Egypt. Salem writes regularly in the Arab and Western press and has been published in numerous journals and newspapers. Salem is the author of a number of books and reports including *Bitter Legacy: Ideology and Politics in the Arab World* (1994), *Conflict Resolution in the Arab World* (ed., 1997), *Broken Orders: The Causes and Consequences of the Arab Uprisings* (In Arabic, 2013), “The Recurring Rise and Fall of Political Islam” (CSIS, 2015), “The Middle East in 2015 and Beyond: Trends and Drivers” (MEI 2014). Prior to joining MEI, Salem was the founding director of the Carnegie Middle East Center in Beirut, Lebanon between 2006 and 2013. From 1999 to 2006, he was director of the Fares Foundation and in 1989-1999 founded and directed the Lebanese Center for Policy Studies, Lebanon’s leading public policy think tank.

Salem is also a musician and composer of Arabic-Brazilian jazz. His CDs can be found on iTunes.

## Session 2:

### **Ghazi Gheraïri**, Secretary General of the International Academy of Constitutional Law

Professor Ghazi Gheraïri is a lecturer-researcher in public law and political science at The University of Carthage, he also teaches at l’Institut diplomatique de Tunis and at Tunis School of politics. He is Secretary General of the International Academy of Constitutional Law, member and spokesmen of the high instance of achievement of the revolution’s goals, of political reform and of democratic transition, member of the editorial

board of the newspaper *Le Maghreb* and general coordinator of the Averroes Foundation for democracy and progress.

### Session 3:

**Björn Rother**, Advisor and Chief of Strategy and Partnership Unit, Middle East and Central Asia Department, International Monetary Fund

Björn Rother is an Advisor and Chief of the Strategy and Partnership Unit of the Middle East & Central Asia Department at the International Monetary Fund in Washington, D.C. and Author of “The Determinants of Currency Crises: A Political Economy Approach.” His interests include frameworks in support of economic transitions and of inclusive, sustainable growth. He worked previously as a consultant with McKinsey & Company Inc., and holds a Doctorate in Economics from the Free University of Berlin.

### Session 4:

**Mustapha Kamel Nabli**, Former Chief Economist and Director, World Bank Middle East and North Africa Region; former Governor, Central Bank of Tunisia

Mustapha Kamel Nabli is currently international consultant, President of North Africa Bureau of Economic Studies International, based in Tunis. He was Governor of the Central Bank of Tunisia from January 2011, just after the revolution, until July 2012. Prior to that he was at the World Bank as Senior Advisor at the Global Prospects Group (1997-1999), then Chief Economist and Director of the Social and Economic Development Department for the Middle East and North Africa Vice-Presidency (1999-2008), then Senior Advisor to the World Bank Chief Economist (2008-2010). Prior to joining the World Bank, he was during the period



1995-1997 an independent consultant and researcher. From 1990 to 1995 he was Minister of Planning and Regional Development, then Minister of Economic Development in the Government of Tunisia. He also held the position of Chairman of the Tunis Stock Exchange (1988-1990). From 1975 to 1988 Dr. Nabli was Professor of Economics at the University of Tunis, and visiting professor at various international universities. Dr. Nabli holds a Master's and Ph.D. degrees in Economics from the University of California at Los Angeles. This talk focused on the economic and social impact of Arab political transitions, and focuses on the examples of Egypt and Tunisia.

## Session 5:

### **Shantayanan Devarajan**, Chief Economist, Middle East and North Africa Region, World Bank

Shantayanan Devarajan is the Chief Economist of the Middle East and North Africa Region, World Bank. Since joining the World Bank in 1991, he has been: a Principal Economist and Research Manager for Public Economics in the Development Research Group; Chief Economist of the Human Development Network; Chief Economist of the South Asia Region and later of Africa Region. He was the director of the World Development Report 2004 (Making Services Work for Poor People). Before 1991, he was on the faculty of Harvard University's John F. Kennedy School of Government. The author or co-author of over 100 publications, Mr. Devarajan's research covers public economics, trade policy, natural resources and the environment, and general equilibrium modeling of developing countries. Born in Sri Lanka, Mr. Devarajan received his B.A. in mathematics from Princeton University and his Ph.D. in economics from the University of California, Berkeley. During this session, he will attempt to address the mechanisms needed to achieve a better social contract for the region.

## Session 6:

**Zafiris Tzannatos**, Former Senior Advisor on Social Policy for the World Bank, International Labor Organization, and Government of the United Arab Emirates

Zafiris Tzannatos is currently a Senior Consultant for Development Strategy and Social Policy living in Lebanon where he was previously Professor and Chair of the Economics Department at the American University of Beirut. He has served as Advisor to the Managing Director of the World Bank where he was also Manager for Social Protection in the Middle East and North Africa as well as Leader of the Global Child Labor Program that he initiated. More recently, he was Senior Advisor for the 22 Arab States for the ILO and, before that, for governments in the Middle East and the GCC—including Lebanon, Qatar and the UAE. He has held senior academic and research appointments in Europe, visited more than 60 countries and worked with international and regional organizations as well as governments of industrialized, transition, emerging and developing economies across all continents. His publications include 14 books and monographs, and more than 200 reports and papers in the areas of development strategy, labor economics, education, gender and child labor and broader social policy. His current research is on the euro-crisis and the post-2010 developments in the Arab region.

## Session 7:

### **Melani Cammett**, Professor of Government, Harvard University and MEI Faculty Affiliate

Melani Cammett is Professor of Government at Harvard University. She specializes in the political economy of development and the Middle East and North Africa and is the author of four books: *A Political Economy of the Middle East* (with Ishac Diwan, Alan Richards, and John Waterbury, 2015); *Compassionate Communalism: Welfare and Sectarianism in Lebanon* (2014), which won the 2015 APSA Giovanni Sartori Book Award and the Honorable Mention of the 2015 APSA Gregory Luebbert Book Award; *The Politics of Nonstate Welfare* (coedited with Lauren Morris MacLean, 2014); and *Globalization and Business Politics in North Africa: A Comparative Perspective* (2007, 2010). She has received fellowships and awards from the Andrew W. Mellon Foundation, the Qualitative and Multi-Methods Research Section of the American Political Science Association (APSA), the Comparative Politics Section of the APSA, the Smith Richardson Foundation, the U.S. Institute of Peace, the Harvard Academy for International and Area Studies, the Social Science Research Council, and other organizations, has published numerous articles in scholarly and policy journals, and consults for development policy organizations. Her current research focuses on the politics of welfare and development and she has a variety of ongoing projects on governance and the delivery of social services by public, private and nonstate actors in the Middle East and North Africa.

### **Hafez Ghanem**, Vice President of the World Bank for the Middle East and North Africa

Hafez Ghanem, an Egyptian and French national, is the Vice President of the World Bank for the Middle East and North Africa since March 2, 2015. He is a development expert with more than thirty years of experience in policy analysis, project formulation and supervision, and management of multinational institutions. Dr. Ghanem leads the World Bank's engagement with 20 Middle East and North African countries through a portfolio of

ongoing projects, technical assistance and grants worth more than US\$13 billion. Eradicating extreme poverty and promoting shared prosperity through the creation of opportunities are core to his vision for the Middle East and North Africa Region.

Prior to his appointment as Vice President, Dr. Ghanem was a Senior Fellow at the Brookings Institution in the Global Economy and Development program leading the Arab economies project, focused on the impact of political transition on Arab economic development.

Between 2007 and 2012, he served as the Assistant Director-General at the Food and Agriculture Organization of the United Nations (FAO). He has many publications in professional journals and was a member of the core team that produced the World Bank's 1995 World Development Report. He holds a bachelor's and master's degree in Economics from the American University in Cairo and a PhD in Economics from the University of California, Davis. He is fluent in Arabic, English and French.

This report and study group have been made possible by the generous support of the **Kuwait Foundation for the Advancement of Sciences** through the [Kuwait Program at Harvard Kennedy School](#).





Opponents of Egypt's Islamist President Mohammed Morsi protest outside the presidential palace, in Cairo, Egypt, Monday, July 1, 2013.  
(AP Photo/Hassan Ammar)

# Introduction

Over the last five years, the Arab world has felt the shockwaves of mass political mobilization on a scale not seen for generations. This new era of political action has rippled through and even beyond the region, touching each nation, but with different results. Outcomes vary from internationally heralded success in Tunisia to nearly unmitigated disintegration of the state and society in Libya, Yemen and Syria. In other countries like Egypt, Morocco and Jordan, tradeoffs between stability and voice frame politics, as citizens eye the bright hope of nascent democracy in Tunisia and the grim specter of proxy war in Syria backlit by regional vested interests and international geopolitics. These multiple outcomes have also attracted a great deal of inquiry from social scientists often focusing, as the Arab citizenry and political class have, on political change. Indeed, the economic and social issues at the root of the Arab uprisings have received little attention and in some cases have been entirely overlooked by the scholarly and policy communities, including the transitioning countries themselves. Now compounded by five years of political turbulence and deteriorating state institutions and capacity, economic conditions have further deteriorated and the challenges have only grown more daunting.

These issues were the central focus of a study group, “Rewriting the Arab Social Contract,” organized by Hedi Larbi under the auspices of the Middle East Initiative at the Harvard Kennedy School’s Belfer Center for Science and International Affairs. Eight distinguished experts with direct operational and academic experience in Arab countries and economies, many during the transitions, contributed over the course of seven sessions to an integrated approach to the historical, social, political, and economic dimensions of this topic: Paul Salem (Middle East Institute), Ghazi Gheraïri (International Academy of

Constitutional Law), Björn Rother (International Monetary Fund), Mustapha Kamel Nabli (former Central Bank of Tunisia and World Bank), Shantayanan Devarajan (World Bank), Zafiris Tzannatos (former International Labour Organization and World Bank), Hafez Ghanem (MENA Vice President at the World Bank) and Melani Cammett (Harvard University).

This report summarizes the contents of those sessions, beginning with Mr. Larbi's conceptual framework laid out in the first session. The report then follows the format of the study group, drawing out the major themes and pertinent details, as recorded by Mr. Larbi. These summaries should not be construed as comprehensive assessments of the sessions, but rather as the points deemed central to the course of analysis defined by Mr. Larbi. Where notable, sections of the discussions following the lectures are commented on, but these were not entirely included in the present report. Full recordings of each lecture are available on the Middle East Initiative's website: [www.belfercenter.org/ArabSocialContract](http://www.belfercenter.org/ArabSocialContract). The report ends with conclusions and questions for further inquiry that will illuminate further analyses into understanding social contracts in the Arab world and implementing changes to them in context.



# Why Study an Arab Social Contract?

Foreword from Hedi Larbi

I set a very ambitious goal for this study group: to understand the conceptual and concrete contours of a new social contract in the Arab world. The ambition begs a question as well: why step back and rethink the Arab transitions in a broader and more integrated manner? The transitions themselves have taken many forms. Tunisia and Egypt have encountered tough transitions, with hotly (mostly genuinely) contested politics, often boiling over into civil strife. Countries like Jordan and Morocco have faced softer transitions, with only marginal reforms flowing from modest increases in political pressures and expectations. In the Gulf States, the threat of political action spurred social welfare spending that, while aimed at tamping down political voice, represented a noticeable if not innovative shift in the contract between rulers and the ruled. Failed transitions have descended into brutal civil wars in Syria, Libya, Yemen, and to some extent in Iraq, inviting regional and international proxy battles, including the ugly and terrible threat of the so-called Islamic State.

Still, these divergent paths stem from the same demands: across the Arab world, people asked for social justice, economic opportunities, freedom, and dignity. These demands have crucial components in economic policies, yet Arab political elites—both emerging and existing—ignored economic reforms in favor of politics and power grabbing. This transition failed to deliver tangible economic and social results to people in most Arab countries, perpetuating frustration and discontent.

Instead, we still need a more integrated approach to transitions, rooted in several key understandings. First, in the real world, economic, social, and political experiences interact and impact each other, meaning reform that does not bring change across sectors will not succeed. Second, in my personal experience of interaction and work in many Arab countries during the transition, to my consternation, I realized that the political elite in most Arab countries in transition had very little knowledge of the economic and social issues of their countries. Worst, economic issues and possible solutions, when debated, are dominated by the political elites and activists and often approached from ideological perspectives. Economic debates are not only rare but are also politicized and often inconclusive. Talking about politics and expressing political opinions is easy. Economic issues are harder to engage. This problem has reverberated far beyond the rooms where these dialogues were held. Since 2011, most Arab citizens do not know where their countries are heading economically—old and new leaders have offered no coherent vision. Old economic policies and cumbersome bureaucratic practices have not

Since 2011, most Arab citizens do not know where their countries are heading economically—old and new leaders have offered no coherent vision.

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changed. Rather, they were exacerbated by costly and ineffective populist policies to buy social and political stability. Even when Tunisia's political process started succeeding, the "new and democratically elected political elite" were not able to provide a clear strategy for resolving the economic woes that faced the country.

The political elite of Arab countries in transition have focused on political maneuvering and have forgotten the economy. However, neither the economy nor the people forget them. The price for this inaction is extremely high. In all Arab countries, no matter how the transition played out, the economic and social indicators have deteriorated across the board since the uprisings began.

This primarily harms the social position and living conditions of ordinary people. For example, Tunisia's economy grew at 4-5% before the uprisings, but has now been at or below 2% for over four years. Unemployment increased especially for young men and women (around 30%, among the highest in the world). The quality of public service delivery has plummeted. Compounding this, governments across the region, including oil-exporters, have run very large fiscal deficits, drying up the fiscal space needed to stimulate growth and address issues like unemployment of and social protection for vulnerable groups. This lack of capacity and flexibility is particularly alarming when considered alongside the security threats confronting the region's stability, created by primarily radical groups and the recent rise of the Islamic State.

Rethinking the transitions and figuring out how to cast an integrated, coherent vision to better respond to the political and economic aspirations of the people is crucial for all countries, no matter where their transitions have led. Arab countries should strive to make the necessary political and economic changes to forge a new political economy environment which supports the structural transformations necessary for accelerated and inclusive growth. This is akin to redefining a new social contract in Arab countries, which will clearly redefine the attributes of new relationships between states and societies or citizens. It is a unique opportunity for Arab societies to recast their values, their political, social and economic choices, their rights and duties, and the role of their states in protecting those values and choices, as well as the systems to hold states accountable to their people.

This study group sought to create guiding frameworks for understanding and implementing these shifts in Arab societies and political economies, leveraging the insights to be gained from a comprehensive analysis of the region's historical political

economy with global experiences of transitions, while allowing each country to fit this knowledge to its unique situation.

The study group consisted of seven sessions, each meant to examine a particular part of the problem, and to build on each other toward the final goal. The sessions break down along three lines: the historical and political contexts, the economic and social fundamental issues, and the social and political means to reframe political economies into a new social contract. In the summaries of these sessions in this report, we hear from people who have been working on these issues for a long time, whom we challenged to bring new thinking, as the failures of old policy prescriptions have become unavoidable and the opportunity for fresh thinking opens up.

First, Paul Salem, a political scientist, looks at the history of the Arab uprisings, and asks fundamentally: What happened? Why did the uprisings occur when they did and how do they fit into a larger understanding of Arab society and history? Then, Tunisian legal scholar Ghazi Gherairi, who took part in Tunisia's political transition from the first protest until the last signature on the constitution, asks if Tunisia really succeeded in completing its political transition and if the dominant narrative is the right one. Also, will the new political system be congruent with the economic and social demands of the people?

Switching gears, three sessions aimed to engage the economic and social fundamentals of the uprisings. First, a unified summary covers the third and fifth sessions on the past, present, and future of Arab economies. Bjorn Rother, a senior economist in the International Monetary Fund's Middle East and Central Asia Division discusses why past development models failed in the Arab world, especially when similarly positioned East Asia succeeded. How did politics and economics affect each other?

And what new elements should Arab political economies exude? Shantayanan Devarajan, current Chief Economist at the World Bank's MENA Division looks toward the future, asking: what if Arab countries agree to debate new social contracts? What are the tenets of a new social contract, and what are the elements

that will help us frame a productive debate? Then, Mustapha Kamel Nabli, former Governor of Tunisia's Central Bank and Chief Economist of the World Bank's Middle East and North Africa Division highlights what happened to Arab economies during the transition. What reforms succeeded if any, and did they generate the environment to pursue an integrated approach to forming a new social contract? And of course, what was missed?

This study group sets its sights on creating guiding frameworks for understanding and implementing shifts in Arab societies and political economies.

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Finally, the group turns toward implementation. Social policy expert Zafiris Tzannatos addresses debating a new social contract, asking: why do neoliberal prescriptions continue to be raised—and continue to fail for developing countries? While debates in Arab world on economics are very rarely informed by analytics, he seeks to examine the economic realities in the region now and how the social contract can be realized amidst the current economic situation. In the last session, Vice President of the World Bank for the Middle East and North Africa Hafez Ghanem and Harvard political economy Professor, Melani Cammett, discuss their views on frameworks for integrated national debates to reimagine the social contract for a more free and inclusive Arab society.



A Tunisian vendor waits for customers as he sells tea to men who worked in Libya and fled the unrest in the country, in a refugee camp in Ras Ajdir, Tunisia at the Tunisia-Libyan border, Monday, March 14, 2011. (AP Photo/Emilio Morenatti)

# Chapter 1:

## **The Arab Spring's Uneven Harvest: Successes, Setbacks and Failed States**

Summary of session 1,  
Presented on September 15, 2015

Paul Salem, Vice President for Policy  
and Research, Middle East Institute

### **Introduction**

Nearly five years since the beginning of the Arab uprisings, with much already said and written on the topic, Paul Salem aimed to bring an innovative perspective to a crowded field using broad, historical facts to develop a new approach to understanding the Arab Spring. Noting successes, setbacks, and failures amongst Arab “transitions,” Salem set his analysis in a dire frame, emphasizing that the Arab uprisings were not simply unrest and political contestation leading to various outcomes, but that nations, cultures, and moral orders had been ripped apart. With a social fabric in tatters, Salem hoped to explain the devastating historical moment by following seasons of change in the Arab world, describing the social contract under contestation, and tracing the factors which propelled countries down various pathways after 2011. Finally, he took stock of Arab countries at present and assessed what paths lay ahead, giving policy recommendations and areas for hope and action moving forward.

# A Long Lasting Transition to Modernity

Beginning with a broad vista, Salem portrayed Arab Civilization as in a prolonged and profound transition process lasting centuries and still underway. Arabs began to realize a decline from their perch at the pinnacle of global power, progress, and culture as Europe rose in the 17<sup>th</sup> and 18<sup>th</sup> centuries, and by the 19<sup>th</sup> century the Arab world was looking for an answer that would produce dynamism to heal a deeply felt wound. This search led to many answers and many projects, all seeking to figure out where the society faltered and how to respond to and match an ascendant West. Various models have emerged over the years, including Mohammed Ali's 19<sup>th</sup> century Egypt, emphasizing a strong, developmentalist state seeking to modernize and uplift via centralized power; the liberal movement of the early 20<sup>th</sup> century, which hoped to copy the West's success by empowering the individual and adopting western values; and the anti-imperialist movement in the late 20<sup>th</sup> century, which emphasized a strong, centralized state directing national resources to uplift the nascent Arab states, led by supposedly "great" leaders, who claimed to embody "the national will."

The Arab Spring is yet another step in [a] broader civilizational transition.

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Within this long lens, the Arab Spring is yet another step in this broader civilizational transition. Running throughout this history are also various Islamist movements, all arguing that only returning to an "ideal" or "pure"

society now lost will serve to right the ship. Salem argued that these movements and the broader historical context in which they occur parallels the West's own centuries long transition to its current state. These are not shallow shifts, but deep transformations that will take decades to work themselves out. And as these transformations take place, profound challenges



are emerging as the Arab states, dominated earlier by the anti-imperialist movement, disintegrate, leading to cases of profound social, cultural, and moral collapse.

## New Social Contracts are Yet to Be Negotiated

Salem sought to parse the concept of social contract proposed by the study group, in order to understand how the deep tears in the social fabric of the region occurred. There are really four separate contracts—political, economic, social, and cultural—each negotiated in distinct ways during the most recent uprisings. Slogans across the region raised clear and cohesive political demands for the political contract: a more or less “democratic” government, elected and accountable. Protesters also laid out a series of demands for economic *outputs*—jobs, bread, and dignity—but did not propose a *contract*, failing to list tradeoffs or changes to old models, making it difficult to reach consensus on necessary restructuring to meet their demands. Still less developed were the social and cultural contracts. Social mores such as individual liberties, importance of individual versus group dynamics, the role of women and others are a wide open field, left unattended by transitional actors and now causing rankling divisions that have erupted in various places in violence. Cultural questions such as the role of religion, morality, faith and others are now the cause of civil wars in many Arab countries.

These questions need answers before Arab societies can move forward, primarily because these are now the contests that define the breakdown of the social fabric in the Arab world. On the most fundamental level, no Arab country has successfully negotiated a full, successful transition to a new *complete* social contract. While

political transitions have moved in certain places, notably Tunisia, none of the efforts so far have gone deep enough to flesh out the terms of new social contracts at the four levels. Making these sorts of agreements requires parties to the contract in question: leaders that can broker deals between various social groups. In fact, the revolutions without leaders may have helped their initial success, but in the end led to breakdown when negotiations for the outcomes of the inaugurated transitions began. In addition to lacking parties to the contracts in question, many Arab countries saw the breakdown of the adjudicator and enforcer of contracts, the state, after which societies failed to hold together at all, much less negotiate a new social contract.

## **Explaining the Divergent Outcomes**

The Arab uprisings occurred as one wave, emanating from Tunisia in a moment of shared empowerment, but crashed differently on different shores, ending differently from Tunis to Cairo to Manama to Rabat and Damascus. Four variables explain these divergent outcomes. First the nature of the national political unit: Tunisia's long history and homogenous and cohesive demographics have worked together to create a tighter knit social fabric, making it easier to complete an arduous transition, in contrast with Syria's multiple sects and ethnic makeup. Second, the dynamic between state and regime: Libya was a regime with no state that disintegrated quickly, while Tunisia's deep institutional fabric within and outside of state bureaucracies proved resilient. Third, the role of parties and movements within countries: the role of a strong civil society in Tunisia's labor movement contrasts sharply with a long-thwarted civil society in Egypt, where Islamists were the only organizing force outside the state and thus performed disproportionately well in early elections. Finally, the geostrategic environment either mitigated

or enflamed breakdown, with Syria's now global proxy war in contrast to Tunisia, which faced little to no geopolitical pressure. Perhaps even more important though, is a lack of international framework to incentivize change in a particular direction, as occurred in Western Europe after World War II or Eastern Europe after the Cold War. Today's Arab transitions have no guiding structure to join, as the West reels from economic shocks and proves unwilling to invest in Middle Eastern rebuilding.

## **From Transition to State Collapse**

Salem closed by taking stock of the current state of affairs and notes for policies moving forward. Trends no longer point to transition but collapse of states and the state system, with failed states, a refugee crisis, proxy war raging, and the Islamic State ascendant. In addition, major long-term problems of climate change, land, water, and demographic shifts only point to a more difficult future. In general, the Arab world no longer shares a common vision for a basic future, reminiscent of pre-World War II Europe, in which deep divisions over vision and identity—what it meant to be alive in the world as a human—took an enormous toll.

## **Policy Recommendations and Areas for Hope**

Still, Salem pointed to post-World War II Europe, which mounted an astonishing recovery from its deep scars in just several decades, as a positive example, also heralding Lebanon's modest recovery from civil war after 1990 as a ray of regional hope. Looking for areas to pursue progressive policies, he emphasized the need for de-escalation of the proxy war in Syria by negotiating stabilized

Support [for] nascent transitions [is crucial]... as the Arab spring spread by example, the experiments underway in tiny countries could have major implications for the future of the entire Arab world and the success of democratization.

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relations between Iran, Turkey, Gulf States and others. This is an achievable outcome which Iran and regional security guarantor the United States are willing to consider, embodied in the historic diplomatic achievement of the Iran nuclear deal. Progress on this front would wind down

regional conflict and edge out radicals currently thriving amidst instability. Following on a restoration of diplomatic relations, he urged states to adopt policies toward inclusive economic growth that would capitalize on enormous human capital in the region, now stretching beyond islands of oil wealth to real business acumen and technical knowledge across the region. Completing his recommendations, he urged all actors to support nascent transitions and fragile but working political experiments in Tunisia and Lebanon, emphasizing that as the Arab spring spread by example, the experiments underway in tiny countries could have major implications for the future of the entire Arab world and the success of democratization.

## Chapter 2:

# **Lessons from the Tunisian Transition: Challenges and Imperatives**

Summary of session 2,  
Presented on September 29, 2015

Professor Ghazi Gheraïri, Secretary General of  
the International Academy of Constitutional Law

## **Introduction**

In his introduction Professor Gheraïri highlighted that after four long years of tumultuous, yet peaceful and civil transition, Tunisia, the cradle of the Arab Spring, is the only country that has completed a democratic transition. From 2011 to 2014, three democratic elections were held resulting in three peaceful transfers of power. A new constitution enshrining fundamental rights and a democratic power-sharing system has been adopted through a democratic process. However, in spite of this undeniable achievement, the Tunisian democratization experience is not yet fully complete. The consolidation process that started in early 2015 will face major challenges. Indeed, in addition to setting up the institutions provided for by the constitution to oversee the consolidation process and create the necessary checks and balances to promote and sustain the nascent democracy, the country has to meet the long awaited demands of the people, especially in lagging regions, for the social and economic improvements for which they rebelled. Gherairi added that Tunisia has also to face an unprecedented regional and geopolitical environment fraught with instability and terrorism,

inside and outside its borders. The terrorist attacks of the Bardo Museum and a tourist resort in Sousse (which happened very close to the date of this presentation), along with external and non-state actors' attempts to thwart progress in the region, testify to the gravity of the threat to Tunisia and its nascent democracy.

In spite of [an] undeniable achievement, the Tunisian democratization experience is not yet fully complete.

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Professor Gheraïri presented a brief socio-political and historical analysis on the Tunisian revolution and provided a detailed account of the distinct features of the Tunisian transition

process, based mainly on the Tunisian tradition of dialogue and consensus-driven decision-making. Finally, he concluded by presenting the key challenges the country faces at this early stage of democratic consolidation.

## **Tunisian Precocity in Progressive and Universal Reform**

Gheraïri characterized the Tunisian demonstrations spanning the end of 2010 until early 2011 as peaceful, civil and civic. In his view, the young demonstrators' claim to universal values of freedom, dignity and social justice was an attempt to move beyond their specific culture and region in their struggle to retake their rights. Gheraïri asserted that these universal values place Tunisia's revolution in a long history of opposition between two movements in the region: reformism versus nostalgia to an idealized past Arab history and civilization. He explained that following Napoleon's campaign in Egypt, the Arab world faced the shock of modernity. The Arab world witnessed the

cultural advancement of the West, compared to theirs, creating an impetus to engineer a solution in order to “catch up” with advanced nations. Two choices were debated at that time. The first was based on the belief that Europeans were advanced because they hewed closely to the requirements prescribed by both their identity and religion, meaning Arabs had to more forcefully embrace their own religion and identity, calling on past traditions, behaviors, and religious teachings to meet current challenges. Salafism emerged as one consequence of this logic. The reformist movement supported a second alternative: they believed that adopting human rights, applying science, and conforming to the rule of law would further strengthen their identity and build a more developed and modern entity. It must be noted that this debate among reformists and nostalgic conservatives still simmers in most Arab countries.

By claiming universal values, the Tunisian revolution is firmly anchored in the reformist movement. From a political history perspective, the Tunisian revolution is a logical continuation of a history of militancy for progressive reforms. Tunisia was the first Arab country with a bill of rights, a constitution (in 1862!), and to end slavery and polygamy. Thus, Tunisia may have been the Arab country where a democratic transition had the highest chance of success.

## **A Secular Tradition of Dialogue and Consensus-based Decision-making**

After this brief historical review, Gheraïri presented his analysis of the Tunisian transition. He believes that Tunisia secured some advantages as the initiator of the Arab uprisings. One of these first-mover advantages is the regime’s lack of experience dealing

with mass popular protests, reducing its ability to confront demonstrators' tactics. Demonstrators took the regime by surprise, and reaped historic benefits, as they quickly toppled the president. In other countries, such as Morocco and Jordan, insight gained from the Tunisian case helped the regimes to prepare, and thus they were more effective in managing the popular protests. As an expert to the committee in charge of the design of the transition process, Gheraïri asserted that to a large extent, the fact that the Tunisian revolution was leaderless constituted an important asset. No authority, movement, figure or political party could claim ownership over these demonstrations, making it difficult for political activists and parties to use them for specific ideological or individual interests. This leaderless reality dictated that all decisions in the aftermath of the revolution be taken with the participation and consensus of all stakeholders. As no one owned the revolution, all stakeholders had a say in the country's transition.

For this reason, most of the committees and other political bodies founded in the aftermath of Tunisia's transition followed the same logic of broad participation, enabling Tunisia to move further despite a fiercely contested political sphere. Among these bodies, two key institutions were set up to articulate and manage the transition process, both basing all decisions on consensus. First, the Higher Authority for Realization of the Objectives of the Revolution, made up of representatives from political parties, civil society, labor unions, businesses, and aided by experts, set the guidelines and drafted the legislation for political reform and democratic transition process.

A second institution, the National Dialogue, was set up in 2013 when the transition process was on the verge of failing. Gheraïri explained that in 2013 under the elected Islamist-led government, Tunisia faced the first political assassinations



since the uprising followed by massive demonstrations against violence and poor management of the country by the Islamist-led government. By the middle of 2013, political tensions jeopardized the entire transition process. The country found its way out of this acute crisis thanks to an active civil society, which formally institutionalized a new “National Dialogue,” spearheaded by four influential national organizations: UGTT (Trade Labor Unions), UTICA (Businesses Association), LTDH (League of Human Rights) and the National Lawyers Association. The National Dialogue redefined the transitional road map and addressed the most contentious political issues which had initially stalled the drafting of the constitution by consensus in the Constituent Assembly. Ultimately, thanks to the National Dialogue Quartet—as they came to be known—a progressive constitution was adopted reflecting the reformist wishes of the majority of the people. An independent technocratic government was installed to manage the last phase of the transition including organizing democratic elections of a new President and Parliament. Tunisia’s constitution conferred equality for men and women, freedom of speech and conscience, a more balanced power distribution (semi-parliamentary regime), and a decentralized state to enable local development. Ultimately, the country experienced three consecutive democratic elections in 2014, and has witnessed a smooth transition of power. In recognition for Tunisia’s participatory and open transition process, the international community awarded the National Dialogue Quartet the Nobel Peace Prize for 2015.

## Challenges to the Transition

Gheraïri concluded by recalling the economic and social issues driving the Arab revolutions and insisted that if dignity was one of the main demands of the Tunisian demonstrators, the solution

does not rest solely with political processes and freedoms. Dignity must be achieved through economic and social development. Tunisians have become impatient as their social and economic expectations have yet to materialize after more than four years of transition. The continued decline of economic and social conditions especially of low income and middle class groups,

If dignity was one of the main demands of the Tunisian demonstrators, the solution does not rest solely with political processes and freedoms.

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wrought in part by the pressures of the transition, could jeopardize the country's outstanding political successes.

He also emphasized the security issues brought about the political polarization and the emergence of

radicalism during the transition. He believes that terrorist attacks and security breaches could further endanger the country's prospects. Attacks at a tourist resort in Sousse and the Bardo National Museum have undermined the important tourism industry, further compromising Tunisia's economy. Whatsmore, with many structural reforms to enact, a massive bureaucracy and geopolitical concerns could stand in the way of courageous efforts at reform. In the face of these challenges, Tunisia needs strong international support to save a nascent democracy in a region at risk of more instability, radicalism and autocracy.

# Chapter 3:

## **Economic Performance and the Case for a New Social Contract in the Middle East and North Africa**

Summaries of sessions 3 and 5,  
Presented on October 6 and 27, 2015

Björn Rother, Advisor and Chief of Strategy and Partnership Unit, Middle East and Central Asia Department, International Monetary Fund

Shantayanan Devarajan, Chief Economist, Middle East and North Africa Region, World Bank

### **Introduction**

Five years after the Arab uprisings, many countries in the region are still struggling to stabilize, achieve higher and more inclusive growth and improve living standards for their people. They have undergone profound and unpredictable political transformation. Some countries are embroiled in civil wars (Syria, Yemen, and Libya), while others have barely begun their transitions, only marginally mending or even restoring the old political system. Only Tunisia achieved a political transition, but now faces grave economic challenges to consolidating its nascent democracy. A series of three seminars (the third through fifth in the series) discussed the economic and social performance of Arab economies, how the political economy has affected the pace of

reforms and the capacity of Arab states to deliver on their social contracts. These seminars also debated the new challenges facing Arab societies and what conditions might allow a new social contract to emerge, restore confidence, and build more inclusive development and politics. The three sessions touched on the entire region, but focused primarily on non-oil rich countries, where most Arab transitions occurred.

In this chapter, Mr. Larbi has combined his reflections on the third session, presented by Björn Rother of the International Monetary Fund's Middle East and Central Asia Division, and fifth session, presented by Shantayanan Devarajan, the current Chief Economist of the World Bank's MENA Region, in this chapter because the analyses covered overlapping time periods, lending deep insight to issues at work in past, present, and future for the Arab economies. The combination of these sessions in this chapter does not represent agreement between the speakers on the issues, but Mr. Larbi's own editorial decision to fold these analyses together to allow the speakers' insights to flow in a time-linear fashion. His reflection on the fourth session follows this chapter, covering Mustapha Nabli's focus on the economic and social effects and policies of the transitions. As highlighted in these chapters, each speaker made important contributions to this portion of the study group on the economic and social fundamentals, so pivotal to understanding the Arab uprisings.

## **Past Development Models (1960s to 2000s) of the MENA Region: Modest Results Compared to Emerging Countries**

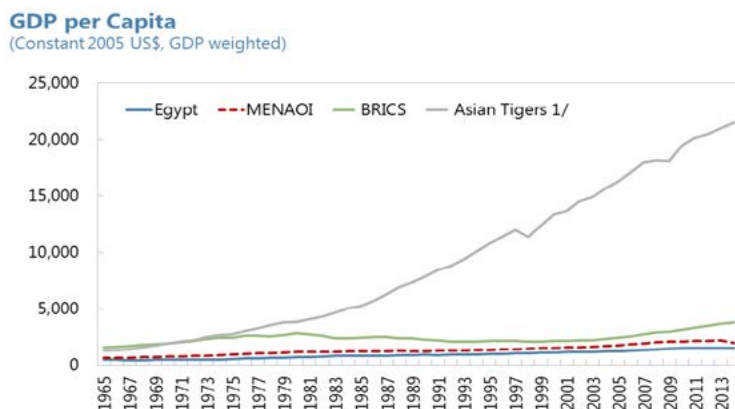
The MENA countries are strikingly diverse. Some countries are oil importers (Jordan, Morocco, Tunisia, Egypt, etc.), others are oil-rich exporters (Saudi Arabia, Algeria, Kuwait, Iran, and Gulf Countries). They also vary in demographic size, from large, densely populated countries of more than 80 million inhabitants (Iran, Egypt) to medium-sized ones of between 20 and 35 million people (Morocco, Algeria, Syria, Saudi Arabia, Iraq, and Yemen, Tunisia) to small states with less than 11 million inhabitants (Tunisia, Jordan, Lebanon, etc.). However, MENA countries share in many other dimensions, not least in language, culture, undemocratic political systems, young population with high youth unemployment, fast urbanization and increasing water stress.

Just after independence (in the 1950s and 1960s) until the late 1970s, states in the MENA region relied on state-led development models that failed to generate enough growth, delivering neither adequate numbers of productive jobs nor increases in living standards, to satisfy their fast-growing populations. With the exception of small Gulf countries, many initiated reforms in the 1980s to shift to a market-based economy. These reforms were not comprehensive and deep enough, nor were these countries' institutions strong enough to enable the needed structural changes, faster economic development, and job creation.

The economic indicators of the region's oil importing countries are unequivocal: as seen in figure 3.1, increases in GDP per capita since 1965 have been marginal when compared to other middle

income countries (MICs), especially those of East Asia. As the figure reveals, real growth in oil-importing MENA countries has been largely stagnant for decades.

Figure 3.1. **GDP per Capita, Comparison between Egypt, MENA Oil Importers, BRICs and the “Asian Tigers” Economies.**



Source: World Bank WDI.

Note: BRICS excl. Russia.

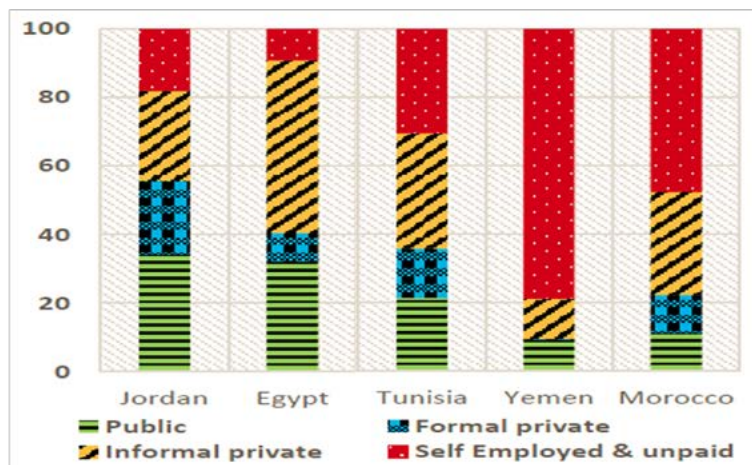
1/ Asian tigers include South Korea, Singapore, Thailand and Malaysia.

Employment distribution between the formal and informal segments of both the public and private sectors reveals the importance of the informal economy, including the dominance of self-employment in micro-enterprises. Informal jobs are generally low productivity, precarious and lack social protection. Figure 3.2 plots the relative size of these different sectors in Jordan, Egypt, Tunisia, Yemen and Morocco. Self-employed and the informal private sector combine to represent a majority of the workforce in all of these countries but Jordan. The public sector also continues to serve as a major employer, especially in Jordan, Egypt and Tunisia. The Yemeni case is particularly bleak: after decades of conflict, the formal private sector is all but non-existent.

Figure 3.2. **Employment by Sector, Percent of Total Labor Force**

### Employment by Sector,

(In percent of total labor force, latest available)



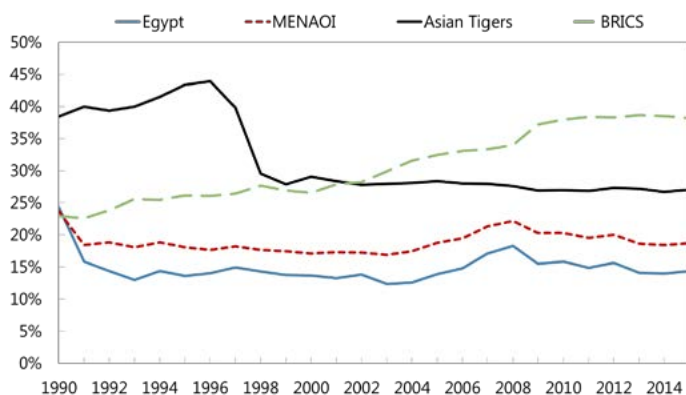
Labor force participation is still among the lowest in the world (in 2010: around 45% vs 65% in East Asia), and unemployment remains prevalent, especially among youth and women.

Including employment in the informal sector, unemployment remained high for the last decade, exceeding 10% (12.5% in Egypt, 13% in Tunisia, above 12% in Morocco, Algeria, Jordan, etc.), well above the average of middle income countries worldwide. Youth and women were the most affected groups, with average unemployment rates in late 2010 above 25% and 20% respectively. Youth unemployment is highest for university graduates at above 30% for both men and women.

Figure 3.3 plots investments as a percent of GDP across different regions. Investment in the MENA region has been relatively low over the last two decades, averaging 20% across the region, with large variation across countries: compared to the BRICS, at 30%, or East Asia at 27%, Egypt wallows at 15%, while Morocco

stacks up well at 28% (Figure 3.3, below). This lack of investment stems from slow or partial implementation of necessary political and structural reforms resulting in poor market institutions and business environment: lack of competition, high barriers to market entry, poor governance, and limited room for political participation (low polity scores, poor level of social services delivery). Conflict is another important factor, as figure 3.4 demonstrates; both high frequency and enduring long duration conflicts plague the region.

Figure 3.3. **Investments as a Percent of GDP**  
(Total fixed capital investments)



Sources: National authorities; IMF staff estimates.



Figure 3.4 **Frequency (L) and Duration (R) of Conflict in MENA**

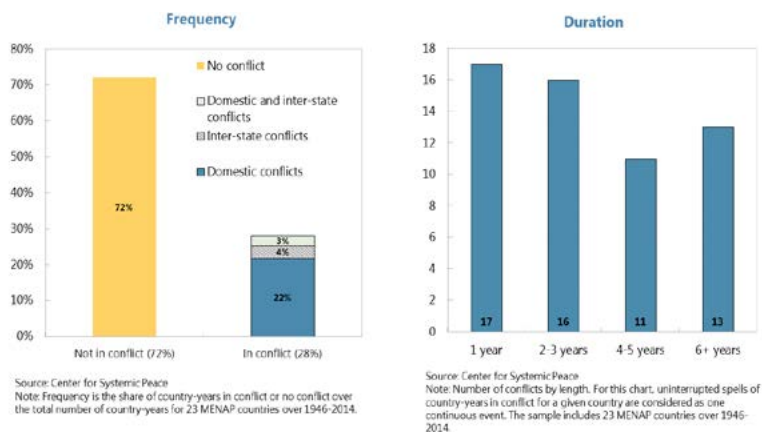
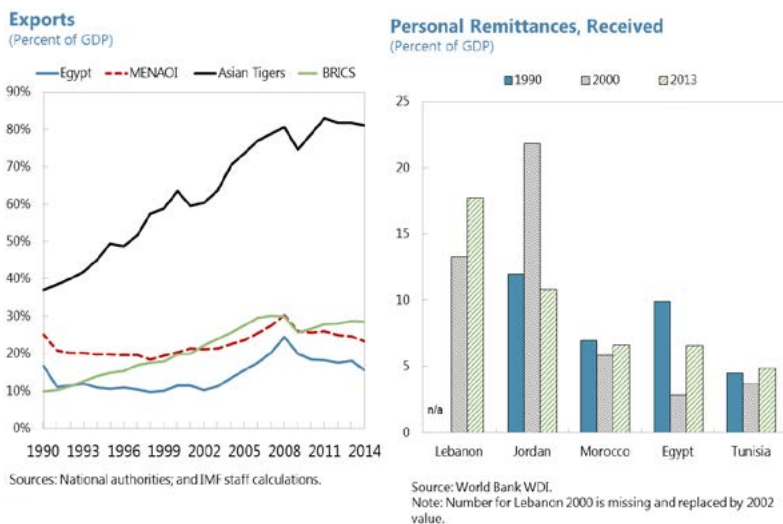


Figure 3.5. **Global Integration of MENA Economies: Exports (L) and Remittances (R) as Percent of GDP**



In addition, the MENA region comprises the least globally integrated economies, demonstrated by two important measures shown in figure 3.5. The share of exports (as a percentage of GDP) of oil-importers has increased more slowly than in most regions, representing less than one-third the ratio of East Asian countries. Most MENA countries still rely on rents from natural resources or remittances of their expatriates to help balance their current accounts. As the figure indicates, remittances remain a vital revenue source in countries like Lebanon and Jordan, whose citizens have had little choice but to seek employment abroad.

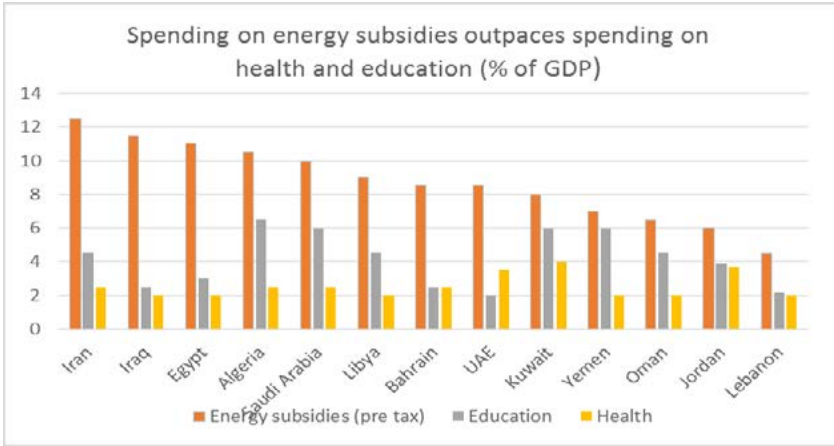
## **The Old Social Contract: Inherently Unsustainable, Driver of Recent Uprisings**

Despite their diversity, MENA countries shared similar social contracts with a few key common features. In return for political acquiescence, loyalty and very limited political rights, rulers offered their people public sector jobs, free or highly subsidized access to public services—especially health and education—and subsidized basic foodstuff and energy (see Figure 3.6). Figure 3.7 plots country scores for voice and accountability over the natural log of GDP per capita. Across the full sample, we see a broadly positive association. The MENA countries, however, largely fall below the trend line, indicating relatively poor performance given their wealth. This lack of voice has been a key feature of the traditional social contract.

The traditional social contract was successful in the early decades following independence when the development model was based on a state-led import substitution. Indeed most countries grew at a reasonably high pace, reduced poverty (see Figure .3.8), and improved their social capital through universal access to education,

fair provision of health care, water, electricity and more. In addition, they managed to keep inequality in check. The distribution of income was fairly equitable, indicated by a Gini coefficient averaging 0.35 and the income of the bottom 40% grew faster than the national average in most countries (see Figure. 3.9).

Figure 3.6 **Comparing Public Subsidies on Energy, Education, and Health**



However, when the post-independence development model ran out of steam in the 1980s and resulted in serious fiscal crisis, countries cut the economic and social benefits of the old social contract while keeping its political component unchanged. The shift to a market-based economy and a partially revised social contract yielded dysfunctional institutions generating very negative impacts on people’s living conditions and economic future. Polls revealed that life satisfaction in the MENA region was declining, whereas elsewhere it was improving. The decline was sharpest in the Arab Spring countries (see Figure 3.10). This heralded the limitations of the old social contract and foreshadowed its demise.

Figure 3.7. Prosperity and Voice, MENA below the Trend

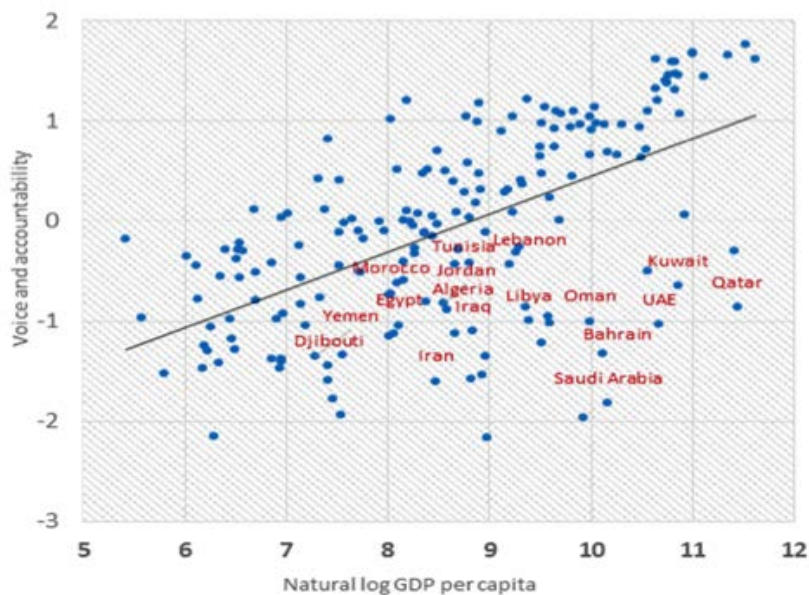


Figure 3.8. Poverty is Very Low in MENA

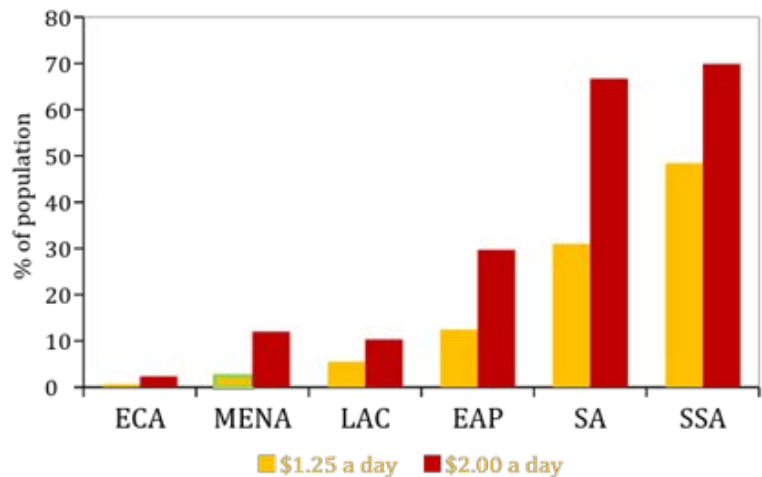


Figure 3.9. **Comparing MENA Inequality to Rest of World**

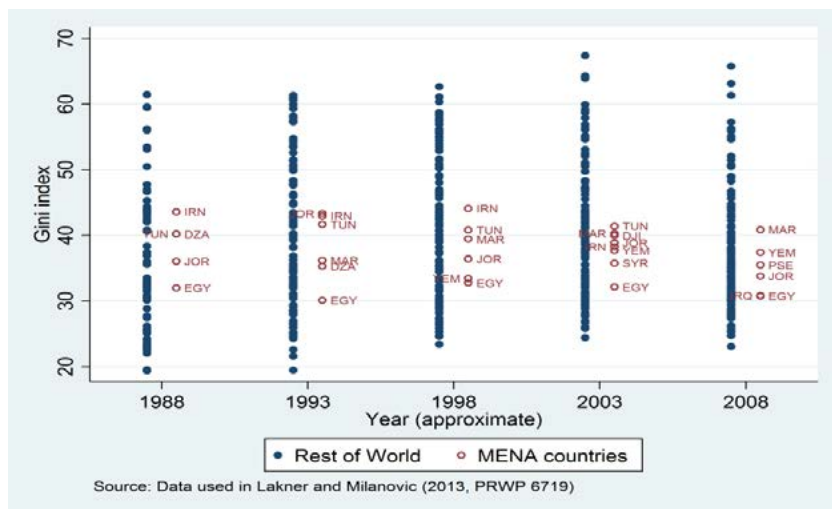
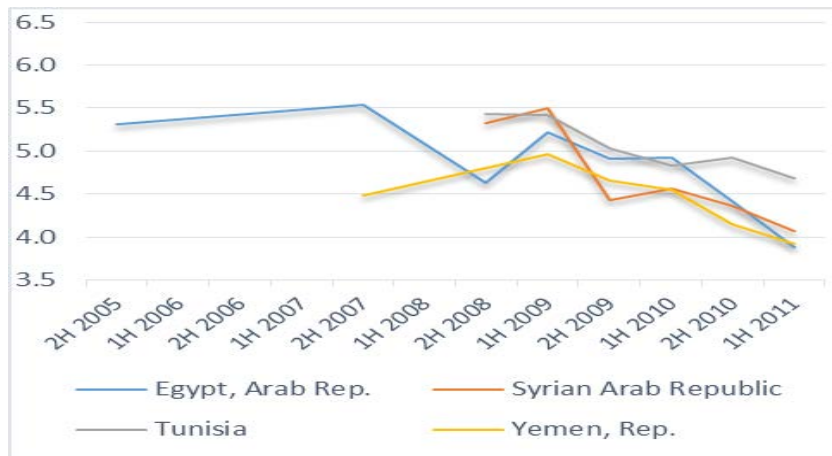


Figure 3.10. **Declining Life Satisfaction during 2000s in Arab Spring Countries**



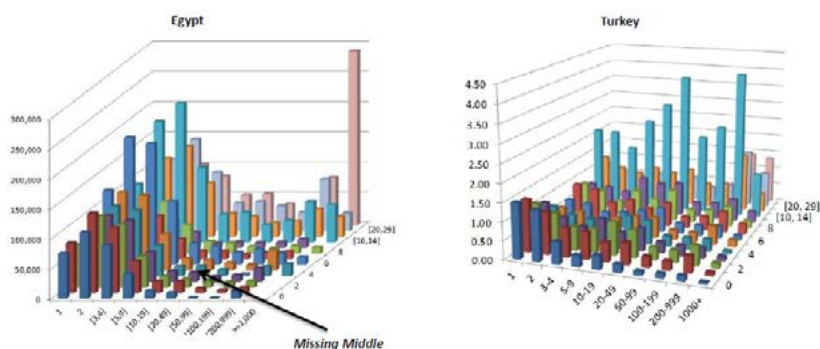
To address the limitations of the post-independence state-based development model and cope with a decade of low growth and large fiscal imbalances stemming from the high cost of the social contract (energy and food subsidies, free access to most public services, overstuffed public sector, etc.) during the 1980s, MENA countries shifted to a market-based economy with increased private sector involvement. They initiated a set of fiscal and structural reforms to promote private investment, restore fiscal stability and revive growth and job creation. However, these reforms did not yield high enough growth. The private sector did not develop as expected and thus did not create enough jobs to compensate for the state's withdrawal and absorb the rapid growth of the labor force. During this period (the 1980s and early 1990s), the youth bulge in MENA was at its peak and the labor force grew at 3.2% per year, the fastest in the world.

As the gap between labor supply and demand yawned wider, with the public sector no longer able to fulfill its role as the main employer, unemployment soared in most Arab countries to become the highest in the developing world. The trend worsened in the decade before the uprisings. Young, educated men and women were the most affected. University graduates made up 30-40 percent of the unemployed. Most jobs were found in the informal sector. These jobs are insecure, of low productivity and leave workers highly exposed to low compensation and lack of social protection. They are particularly unattractive to women, whose participation in the labor force at about 22% is among the lowest in the world.

Obviously, one of the root causes of the poor performance of MENA economies in the last decades, measured by unemployment and popular dissatisfaction, is the failure to develop a vibrant private sector and accountable institutions to deliver quality services and sustain faster, job-creating growth.

Micro and small companies (96%) and a few very large firms (3%) dominate the private sector, as seen dramatically in figure 3.11. Unfortunately, these micro and small firms rarely grew. Why? The business environment in most MENA countries was rigged by privileges and cronyism, enabling only those connected to the ruling elite to invest in lucrative or rent-generating activities. Private investors in MENA countries not connected to rulers continue to face high entry barriers to many productive activities, poorly enforced and outdated regulations, limited access to finance and growing corruption. As a result, the private sector lacked the necessary level playing field and competitive environment to innovate and grow.

Figure 3.11. **The Missing Middle in MENA Economies, Comparison to Turkey**



Lack of accountability and inappropriate policies (lack of reforms) led to poor institutions and service delivery. Most Arab countries, including very rich ones, score poorly in governance, effectiveness of the public sector, and international education tests. In recent surveys, people expressed dissatisfaction with the quality of most public services (health care, solid waste management, education infrastructure, water and electricity, etc.). High absenteeism of teachers and lack of quality of health and other public services were emblematic of state institutions lacking accountability, a root cause of the deterioration of public service delivery.

## **During the Transitions: New Challenges Mount while Reforms are Ignored**

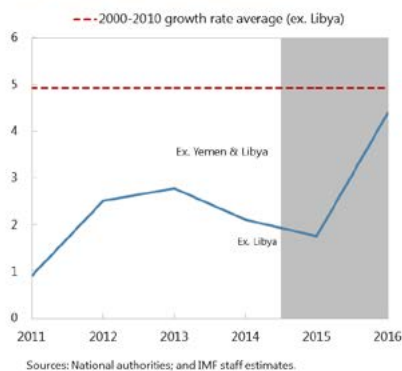
After the Arab uprisings, despite a highly volatile political context, macroeconomic stability has been broadly maintained. However, reforms for more inclusive, faster growth remain mostly unfinished business. As a result, over the last four years, most economic and social indicators deteriorated. Budget deficits increased due to popular pressures for increased wages and jobs in the public sector, as well as increases in security expenditure to maintain public order and stem threats from radical groups. Public debt has also increased by an additional 5 to 7 percentage points, depending on the country. Gross international currency reserves diminished dramatically, especially in Tunisia and Egypt where reserves dipped to only slightly higher than the three months of imports threshold. As demonstrated in figure 3.12, GDP growth was halved in most countries, dropping from an average of almost 5% to just above 2% (left panel in figure 3.12), resulting in higher unemployment—rates as high as 15% in Tunisia, 13.4% in Egypt, 14% in Jordan, etc. (right panel in figure 3.12)—especially for young men and women, for whom unemployment is above 25% on average. In addition, heightened social tension and frequent strikes, often associated with revolutions, drastically decelerated productivity growth, which fell in some cases into negative territory (see figure 3.13).



Figure 3.12 and 3.13 **Deteriorating Economics After/During Transitions**

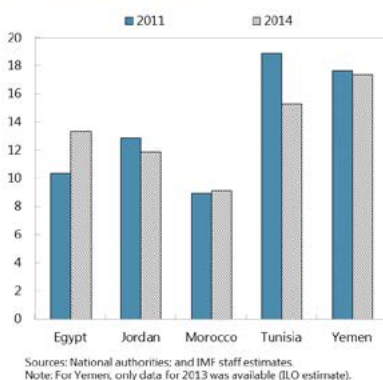
### Real GDP Growth Still Below Historical Average

(Weighted average, annual percent change)



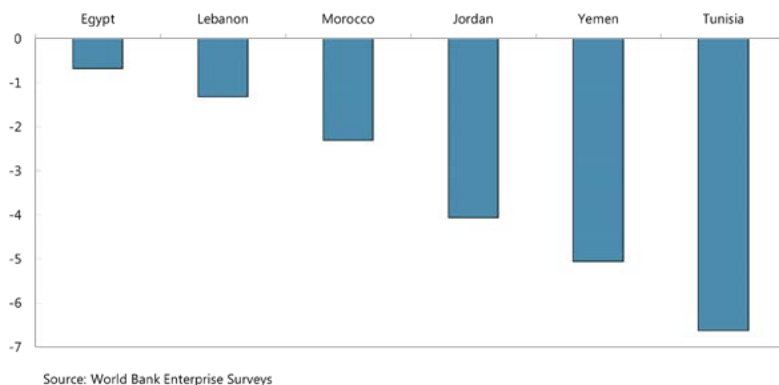
### Unemployment Rates

(Latest available data, in percent)



### Average Annual Labor Productivity Growth

(Between 2010 and 2013)



Reinforcing the strong correlation between foreign direct investment (FDI) and political stability, the region's instability after 2010 led to a decrease in FDI. The left panel in Figure 3.14 plots net FDI over political stability. While the relationship is fairly noisy, we see that most countries in conflict have low political stability and net FDI near or below zero. Lately, the region has also experienced a sharp increase in security and

military spending (see the right panel in Figure 3.14), reduced tourist arrivals and a proliferation of refugees (see Figure 3.15).

Figure 3.14 **Instability vs. Investment (L) and Military Spending (R) in MENA**

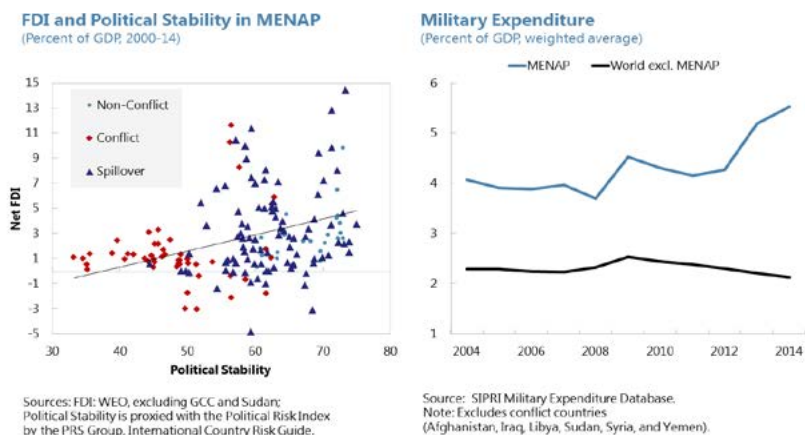
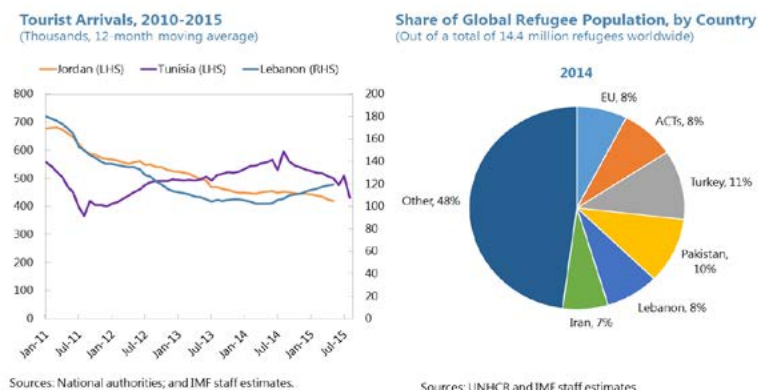


Figure 3.15: **Tourism Down, Migration Up in MENA**



From an economic development and institutional environment perspective, the present looks all too similar to prior to the uprisings. Most countries have initiated few structural and

fiscal reforms, often in crisis-driven efforts incapable of creating long-term change. The impact of these limited efforts will depend on the pace and quality of their implementation. However, new threats and downside risks emerged along with new opportunities. These could be leveraged through continued and increased international support to fill the growing need for external financing and sustain the reform efforts toward new paths of more inclusive and jobs-rich development in the region.

## **The Case for a New Social Contract: Deep, Comprehensive Reforms Urgently Needed**

The speakers were unanimous that many of the pre-uprising economic and social problems have only worsened during the transitions. Speakers advocated for a new social contract to break up old policies and governance systems. Despite the lack of significant reforms and change, a new social contract is needed, not only to replace broken deals of the past, but also to overcome the serious challenges the region now confronts. The region is in turmoil, riddled with severe conflicts and sectarian tension, shaken by an unprecedented refugee crisis, threatened by growing violent radicalized groups, weakened states, sluggish economic growth, declining oil prices, and alarming unemployment levels, especially for the youth. The region also faces downside risks in global markets: potential economic slowdown in China, expectations of higher interest rates in the United States, and falls in commodity prices, among others, compound ongoing problems in the region, and raise the risk profile for outside investors.

The old concept of an overwhelmingly interventionist Arab state working in partnership with crony capitalism must be replaced

by a new institutional framework where the role of the state and its relationship with society is entirely revamped. Devarajan emphasized the need to add more accountability and impartiality from the state and more participation—in both policy and the market—from citizens. While taking into account each country’s specific needs, guiding principles of a new social contract in the MENA region should include focusing the role of the state on promoting and enforcing the rule of law and human rights; consolidating security, political stability and inclusion; and building cohesive, just and prosperous societies. On the economic and social fronts, the state should: protect property rights and maintain a level playing field for businesses and citizens aimed at unleashing their entrepreneurial potential, fostering innovation and social responsibility; increase trade competitiveness and integration with the global supply chain; limit itself to serve and answer to the people only, ensuring effective service delivery through market mechanisms when prudent; and provide social protection for deserving citizens through appropriate and efficient mechanisms. Citizens should be encouraged and given the necessary space to participate actively in setting, monitoring and implementing public policies.

## **How to Get There: National Social Dialogue**

*How to convince countries of the value of and means to a new social contract?* Devarajan and Rother agreed this is the most challenging question moving forward. Each suggested various mechanisms to engage and facilitate a thorough social dialogue among key stakeholders within countries. Rother argued for a carefully planned process, starting with widely-popular, “no-regret” moves, including technical measures like making public spending more efficient alongside more political ones like

increasing government transparency. Both speakers advocated a forum for public debate on major political, economic and social issues, allowing citizens and key social and economic actors to communicate with government officials on priorities for institutional and policy changes, which will form the foundation of the new social contract. Debates should be structured around priority political, economic and social issues, as mentioned above.

Like in many transition countries, governments should take the lead to initiate, and if possible institutionalize, a national social dialogue to enable a participatory policy-making process and build a consensual new social contract on solid grounds. In the absence of government initiative, major civil society organizations should work with key social and economic players and government officials to help them create a participatory national social dialogue. Given the implementation gap in past economic and social reforms, implementation of the new social contract should be a major focus of any effort. Rother also added that a particular effort should be deployed to mobilize international support through financing and trade access. The capacity to properly manage the new social contract should be put in place early on in the process to build credibility and begin restoring trust between citizens and the state and building the political buy-in necessary to drive tough reforms.

# Chapter 4:

## **The Economic and Social Impact of Arab Political Transitions**

Summary of session 4,  
Presented on October 20, 2015

Mustapha Kamel Nabli, Former Chief Economist and Director, World Bank Middle East and North Africa Division; Former Governor, Central Bank of Tunisia

### **Introduction**

Mustapha Kamel Nabli brought experience as both policy practitioner and public servant during the transition to the study group, from his service as Governor of Tunisia's Central Bank from 2011-2012, preceded by his tenure as Chief Economist and Director at the World Bank's MENA Region. His presentation addressed three main questions: What was the economic and social impact of the transition? What shaped economic policies and reforms during the transition? And finally, are these reforms and policies leading toward the emergence of a new social contract?

In his presentation, Nabli focused on the negative effects of Arab political transitions on economic and social indicators, leveraging the cases of Egypt and Tunisia to highlight trends across the Arab world. He emphasized that an overall negative context during the transitions caused poor economic and social performance.

Furthermore, the transition environment favored politically expedient reforms to the detriment of more important economic and social reforms.

Turning his analysis toward the future, Nabli posited that in both cases studied and across the region, elites have remained entrenched and the political power balance shows no signs of tipping toward meaningful reform. In that sense, the old social contract has yet to be fully dismantled or changed. Public appetite for such a shift seems weaker than needed and lack of public leadership, dialogue, and institutional capacity may lead to stagnation, or at best, marginal change. Nabli placed great importance – and hope – on institutional reform for genuinely inclusive growth and politics to emerge, particularly in his home country Tunisia.

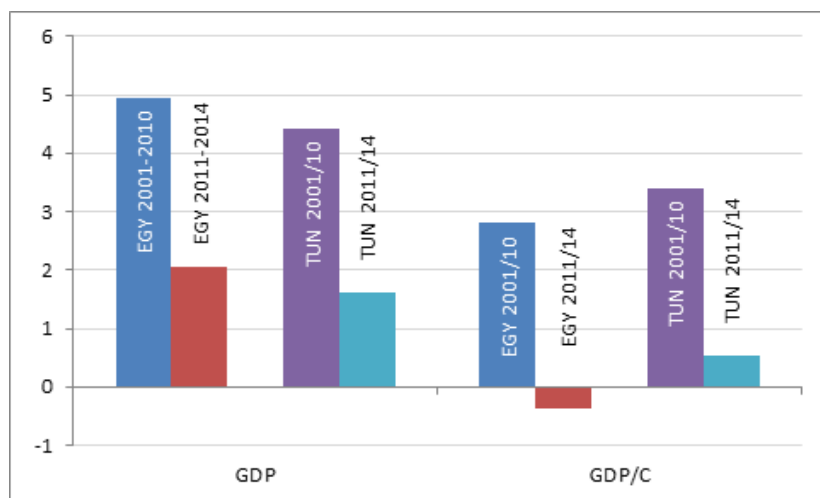
## A Costly Political Transition

*Expansive fiscal policy responses were the most important feature during the transition and have proven ineffective.* During the uprisings, transition governments responded to relentless social tension, popular demands for jobs and welfare support, and looming economic downturn with a “two-pronged” policy: (1) an expansionary fiscal policy pursued through higher public investment, most importantly through increased wages and employment in the public sector; and (2) higher subsidies, especially for energy products and basic food stuffs. These fiscal policy responses were leveraged by supportive monetary and trade policies. In the absence of expected growth and due to lack of or limited fiscal space in non-resource rich countries like Egypt and Tunisia, these policies translated into soaring fiscal

deficits, inflation and public debts (see below) without mitigating the deterioration of the social conditions of the people.

*Over the transition period (2011-2014), economic and social conditions deteriorated.* Referring to Egypt and Tunisia, GDP growth dropped by about 3 percentage points from an average of almost 5% during the decade preceding the uprisings, to an annual average of about 2% in 2011-2014 (see Figure 4.1 below). GDP per capita remained flat or marginally increased while inflation shot up, indicating weakening purchasing power for the population and increased poverty (right side of Figure 4.1 below). Investment-to-GDP ratios dropped by 2 to 3 percentage points and foreign direct investment (FDI) was more than halved. Domestic savings rates declined by an average of 7 percentage points. Current account deficits as a percentage of GDP plunged by 4 to 5 percentage points.

Figure 4.1 **Growth in GDP and GDP per Capita in Egypt and Tunisia, Comparing 2000s to 2011-2014**





Meanwhile, unemployment, one of the key triggers of the uprisings, increased in all Arab countries, with a notable negative impact on two key segments of the population: youth and women. For example, in Egypt, unemployment increased from 10% before the uprisings to 13.4% in 2014. Tunisia witnessed the largest deterioration of unemployment: from 12.0% in 2010 to an average of 15.5% between 2011 and 2014. Particularly hard hit were university graduates, up from 23% jobless in 2010 to 30% in mid-2015. University graduates in other Arab countries fared only slightly better, with unemployment rates rising to just below 30% by 2015. Stagnating or declining GDP per capita, higher unemployment and rising inflation now drive increased poverty, especially among the most vulnerable segments of the population. Special safety net programs and cash transfers have mitigated some of the adverse effects, but proved insufficient to offset the tremendous impact of increased unemployment and inflation. This slide has coincided with deteriorating quality of most public services, as recognized by citizens across the Arab world.

## **No Fundamental Economic and Social Reforms during the Transition**

Due to the difficult political transition process and constant social tension in most transition countries, transitional governments did not undertake any of the overdue structural reforms. For example, in Tunisia, attempts to move forward on a new investment code, a Public-Private Partnership law or a new banking law have seen little progress. The political elites instead favored political debates. As a result, Tunisia's economy continues to deteriorate despite a notably improved political situation. The experience of Egypt was not much different.

While it is widely agreed that the limitations of past economic and social development models in Arab countries and the failure of the old social contract were the main cause of the uprisings in 2011, the economic and social situation has gotten much worse during the transition period, in the absence of needed reforms. Moreover, new challenges and major risks emerged during the transition: insecurity and radicalism, fiscal and external imbalances, higher unemployment, weaker public institutions and law enforcement, increasing social demands, and others.

The economic and social situation has gotten much worse during the transition period, in the absence of needed reforms.

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## Very Hesitant Moves Toward a New Social Contract

Nabli asserted that a desirable new social contract should move the region toward a more open political system, a more competitive economy where the state takes a more strategic and regulatory role aimed at ensuring broader access and a level playing field for a more dynamic private sector, and finally to a more inclusive economy and targeted redistribution system. But, there is no indication of emerging momentum toward this sort of new social contract in Arab countries. The lack of fundamental political and institutional reforms left the same entrenched elites and interest groups in place with the capacity to influence decisions and undermine necessary reforms. There has been no real change in the balance of power between the main stakeholders, even in Tunisia and Egypt, where transitions were the most pronounced. The same interest groups and key actors still dominate. In Tunisia, the middle class, made up of the public and formal private sector employees and from which most political power is derived, is represented by labor unions who not

only retained their power, but increased it during the transition. The military and security apparatus remained as powerful in Egypt as before the Arab spring. Business elites remained as influential (if not more) as in the past in Jordan and Morocco, as well as in the rest of Arab countries. Therefore, there has been no real disruption in the equilibrium among key actors that might allow change to the political economy that prevailed before the uprisings. This reality makes consequential changes in the past authoritarian bargain unlikely, including in Tunisia, despite radical and meaningful change in its political system.

Recent polls have demonstrated that support for principles such as democracy and good governance have strengthened since the uprisings. However, desire among the public for such a shift is still much weaker than needed. This support remains modest compared to current democracies or during past democratic transitions

around the globe. Furthermore, on the economic front, little has changed or even been debated with regard to the role of the state and the private sector, distributive issues—other than increased subsidies—governance and the business environment. Ultimately, many impediments remain to fundamentally change the relationship between state and society in Arab countries. Among these impediments, several stand out: absence of meaningful national debates on economic and social reforms, weak or fragmented demand within civil society, poor implementation capacity of public institutions, and lack of reform-oriented leadership or political parties committed to changing the old social order.

There has been no real disruption in the equilibrium among key actors that might allow change to the political economy that prevailed before the uprisings.

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While the old social contract has yet to undergo radical change, people's aspirations for changing the old model are still alive and may have increased following the deterioration of their economic conditions. Zeroing in on Tunisia to foreshadow the fate of the region, Nabli placed great hope in the successful and complete implementation of the new constitutional institutions. If functioning well, these institutions could guide economic and social policies that would spur an inclusive growth recovery and vibrant future for the country. Otherwise, he warned that Tunisia's old social contract would remain broadly unchanged, leading the country to develop a poor quality, possibly unstable democracy. The question remains: what types of drivers and institutional processes are required and how to bring them about in order to move toward genuine transformation?

## Chapter 5:

# Writing a New Arab Social Contract: The Need for Work and Dignity

Summary of session 6,  
Presented on November 3, 2015

Zafiris Tzannatos, Former Senior Advisor  
on Social Policy for the World Bank,  
International Labor Organization, and  
Government of the United Arab Emirates

## Introduction

In the sixth session of the study group, Dr. Zafiris Tzannatos, former Senior Advisor on Social Policy for the World Bank, International Labor Organization, and Government of the United Arab Emirates, asked whether the Arab uprisings were caused by “bad politics or bad economics?” Sticking to his chosen discipline of economics, he made a case for a combination of both, but emphasized the latter, arguing that market reforms in the 1990s precipitated a major shift in the social contract, giving way to a toxic political economy that fueled dissent. He also challenged the assumptions and conclusions of earlier presenters on the central problems in the region’s labor market outcomes. After highlighting these alternative understandings of the issues, he proceeded to parse questions of designing a new social contract, advocating a precise understanding of the aims and mechanisms for promoting a new deal for and amongst Arab citizens.

## Bad Economics, Bad Politics, or Both?

*Was it bad economics or bad politics that brought about the Arab Spring?* Some analysts have argued that while economic policies were improving steadily starting with pro-market reforms in the 1990s, politics ultimately let the region down. However, this argument ignores the numerous mistakes made in economic policies, including the reforms of the 1990s.

As seen in Figure 4.1, all 22 Arab countries fell into the worst quadrant of economics and politics during the 2000s—citizens had given up their voice, but had not gained higher standards of living.

Still, the economic reforms introduced in the 1990s did yield real success: a revival of economic growth partly assisted by the high prices of oil during the early 2000s; reduced deficits, debt, inflation and, indeed, unemployment, especially for youth. Despite these macroeconomic successes, the issue is to what extent the fiscal reforms that were adopted yielded meaningful results on economic and social issues.

To understand this, one must trace the development of the social contract in the Arab world through recent history. The traditional social contract, established in the 1950s and 1960s, whereby the population exchanged political freedom in return for public sector jobs, free public services, low taxes, and other state handouts came under pressure from increasing fiscal burdens, exacerbated by slow productivity growth and weak competitiveness in the private sector. Governments could no longer co-opt the middle class and the educated youth into relatively well-paid civil service jobs, which constituted a mechanism for upward social mobility and also served as a form of social protection. That contract was

abandoned in the 1990s—starting with Tunisia. The pro-market reforms that followed were implemented in such a way that the Arab world found itself in 2011 with a “new social contract” that was neither participatory nor inclusive.

The post-1990 market-based social contract did not create a transparent and level playing field for the private sector, a balanced public/private interface, or a distributional mechanism based on merit or need. The economic reforms downplayed the role of public investment on the assumption that it would be replaced by private investment. Private investment failed to pick up while foreign direct investment (FDI) has been lower than in most other regions. Trade policies favored liberalization, paying little heed to local production or their overall impact on

Figure 5.1. **Governance versus Economic indicators, Worldwide**  
*Arab states in red.*



the economy. Intra-regional exports of non-oil goods remained much below their potential, and regional trading agreements have not contributed to deeper international integration for Arab countries. Institutional reforms, in such areas as transport and

customs clearance, were few. The sale of public assets was not transparent, amounting more to a denationalization process for the direct benefit of political elites than independent privatization. With financial policies focused on liberalization, high inflation rates led central bankers to focus too much on price stabilization, instead of adopting a more balanced approach including attention to productive investments and promoting full employment. Many Arab currencies followed the US dollar and the Euro, tying monetary policy to that adopted by central banks elsewhere. The pace of economic diversification has been slow. Public investment, especially in socially beneficial infrastructure and human development, was reduced in the hope that it would be replaced by the private sector. However, privatization failed to produce the expected economic efficiency gains. Much of this malaise stems from poor economic policymaking—bad economics.

This slow “trickle down” was coupled with the state abandoning the social provisions of the old social contract. The public sector no longer served the function of an employer of last resort, the incomes of public sector employees were lowered, social services were privatized and public expenditure on public services declined. By 2010, the Arab region stood out as the only region in which citizens were more pessimistic about their prospects than earlier in the decade. Social protection that used to be administered (wrongly) mainly through employment in the public sector, various subsidies and access to education and health services were all reduced. Economic growth faltered as the extractive institutions of the “rentier state” came to dominate. In the past, Arab politicians promised an “egalitarian state” that would meet the citizens’ needs. While neither system is a fully competitive “productive state”—based on a level playing field for all citizens—before market reforms the population could at least depend on a certain degree of social protections. After privatization, insecurity increased as wealth became concentrated in the hands of a narrow elite.



## In Defense of Arab Youth: Questioning the Youth Bulge and Labor Market Failures

*Were poor labor market outcomes and resulting social discontent in 2011 caused by problems with labor demand or labor supply?* Labor supply—in terms of a demographic surge (or “bulge”) of youth (many of whom were unemployed, having acquired low quality and irrelevant education to the needs of the labor market)—contributed significantly to the uprisings. There is nothing pathological about Arab youth. Unemployment problems have been more widespread across other demographic groups and the binding constraint in the labor market has been on the labor demand-side. Arab economies have not been creating enough

By 2010, the Arab region stood out as the only region in which citizens were more pessimistic about their prospects than earlier in the decade.

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decent jobs to meet the growing labor supply. Though improvements should be made on the labor supply side, the common references to too many young people in the Arab region (the alleged “youth bulge”), too many unemployed youth relative to adults, or inadequately educated youth tend to overestimate the supply side issue.

Having reviewed widely-accepted explanations for the Arab Uprisings, the failure of public education to deliver quality and relevant training appears to be a common theme. This poor education is allegedly the prime cause for unemployment, especially among youth. At the same time, students were said to be pursuing credentialism, choosing easy subjects in anticipation of comfortable jobs in the public sector. Government jobs, which in some Arab countries pay 30 percent higher wages than those in the private sector and offer many non-pecuniary benefits, drew talented youth away from the private sector. A massive influx of young people,

failed by the education system and the hiring practices within the public sector, joined the labor force and failed to find employment. Considered together, it is tempting to conclude that the Arab Uprisings were spurred by hordes of disenchanted, unemployed youth. This argument is internally consistent and in fact, not new. Bad education and a bloated public sector were two key diagnoses in the 1990s. Still, while this logic may well be true, additional factors should also be considered.

First, the youth bulge. While the Arab region remains relatively high in fertility statistics (for example, 3.2 births per capita compared to world average of 2.6 in 2000), the bulge began its decline in the 1980s (left panel in figure 4.2) and was practically irrelevant in the Middle East by the 1990s (right panel). The real bulge happened in the 1980s and was *less* a factor by 2010. Adult unemployment in the Arab region is also the highest in the world. The problem is a lack of jobs for all, not only for the “poorly-educated and ill-motivated” youth.

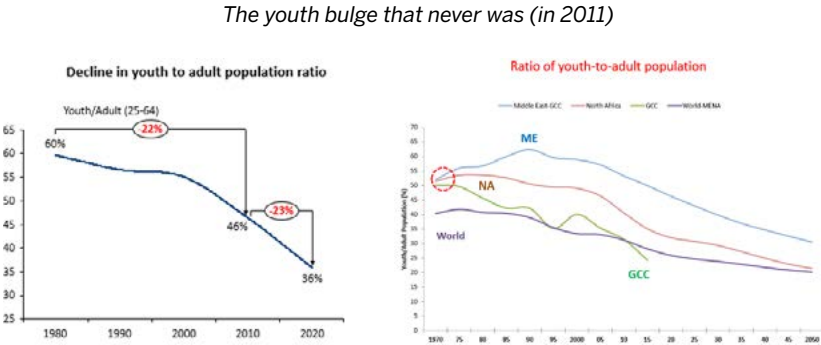
If there were more youth and more of them were unemployed in the 1990s when the economies were so underperforming, why did so few revolts occur then? Perhaps this can be explained by the fact that in 1990, there were more than 30% more unemployed youth than adults. In 2010 there were 5% more unemployed adults than youth. This suggests that the youth were more employable in the 2010s than the adults, though it is hard to pinpoint if this was due to educational attainment, more flexible labor markets (which offer less employment protection), more tolerance toward the informal sector, or other factors. Still, the precipitous decline in youth-to-adult unemployment over the last several decades (for an illustration of this trend, see Figure 4.3 below), leads one to conclude that adult unemployment was an important driver behind social discontent in 2010. Student demonstrators were

backed by less visible adults, who both allowed and encouraged youth action.

Still, the policy community continues to stress youth unemployment. The predictions made at the World Economic Forum in 2012 by many academics, practitioners, politicians, journalists and others are a case in point. The predictions referred to the number of jobs that the MENA region should create by 2020, included in the title of a special volume: “Addressing the 100 Million Youth Challenge”. The predictions imply that in an 8-year period, job creation should average about 12.5 million per year. In reality, the labor force totals less than 100 million, with growth declining significantly over time, now below 3 percent. Looking instead at the UN data, a more modest, though still ambitious figure emerges: the new jobs required turn out to be around 54 million by 2030.

Regarding education, low quality education reduces employability, *not* employment. When workers do not possess required skills, they do not necessarily end up unemployed (production does not stop) but they are paid less. Furthermore, low quality education

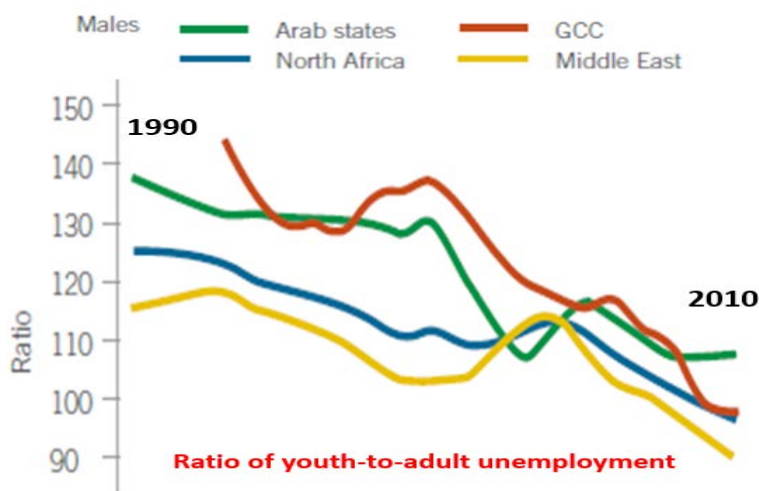
Figure 5.2. **Youth-to-Adult Ratios in the Middle East Over Time**



is a constraint when the skill requirements of production are high, which is not the case in the Arab region where firms are old, many barriers to entry exist, there is little competitive pressure to modernize and all private sector business and investment climate reports are negative (e.g by the World Economic Forum, the World Bank, etc.). The Arab region has one of the highest rates of emigration of educated and skilled workers, supporting the view that the motivation and ability of Arab job-seekers fit into more sophisticated economies, but not their own countries.

Preference for public sector jobs is not the fault of the young: when faced with a choice between two types of employment, one having higher wages, better employment conditions, more benefits and job security, any worker would be “irrational” to decide to work in the other. This is a criticism of the conditions of employment in the public sector, and not of its size, which are the critical determinants of the probability of finding a job and thus

Figure 5.3. **Ratio of Youth-to-Adult Unemployment in the Middle East Over Time**



incentives for workers and governments to invest in the wrong type of education.

One can add that unemployment in the Arab region is very much a gender issue. At the time of the uprisings, the unemployment rate for Arab men was not significantly different than that in other regions, dipping lower, in fact, than the corresponding rates in Central and South Eastern Europe, the Commonwealth of Independent States, the developed economies and Sub-Saharan Africa. This trend occurred despite the massive gains women made over time in terms of enrollment and superior scholarly achievement compared to young men. Well-documented preferences of young Arab women for public sector jobs—understandable in comparison to 48 hour workweeks for low pay in the private sector where maternity benefits, holidays, family leave and so on are still in their infancy—has been associated with exceptionally high unemployment rates, especially among the higher educated. If this is not explained by preferences for public sector employment, it can perhaps be attributed—at least in part—to conservative values and societal attitudes toward women. This is not a small issue. This year's report by the World Bank on *Women, Business and the Law* identified 30 economies in the world with ten or more legal differences in the treatment of women and men. All 16 Arab countries included in the report were among these 30 countries.

In fact, employment creation has been fast following the adoption of structural adjustment measures in the 1990s. But this growth in employment was primarily in poor quality jobs and occurred alongside a contraction in productivity and skilled labor. Most new jobs received low wages and, in the ILO's language, were not decent, meaning that job growth—while real—was not economically meaningful. More specifically, the diagnosis points more toward demand deficiency unemployment than structural

unemployment, which springs from various types of mismatches of demand and supply. In plain English, the economy does not create enough jobs.

In conclusion, the low-skill, low-productivity, low-wage Arab economies will not be transformed into high-skill, high-productivity, high-wage economies simply by increasing and improving schools, vocational centers and universities. The obstacles to making productive use of the increasingly educated Arabs lie mainly on the labor demand side, the structure and nature of which is still being determined in many cases more by political considerations than competitive market forces. Correcting these shortcomings will require a new social contract.

## **Acute Need for a New Social Contract**

The Arab region needs a new social contract to replace the policies introduced in the 1990s. The new contract should continue to adhere to basic fiscal fundamentals so blatantly ignored before 1990. However, the ideological belief that the private sector is a panacea should be adjusted by the recognition of the fundamental need for truly competitive markets. Policies should not be based on optimistic assumptions regarding the expected depth and speed of the effects of structural reforms. And the premise “economic reforms first, political after” upon which much was based since the 1990s needs to be revisited. It is not always true that radical reforms can be taken only by autocratic governments as democratically-elected governments are perceived as overly beholden to the electorate.

This trade-off between economic and political rights is artificial. The two must go hand in hand. Pro-market reforms since the 1990s

failed to create sustainable political institutions. They also failed to deliver employment and social services to meet the growing aspirations of increasingly educated Arab citizens. Despite relatively fast employment creation, jobs were not decent, while the roll-back of the public sector did not produce the expected emergence of a competitive private sector. Economic opportunities and wealth accumulation benefited a few insiders. While the reforms managed to reduce deficits, debt and inflation—as any kind of fiscal reforms would do—fiscal adjustment is not the same as economic adjustment. The reforms led to an increasing sense of insecurity and alienation among citizens.

Broadly speaking, priority policy areas that apply more-or-less across the Arab region include, at the *general* level: (a) the development and coordination of sustainable *economic* policies that would increase labor demand; (b) the introduction or improvement, where it exists, of social dialogue; and (c) an expansion of the coverage and improvement in the efficiency of social protection in order to create an effective social safety net or social protection floor. At the more *sectoral* level, migration, active labor policies, education and, more broadly, skills development are areas that can also make a contribution to addressing issues in the labor market. Still the prospects for reducing unemployment are not promising: the ILO estimates that it takes on average 15 years after a crisis before unemployment returns to its pre-crisis levels.

Designing and implementing such social and economic policies would require a significant improvement in statistics and information systems in the Arab region so that facts are well established at country level while a regional picture emerges in the form of country, not population, weighted, averages (which skew toward large countries like Egypt). Demographic changes were very pressing in the 1970s and 1980s but there should no longer

distract us from making policies. And the old social contract was very pressing until the 1990s but now it is time to change the social contract that followed it along with how structural adjustment is implemented.

## **Designing a Process for a New Social Contract**

*Above and beyond market reforms, social dialogue is crucial for rewriting the social contract.* Numerous factors influence the creation and viability of a social contract. The process of rewriting a social contract must be distinguished from a focus on formal definitions of structural and fiscal reforms. The latter should be part of the social dialogue amongst stakeholders. Communication between social groups on the socio-economic objectives, possible policy options to achieve them and the distribution of their benefits among the different segments of the population is the heart of the process of rewriting the social contract. Furthermore, countries face various approaches to the concept of social contract to choose from, both in philosophical understandings of social good and in various approaches to applying principles of governance. For example, social protections are understood differently, even among international institutions. The World Bank's concept of social safety net and the International Labour Organization's concept of social protection floor, while seemingly indistinguishable, contain fundamentally different assumptions and policy implications. The safety net catches people who fall below a certain income level or standard of living, while protection floors attempt to provide equal opportunities to all people in a labor market. Because regime capture of the state—and associated corruption and mismanagement—prevails in the Middle East, it is important for the social dialogue to shed light



on the long persistent confusion between the state and regime and clearly distinguish these two institutions and their responsibilities.

Systems and resources differ from country to country even amongst advanced capitalist economies, because of unique and varied institutions and norms, making it difficult to distill policy advice into technical prescriptions applicable to all countries. Policies and related reform agenda and sequencing should be tuned to each country's context and capacity. Social dialogue within individual Arab nations is thus foundational to navigate the current crises, reform their economies and rewrite more viable social contracts.



National observers and officials count votes at a polling station in Tunis, Tunisia, October 23, 2011. (Sipa via AP Images)

## Chapter 6:

# **Toward a New Social Contract in the Middle East and North Africa**

Summary of session 7,  
Presented on November 10, 2015

Melani Cammett, Professor of Government,  
Harvard University and MEI Faculty Affiliate

Hafez Ghanem, Vice President of the World  
Bank for the Middle East and North Africa

## **Introduction**

The last session was organized in the form of a panel discussion. The main objective of the session was to chart a road map to help countries of the region design their own approach toward developing an inclusive new social contract. Building on what we learned from the past six sessions and drawing on their own research and experiences, the panel members were asked to provide practical suggestions on the key elements of a new social contract in the MENA region, and most importantly, on how countries of the region can promote and institutionalize productive social dialogue to facilitate a participatory and inclusive development and implementation of such a new social contract. The session begins with an introduction by Mr. Larbi consisting of a summary of the previous sessions, followed by comments by the two guest speakers and concluded with a general discussion and debate. In their comments, the speakers answered a few questions sent by the facilitator to help prepare their interventions.

# Introductory Remarks by Hedi Larbi

## Developmental State, Authoritarianism and the Old Social Contract

The rise of authoritarianism in the MENA region dates back to the late 1950s and early 1960s, when most Arab countries regained their national sovereignty from colonial powers. New leaders driven by national aspirations, inspired by statist development models, claimed to “embody the national will” and set out to build modern, strong, centralized states. With little variation, they adopted state-led development models underpinned by similar implicit social contracts granting limited voice and rights to the citizenry (restricted political space). In exchange, the state provides the citizenry with employment in the public sector, subsidized energy, basic food stuffs, healthcare, and other public services, along with free education.

In the first two decades following independence (1960s and 1970s), this development model enabled countries to deliver on the terms of its social contract and achieved major strides in economic and social development: growth was high, poverty was reduced, child mortality declined and life expectancy increased, all while basic public services improved, especially in health and education, where enrollment in primary schools exceeded 80% (more than double the rate of the 1960s).

## Structural Adjustment and Break-up of the Old Social Contract

However, the state-led development model ran out of steam in the late 1970s and early 1980s when oil prices collapsed and twin deficits in fiscal and current accounts, generated by inefficient high public spending, numerous loss-making state-owned enterprises and costly welfare policies, became unsustainable. With the failure of the statist development model and the Arab socialism adopted by several countries, the regimes of the region looked to “open up” with neoliberal reforms to the promise of a global market economy.

Without political opening, the social and economic adjustment costs of this change proved to be very high.

From the 1980s until the mid-1990s, most Arab countries experienced more than a decade of negative or very low growth per capita.

The informal sector ballooned, characterized by low-quality, low-paid jobs in low productivity sectors, insecure employment,

and poor investments in human capital. Unfortunately, this period of adjustment (i.e. substantial public spending cuts and the privatization of state-owned enterprises) and economic recession coincided with the height of the youth bulge in most Arab countries. Thus, in contrast to East Asia, the region did not reap the expected dividend from a growing educated young labor force. Countries in East Asia used this additional supply of educated labor more effectively, achieving higher growth and greater economic inclusion of youth. By the end of the 1980s, most Arab countries were no longer able to fully meet the terms

With the failure of the statist development model and the Arab socialism adopted by several countries, the regimes of the region looked to “open up” with neoliberal reforms to the promise of a global market economy.

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of the old social contract, leading many observers to trace the initial seeds of Arab Spring to this period.

Further reforms were undertaken starting in the mid-1990s. These reforms, along with higher oil prices, yielded relatively better outcomes in terms of growth, job creation and basic services. But further structural adjustments, including reducing the role of the state in the productive sectors and creating a level playing field for business, failed to take hold. Nor did these regimes make any meaningful political reforms or promote policies that encouraged private investment and employment growth. By 2000, the limitations of these policies all but ensured anemic growth, high unemployment, declining quality of public services, high perception of inequality and social injustice, rampant corruption and crony capitalism—the grievances that drove the Arab Spring. These problems only grew into the mid-2000s, as the region faced a series of growing challenges, not least of which was the continued rise of unemployment of educated youth, exacerbated even further by the global financial crisis in 2008.

## **Costly Transition without Significant Reforms**

Unfortunately, many of these problems have only gotten worse during the transition period of 2011 to 2014. Four years after the Arab uprisings, Tunisia is the only country which has achieved a successful political transition, but its economy and security have declined dramatically. Egypt remains an authoritarian regime also beset by grave security and economic challenges. Other major uprisings in Libya, Syria and Yemen, were engulfed by civil wars. Few marginal political reforms took place in other Arab countries. For most countries, the lack of fundamental political

and economic reforms left the same entrenched elites and interest groups in prominent positions, with the capacity to influence decisions and undermine necessary reforms.

Faced with dire circumstances, transitional governments adopted expansionary fiscal policies (increasing wages, public sector jobs, and subsidies) and monetary measures to contain social demands and limit the economic damage of the uprisings. But decline accelerated. Across the region, growth has declined by more than 50% of its average during the 2000s over the transition period and unemployment has further increased, especially among the youth and women. Poverty has likely increased, and quality of public services declined. Fiscal and current account deficits and public debt soared for non-oil exporters. Private investment—domestic and foreign—has declined as result of the prevailing poor business environment, terrorism and related insecurity, and heightened risk perception. Labor productivity and total factor productivity growth have plunged in most Arab countries.

Political instability, growing conflict, rising violent non-state organizations, and revived sectarian and tribal rivalries have all worked to undermine states, representing an existential threat to the social fabric of Arab societies. The latest surveys confirm the high level of dissatisfaction among Arabs in the region, and very low trust in politicians and some public institutions.

## **Glimmer of Hope**

But not all signs are so bleak. Taking a long historical perspective, the Arab uprisings could be considered part of a slow but gradual modernization process of Arab societies. Most recently, Mohamed Ali in Egypt in the late 19<sup>th</sup> century and later liberal

Arab leaders in the mid-20<sup>th</sup> century, like Nasser and Bourguiba, inspired by the West and Ataturk's radical modernization policies, attempted to build strong modern institutions and uplift Arab societies. These attempts have often been opposed by reactionary religious movements who advocate a return to "pure religion-based society". If history is of some guidance, this transition parallels Europe's own slow process of modernization. Arab States may fail or weaken but will rebound in different shapes and forms, promoting in the process an intense politicization of the citizenry and creating new Arab political ideas and movements. Thus, we see a strong and growing desire across the region for equitable social and economic development, and for capable and accountable governments committed to the rule of law and citizens' rights.

In addition, the region has strong assets to build on, including: a skilled labor force with large numbers of educated youth; an engaged population yearning for social justice and economic opportunities and which supports democratic values, the rule of law and condemn violence and radicalism; a large potential domestic market of over 310 million people with proximity to Europe and Africa's markets; and finally, in addition to good infrastructure and rich natural resources.

## **Toward a New Social Contract**

### **Comprehensive Reforms are Needed**

The focus on political transitions has led many political actors to position themselves by using different tactics to eliminate or marginalize their competitors. These political maneuvers have resulted in tumultuous transitions fraught with polarization, and



in some instances violence, failure and even state collapse. The uprisings were motivated by a desire for real and comprehensive change. The people of the region not only want political change, but also economic and social reforms that can provide better jobs and improve their living conditions. The realization of this goal requires a radical change of the role of the state and its relationship with society. The political transitions could have taken this up as a matter of priority and set in motion durable structural political and economic reforms. Given the strong linkages between economic and political spheres, these reforms must be pursued simultaneously. A piecemeal approach is too disjointed and will fail to ensure that interlinked reforms are collectively feasible. A comprehensive approach can exploit tremendous potential for mutually-reinforcing policies, helping deliver the kind of profound societal transformation the Arab world needs.

## Contours of a New Social Contract

Rapid and meaningful change is needed to break up old policies and governance systems, and to redefine the terms and institutions of a new Arab social contract. The old concept of an expansive state should give way to a new role of a state that works for the people, becomes productive (and not only allocative), accountable and capable of effectively delivering economic and social services that meet its citizens' expectations and needs. In return, citizens are obliged to pay taxes and to accept the state's monopoly on coercive force and other agreed curtailments of their freedom.

There is a broad consensus among the speakers of the study group that, despite the lack of significant reforms or change in the balance of forces among the key actors, a new social contract

is not only needed to replace the broken old one, but it is also critical to overcoming the serious challenges the region confronts today. The region is in turmoil, riddled with severe conflicts and sectarian tension, a refugee crisis, growing regional threat of radicalized groups, weakened states, sluggish economic growth, declining oil prices, and alarming unemployment levels, especially among the youth.

Obviously, a new social contract should be tailored to the specific economic, social and political conditions of each country. Still, the first objective and guiding principle of a new social contract in the region should consist of promoting and consolidating political stability *and* inclusion, and building cohesive, just and prosperous societies. On the economic front, the state should protect property rights, provide a level playing field for businesses and citizens, ensure accountability and transparency in service delivery (possibly through market mechanisms), and provide social protection for deserving citizens through cash transfers instead of general subsidies. Citizens would pay fair prices for private goods, and play an active role in the economy and social development, in general, through active participation in public policy design and implementation.

## Effective National Social Dialogue

The question of how to get countries to craft a new social contract has been one of the most challenging issues the study group has tried to address. One way is to set up a mechanism for a thorough and open social dialogue. The dialogue should facilitate public debates and communication with citizens and key stakeholders on the major political, economic and social issues and the priority of policy changes to be implemented. Debates should be structured around several policy issues to help foster fiscal stability and

private investment, create more quality jobs, improve delivery and access to public services (especially education and health care), protect vulnerable groups and enhance governance. In the absence of such a mechanism, civil society must act, working with key players and governments, to create an institutional mechanism to hold a participatory national dialogue on the terms of the new social contract, its implementation, and how to respond to challenges over time. Given the implementation gap in past reforms, implementation of the new social contract should be considered carefully and the capacity to deliver should be put in place early on in the process to build credibility and start restoring trust of the citizenry in the state.

## **Five Priorities for Inclusive Growth**

### **Comments by Hafez Ghanem**

Gamal Abdel Nasser was the author of the social contract used by other Arab leaders' from the 1960s forward. This social contract was relatively straightforward: citizens traded high economic benefits in the form of massive subsidies and guaranteed employment in the public sector, driven by statist policies, for few political liberties and no meaningful voice in a one-party, authoritarian system. This system, however, was not sustainable. Governments can no longer underwrite subsidies that continue to grow in relation to GDP. Price controls drive massive shortages. And unemployment is rampant, especially among the young and educated. Combined with exposure to wider political thought with the Internet, the social contract ultimately proved unsatisfactory, helping to inspire the Arab Spring.

While not mono-causal, the Arab Spring was driven by a general sense of exclusion and a basic unfairness that similarly underlies the growth in violent extremism. No economic variable, including joblessness, explains greater terrorist recruitment. Instead, general feelings of marginalization amongst individuals and within ethnic and geographical groups springing from relatively worse outcomes, drive some to extremist groups. For example, Sunnis in Syria and Iraq felt marginalized, as do citizens in less developed areas of Western Tunisia, making them vulnerable to the ideology of ISIS and other groups.

To address these systemic challenges, broader inclusion is needed. An inclusive agenda must focus on five priorities:

1. **Inclusive Institutions:** Governments and other social actors must provide greater voice in economic decision-making, even if this is limited to consultation in authoritarian regimes. Responsive institutions are important, not only for feelings of inclusion, but for implementation. When people are not involved in decision-making, they are not dedicated to implementing.
2. **Inclusive Entrepreneurship:** The MENA region hosts too many micro-enterprises, which really represent self-employment or informal sector employment, with only a handful of large, state-protected or politically-connected firms. There is a “missing middle.” We must grow this entrepreneurial space and remove barriers to entry that the government erects to support entrenched elites. In short, this is the crucial means to leveling the playing field.
3. **Education System:** While access is already well-secured, with almost 100% enrollment rates, quality varies considerably. Efforts must now be made to revise an outdated curriculum with greater focus on STEM fields, and to reform a pedagogy

stuck on rote methods. Curriculum and pedagogy must meet the needs of a 21st century marketplace, emphasizing skills like problem-solving and teamwork. Further still, delivery must be ensured by increasing teacher accountability to address lack of quality and widespread absenteeism.

4. **Incorporate Lagging Regions:** Many rural areas, especially those dependent on subsistence agriculture, remain marginalized politically and economically. Political settlements must extend voice and include these areas in meaningful ways. The same problems have persisted for centuries in these areas. While mechanisms must be calibrated correctly, this is not a technical problem, but a political one.
5. **Including Women:** Female participation in the labor force remains far behind other regions, even behind sub-Saharan Africa. Education rates are high for women, even in post-secondary training. This underutilization of human capital does not bode well for long-term development goals. Historical evidence makes clear that building a middle class depends on two-breadwinner households.

## **Historical and Comparative Political Economy of the Arab Uprisings**

Comments by Melani Cammett

*What do past experiences of economic and political transitions say about the prospects for the Arab uprisings?* In many respects, patterns of democratic transition and economic change in the Arab world have not been exceptional. Economic disruption is

a hallmark of political change. Transitions are often costly and further degrade state capacity. When state institutions, possibly already weak, are in flux, their necessary role as regulators and guarantors of markets is limited. What has occurred in the Middle East is hardly unique.

Rising popular expectations put greater pressure on policymakers, demands that motivate populist economic policies that are fiscally unsustainable (e.g. increasing blanket subsidies and other transfers). When subsidies that are already in place need to be reduced, this is even more politically difficult amidst high popular mobilization. While the Egyptian constitution goes a step further—even allocating budget shares for specific social sectors—this general trend is fairly common in transitions and is endemic to the politics of the day. Entrenched economic elites—or those who were privileged under authoritarian rule—are difficult to dislodge and often pose an even greater threat to political and economic reform.

During transitions, economic policies are rarely the focus of elites, even if these problems underlie the basic challenges that a new regime confronts. Tunisia provides a telling example, with many discussions on the shape of political institutions, but little talk of an economic vision from leadership on either side of the political class. Typically, protracted and unconsolidated transitions further disrupt growth. At the same time, a prolonged process may also dampen the citizenry's optimism for democracy. That being said, we should not necessarily prefer smoother transitions. After all, smooth, predictable transitions are often “pacted,” resulting from an elite bargain that keeps many of the old elites and institutions in place. The central tradeoff may be risking low growth for the hope of real economic transformation—or genuine democracy.

The question then becomes: how do you bring about fundamental change while minimizing the significant costs concomitant with turbulent or even violent transitions? First, the transition itself must be disruptive, reconfiguring the preexisting social and economic order—and not just the political order. It is difficult to make this happen through pacted transitions that maintain old power structures. The transition must entail a social revolution, something that does not happen overnight. Second, we need an active civil society that can help steer the revolution and prevent it from being captured by elites. Tunisia's experience shows the important role of civil society pressure on the process and this principle even extends to more authoritarian regimes.

Alongside the political transition, economic and social policies need to be reconfigured toward a more inclusive development agenda. Such an agenda must focus on social sectors, health and education in particular. While the economic literature tends to focus on inequality and, increasingly, inequality of opportunity, this debate brings up thorny normative questions. In particular, the discourse on opportunity presumes that, given the right chances, all will rise and in so doing tends to neglect or downplay the need for policies that support the poor and marginalized by providing a floor below which they cannot fall. Instead, it is more constructive to consider the sectors critical to the development model (e.g. education, healthcare, creating a productive labor force) that have a greater marginal benefit for society while ensuring the basic needs of the poor. In addition, when considering the most effective model for competitive growth in the global economy, export-led industrialization is losing its viability, particularly for the middle income countries of the Middle East. This trend leads to a higher premium on a skilled, healthy workforce to compete in a higher value-added, knowledge-focused segment of the world economy. Making this a viable model, quality becomes paramount, emphasizing the need to move beyond public-funded,

access-driven development outcomes. Market driven policies may become more relevant to these goals.

How we define this model, and how it can emerge, is a more complicated question. Two models emerge to pursue these social development agendas: bottom-up and top-down. Broad-based social movements have driven meaningful change in some regions, such as those that have succeeded in Latin America. These kind of movements have not been as vibrant in the Middle East, leading to talk of top-down approaches, such as those pursued in earlier stages of development. In the tradition of authoritarian cooptation, Middle Eastern regimes may attempt to use social policies to maintain power, while still delivering these services in a more nimble way. Still, civil society remains important in this climate, and would be more promising for developing genuinely inclusive social policy programs. Navigating these competing processes is not easy, but is the fundamental reality for the transitioning states of the region.





# Conclusions and Questions for Further Research

1. **Recent Arab uprisings, and the meager harvest they yielded, could be understood as another phase of a longer historical process of modernization and cultural adjustment which started in the 19<sup>th</sup> century in the Arab world.** The challenging economic and social roots of these uprisings, the growing politicization of the citizenry and the subsequent mass mobilization of conservative, illiberal and liberal forces, and the regional instability generated by the uprisings, have delayed the final outcome of this phase. Still, the underlying issues are far from addressed and the momentous changes in the Arab world are far from complete.
2. **Many of the political, economic and social problems that triggered the uprisings have gotten worse during the transition period of 2011 to 2014:**
  - Across the region, growth has declined by more than 50% of its average during the 2000s over the transition period and unemployment has further increased, especially among youth and women.
  - Fiscal deficits and public debt soared for oil and non-oil exporters alike.
  - State institutions weakened and lost part of their already poor capacity.
  - The stability of the whole region is seriously threatened by the ongoing conflicts, rising violent non-state organizations, and revived sectarian and tribal rivalries.

3. **Social welfare protections in most Arab countries prior to the uprisings compare favorably with those of other middle income countries, but persistent economic underperformance made them unsustainable, especially in non-oil exporting countries.** Arab states consistently ranked near the top in expenditures on social welfare programs among developing countries, one of the key elements of the “old social contract.” But lagging growth and job creation threatened these programs. “Market” economic reforms started in the mid-1980s did not deliver the growth and jobs necessary to support Arab welfare policies.
4. **The political economy environment in countries across the region did not change in a meaningful way.** Key actors in the economy remained almost the same during and after the transitions. Economic reforms necessary to create a more level playing field and develop efficient institutions were not undertaken. Economic advantages and benefits are still distributed according to the same rules of the game as prior to the uprisings.
5. **The people of the region not only want political change, but also economic and social reforms that can provide better jobs and improve their living conditions.** While the political elite focused only on political transition with widely-known poor results, the realization of this goal requires a radical change of the role of the state and its relationship with society. Political transitions missed the opportunity to take these reforms up as a priority and set in motion durable, structural political and economic reforms. Given the strong linkages between economic and political spheres, these reforms must be pursued simultaneously. An integrated approach would have facilitated the delivery of the kind of profound societal transformation the Arab world needs.

6. **Institutionalized and continuing inclusive social dialogue holds great promise to address the varied perspectives of key stakeholders and help them parse the nuances in shaping, interpreting, and implementing a new social contract.** Rapid and meaningful change is needed to break up old policies and governance systems, and to redefine the terms of a new Arab social contract. Such a new social contract should be tailored to the specific economic, social and political conditions of each country. As a matter of priority, it should promote political stability *and* inclusion, and build cohesive, just and prosperous societies. An institutionalized social dialogue or similar social forum for deliberation is essential to help design and build consensus on the terms of the new social contract. Such a dialogue should facilitate public debates and communication with citizens and key stakeholders on the major political, economic and social issues and the priority of policy changes to be implemented.
7. **The United States and European nations must commit more support to successful cases in the Arab world.** Just as the Arab uprisings spread from Tunisia across the region, the power of examples of success, however modest, should be taken seriously as a driver for positive change across the region. Similarly, narratives coming from failed transitions will shape perceptions about what is possible in the region. In addition, states like Tunisia, which reaped modest success with a political transition, have a long ways to go in delivering on the economic and social demands of the revolution. Because difficult and drastic changes are needed, external support will be crucial in helping countries that are moving toward reform—either dramatically as in Tunisia, or gradually as in Morocco, Jordan, and others.

# Questions for Further Research

- 1. Seeking a new development model for the Arab world:**  
A new development model is a recurrent demand in most Arab countries, which is currently without an answer. Since a development model is the outcome of a long and iterative process, this begs the question: What process should Arab countries set in motion to redefine the relations between the state and society, including the nature of the economic order and the distribution policies that best fit Arab societies?
- 2. Questioning the market-based economy in the Arab world:**  
Did the “market” reforms of the 1980s-2000s provide the right policy prescriptions and institutional frameworks to establish an effective competitive market economy? What did policymakers do or not do to give a market order the chance to function properly? In short, were market reforms bad policies or were they poorly implemented?
- 3. Lessons from around the globe:** What lessons can be drawn from other countries’ experiences, in other regions, of economic crisis or transition, regarding institutionalizing social dialogue as an inclusive forum where key stakeholders engage and commit to shared policymaking and implementation of agreed reforms?
- 4. A need to change the public policy making process:** What are the steps to shift to a more inclusive policymaking process based on discussion among key stakeholders, focused on developing a shared understanding of the problems facing countries and exploring options for policies that will achieve development goals and pursue them with a results-oriented approach?



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