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# Arab Middle Class

## Measurement and role in driving change

Economic and Social Commission for Western Asia

# **Arab Middle Class**

## Measurement and role in driving change



**UNITED NATIONS**  
Beirut

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## Background papers

Abu-Ismaïl, Khalid and Niranjana Sarangi (2013). *A new approach to measuring the middle class: Egypt*. ESCWA.

Mohiedin, Mohamed (2014). *The making of the middle class in Arab countries: a socio-historical analysis*. ESCWA.

Prasad, Naren (2014). *Broken relationship: social policies, Arab States and the middle class*. ESCWA.

Sumpf, Denise (2014). *Middle class political participation in Arab countries*. ESCWA.

## Region and country codes

Arab World	ARB
Commonwealth of Independent States	CIS
East Asia and the Pacific	EAP
Europe and Central Asia	ECS
Latin America and the Caribbean	LAC
Middle East and North Africa	MEA
South Asia	SAS
South East Asia and the Pacific	SEAP
Sub-Saharan Africa	SSA

Country codes are available from

[http://wits.worldbank.org/WITS/wits/WITSHELP/Content/Codes/Country\\_Codes.htm](http://wits.worldbank.org/WITS/wits/WITSHELP/Content/Codes/Country_Codes.htm).



Hope for change swept across the Arab region in 2011, driven by a middle class newly awake to the sense that longstanding trade-offs were no longer delivering on the promise of a better life. However, disillusionment and turmoil followed the popular uprisings, along with moves to restore the status quo.

# Foreword

The geopolitical and socioeconomic map of the Arab region is currently facing the most serious existential threat since the creation of independent Arab nation States in the mid-twentieth century. Disillusionment with the prospect of a serious peace process in Palestine; the seizure of vast areas of land in the Arab Mashreq by the so-called Islamic State; high youth unemployment; governance fragmentation; and global marginalization all paint a bleak picture of a region that, only three years ago, looked set to provide a commendable example of non-violent democratic transition. The present report explains in detail how the underlying political economy factors driving the rise and fall of the Arab middle class might best explain why a region, abundant in human and natural resources and unsurpassed in its heritage, cultural endowments and diversity, is seemingly unable to confront ethno-religious threats. The fate of the Arab middle class, inferred from rigorous socioeconomic analyses, sheds light on this question. This report concludes that the empowerment of the Arab middle class could carve a way out of the current development and governance debacle.

This report introduces three distinct and novel technical approaches, then sets out methods for sustaining, empowering and enlarging the middle class. The first approach relates to the measurement of the middle class based on a definition that incorporates the quantity and quality of their consumption expenditure, thus overcoming the many shortfalls of international definitions built on dubious assumptions of purchasing power parity. However, given the inevitable limitations of relying on a single definition when dealing

with an issue as complex as the middle class, this report also offers a sociological definition that classifies the middle class by their occupational and educational characteristics. Combining both definitions provides a strong basis for addressing basic questions relating to the identity of the Arab middle class and their fate, and leads to some surprising conclusions. Contrary to popular belief, the middle class in the Arab region has not been eliminated. Prior to the Arab uprisings, it remained constant as a percentage of the population, increasing in size in some countries. Since then, however, the middle class has been shrinking, especially in countries that have witnessed popular revolts, notably the Syrian Arab Republic and Yemen. This report's main message is clear: a strong negative correlation exists between social unrest and the size of the middle class in the Arab region. Increases in middle class size, owing to decades of successful public policy implementation, have been reversed by inappropriate policies, leading to social upheaval.

The second novel approach applies to Arab middle class profiling. Variables, such as education, employment and mobility, in relation to multidimensional poverty, were combined to develop a profile of the Arab middle class. Evidently, young people with high school and higher education qualifications are the driving force behind the growth of the affluent and middle classes in the region. Education remains the most influential policy option in explaining the resilience of the Arab middle class until 2010, and it remains the strongest policy tool for its enhancement. For profiling purposes, this report presents

innovative work on multidimensional poverty in the Arab region, distinct from the global Multidimensional Poverty Index methodology that is skewed towards least developed countries. Understanding poverty in the region is paramount to understanding the middle class and therefore to answering this report's fundamental questions: what policies and measures prevent the current middle class from falling into poverty; can push the poor into the middle class; and can guarantee unrestricted social mobility?

The third novel approach lies in using such profiling results, among others, to provide a socioeconomic narrative of the decade leading up to the uprisings, from a middle class perspective. The fading social contract characterized by a lack of structural transformation and decent jobs; falling wages as a share of gross domestic product (GDP); inefficient public finances; unfair subsidies; and the breakdown of public health and education, combined with non-transparent repressive political systems, are all powerful examples of a rapidly changing political economy that has directly affected the welfare of the middle class in most countries. The increased capacities of Arab youth, as evidenced by improvements in health and education, and their inability to translate these human development gains into higher incomes and political participation explains why the middle class shifted allegiance and took to the streets three years ago. Since then, the erosion of the Arab middle class can only be explained by the political failure to empower them, thus allowing violent non-State actors to fill the vacuum.

The present report offers a set of policy recommendations for the development of a short and medium-term policy framework to protect the middle class from falling into poverty and enhance the poorer classes' ability to join the middle class, by underscoring the importance of a socially

conscious developmental State. The report's conclusions are clear: the middle class is not demanding more hand-outs; it is requesting equitable development and decent employment opportunities. This requires a shift from a rentier State based on authoritarian bargaining to a developmental State where productivity enhancements drive economic growth and inclusive social and economic policies underpin economic and social justice. These initiatives will not be effective if serious governance reforms are not undertaken to meet the growing demands and aspirations of an increasingly capable Arab middle class.

Lastly, this report and its policy recommendations should not be viewed in isolation. It is an integral component of an immense effort by ESCWA to establish an intellectual foundation for a new Arab development paradigm built on sound macroeconomic policies, good governance and sustainable social policies within a regional integration and cooperation framework. This effort is also reflected in the recently launched report entitled Arab Integration: A 21<sup>st</sup> Century Development Initiative and the soon to be launched Arab Development Outlook: Vision 2025 Report, the Arab Economic Integration Report, the Arab Poverty Report and the Arab Governance Report. Nonetheless, as these reports bring together hundreds of Arab intellectuals and policymakers to develop a new and daring vision for the region, the forces of disintegration, extremism and occupation are forging ahead with their enterprise. Only an empowered middle class, the backbone of progress, democracy and prosperity, can challenge these destructive forces and broaden the horizons of Arab aspirations.



**Abdallah al-Dardari**

Report task leader

Deputy Executive Secretary for Programme  
ESCWA

# Preface

The decision to publish the present report on the Arab middle class was reached in 2012 following internal discussions at the Economic and Social Commission for Western Asia (ESCWA), when it became apparent that little was known about this social group, although it clearly holds the key to the Arab region's future development prospects. In June 2013, an expert group meeting was held to discuss a methodological framework for measuring the middle class. International and regional experts, academics and policy makers were invited to review the topic and provide guidance.

Armed with expert suggestions and recommendations, the drafting team went back to the drawing board. A new methodology for measuring the middle class was elaborated using a simple definition that assigned middle class status to the economic group whose total expenditure lay above an appropriately defined poverty line, but whose expenditure on non-essential goods and services was less than the value of that poverty line. Another definition was applied to capture the middle class as a social group mainly engaged in professional occupations. This methodology, published separately in an ESCWA background paper entitled "A new approach to measuring the middle class: Egypt", formed the basis of the analyses in the first two parts of this report. Three other background papers were also prepared as part of the present report, tackling the middle class from three distinct intellectual perspectives: historical, socioeconomic and political.

By applying this methodology to household data from nine Arab countries, this report shows that middle class size remained stable in most countries from 2000 to 2010, with the exception of Egypt where the middle class shrank by nearly one third over that period. It also highlights how the conflicts in the Syrian Arab Republic and Yemen devastated the middle class and increased inequality after 2010. On a positive note, the middle class, along with other groups, has enhanced its capabilities as demonstrated by increased human capital, although the labour market has not rewarded its efforts.

These stylized facts lend further substantive evidence and support to calls for a new Arab social contract and a more inclusive economic development model. To this end, the present report argues that the middle class must spearhead development policy initiatives and that good governance and decent jobs should be the main vehicles of this new model, rather than hand-outs as was the case under the old social contract.

On behalf of the authors,



**Khalid Abu-Ismaïl**

Lead author of the report  
Chief of the Economic Policy Section  
Economic Development and  
Globalization Division  
ESCWA

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The report team consisted of Mr. Abdallah al-Dardari (task leader); Mr. Khalid Abu-Ismaïl (lead author); Mr. Naren Prasad (author and report coordinator); Mr. Aljaz Kuncic and Mr. Niranjana Sarangi (authors); Ms. Zara Ali, Mr. Fouad Ghorra, Mr. Kenneth Iversen, Ms. Dina Magdy and Ms. Maya Ramadan (research support); Ms. Noha al-Mikkawy, Ms. Mona Hammam, Mr. Raymond Torres, Mr. Zafiris Tzannatos and Mr. Tarik Youssef (advisory group); and Mr. Youssef Chaitani, Ms. Mehrinaz al-Awady, Ms. Asya al-Meehy, Mr. Aziz Hallaj, Ms. Gretchen Luchsinger, Mr. Mohamed Naciri, Ms. Gisela Nauk, Mr. Adib Nehmeh and Ms. Racha Ramadan (readers).

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Arab Middle Class  
Measurement and role in driving change

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# Overview

Hope for change swept across the Arab region in 2011. It was driven by a middle class newly awake to the sense that longstanding trade-offs were no longer delivering on the promise of a better life. However, disillusionment and turmoil followed the popular uprisings, along with moves to restore the status quo.

Today, the only sustainable way forward is to fully engage the middle class in reshaping a future for the region far different from the recent past. The present report entitled *Arab Middle Class: Measurement and Role in Driving Change* contends that the middle class holds the keys to long-needed economic and political transformations, upon which genuine peace and broad prosperity will depend.

It might seem unrealistic at this moment to propose a middle-class friendly reform agenda, but anti-development, and therefore anti-middle class, policies have propelled countries into conflict. In many Arab countries, the breakdown began because of a failure to anticipate and respond to shifting middle-class expectations.

This report adopts an entirely fresh approach. It contains an unprecedented narrative on the Arab region from a middle-class perspective, highlighting the essential moderating role of middle class citizens. Around the world, they have been the main drivers of successful development experiences, the backbone of democracy and the market economy, and a force for social cohesion and political stability.

In Arab countries, however, little has been done to understand them, even on the basic level of defining who they are. This report takes up the challenge, using an innovative method that combines economic and social criteria. It analyses how the middle class has fared since economic reform programmes began in the 1990s and its links to a region-wide deficit in democratic governance.

In an effort to assist the region in negotiating the complexities of transition, this report sets out the main premise for a new socially inclusive development model, centred on and guided by an empowered middle class, under the governance of a democratic developmental State. As the middle class gains opportunities and freedoms to flourish, the promise and hopes of all Arab citizens have a far better chance of being fulfilled.

## [An authoritarian bargain collapses](#)

Constituting nearly half the Arab population and its largest economic resource, the middle class had made no real political demands until 2011. For decades, generous public services and subsidies had buoyed its numbers. There were dramatic improvements in health and education services that increased the educational attainment and well-being of a large portion of the middle class, and State policies guaranteed public sector jobs to university and secondary school graduates.

For many members of the middle class, this “authoritarian bargain” seemed acceptable. Government policies benefited

## Who are the members of the middle class?

A major aim of this report is to define the members of the Arab middle class, as a first step towards understanding how to tap their potential. There has been no consensus thus far on a definition, beyond the general notion that the degree of choice people have in how they spend their household budget is critical in delineating their social class.

Conventional measures to define people living in poverty are mainly based on the amount they spend daily to meet basic needs. Those who spend below a set amount are poor and those who spend above it are not. The issue becomes more complex, however, when both the quantity and quality of consumption are taken into account. For example, where does the middle class end and the affluent class begin?

This report proposes a measurement that combines economic and social definitions. The economic definition takes into consideration both the quality and quantity of household expenditure. Therefore, middle class members are those who can meet all their basic needs. The affluent are those who spend more than the national poverty line on non-essential goods and services. In contrast, the social definition classifies the middle class based on a set of social attributes, regardless of their level of material welfare. It covers people employed in the formal private or public sectors, within a “white collar” occupational category, and who have secondary education qualifications and above.

The present report applied this dual approach to national data from nine Arab States, taking into account specific country contexts while allowing room for comparisons. It avoids the pitfalls of more universal definitions of poverty lines, which may not be relevant to this report’s purposes, especially in middle-income States, and indicates how different but equally vital issues interact in a complex reality.

them and basic stability was maintained in return for limited political freedoms and participation. It was a markedly different model from those in other regions of the world, where dynamic economies produced a middle class that questioned the status quo and pushed for democratic change and accountability.

However, the authoritarian bargain came with an expiration date. Educated middle-class people realized that their political and social systems were lacking.

Over time, good jobs, once plentiful, diminished. Education and health care became poorer in quality and more expensive. Development policy was no longer oriented towards economic development, but to secure short-term

political support. Flourishing patronage networks favoured some groups over others, undercutting social cohesion and encouraging significant disparities.

The lack of political freedoms meant that people could not readily express their discontent or demand change. Frustration finally boiled over in 2011.

### A disempowering adjustment

The authoritarian bargain began to collapse in the 1990s with the onset of economic structural adjustment programmes. Across the region, especially in oil-poor economies, Governments adopted economic reforms to face mounting financial pressures. Middle-class citizens bore the brunt of this with few compensating benefits, as subsidies and public expenditures were slashed, State-

owned enterprises were privatized and trade was liberalized.

Although Arab countries allocate a large share of public funds to health and education, adjustment-related budget cuts reduced their quality and accessibility. Consequently, many middle class families turned to costly private education, increasing their out-of-pocket expenditures. Moreover, individuals found themselves paying nearly half of total health expenditures out of pocket, the highest percentage in the world after South Asia. This additional spending squeezed middle-class budgets, making families vulnerable to slipping into poverty.

A freeze on civil service recruitment and the increasing use of contract workers for public services (two hallmarks of the adjustment programmes) dashed the expectations of young middle-class aspirants for secure government jobs with decent wages. Despite being highly capable, they found few other opportunities.

Although economic growth accelerated in the decade before the 2011 uprisings and the region's employment growth rate was the highest in the world at 3.3 per cent, compared to 1 per cent in East Asia, most jobs were informal and badly paid, and productivity gains in the region were the slowest in the world.

Many Arab economies became dependent on imports and low-value services, while the manufacturing sector – the powerhouse of development and employment in other regions – remained anaemic. Countries excessively dependent on oil resources did little to invest in productive capacities and basic economic structures, and remained at the mercy of international oil markets.

The lack of decent jobs meant that 26 per cent of the region's youth were unemployed in 2012, compared to a global average of just under 13 per cent. In a number of Arab countries, young university graduates are more likely to be unemployed than their less educated peers, and the female unemployment rate is strikingly high, even though women comprise the majority of skilled university graduates. The region now has the world's lowest return on education and, with declining wages, offers little incentive for future generations to invest in schooling.

Furthermore, the reforms were guided by undemocratic regimes to fulfil interests that diverged widely from global development goals. On the one hand, regimes practised restraint to avoid social unrest. For instance, subsidies benefiting the middle class and wealthier groups mostly remained intact. On the other hand, they implemented cosmetic trade reforms and privatization policies that did little to revitalize economies and more to line elite pockets. Patronage networks, having grown strong following decades of the "authoritarian bargain", efficiently channelled takings to a tiny minority.

Consequently, inequality has soared across the region, contrary to what official statistics generally suggest. This report finds quite striking disparities reflected in the increasing ratio between the average expenditures of the "rich" and other classes in nearly all countries.

### Unanticipated consequences and hope

The pressures of the reform years finally manifested themselves in the 2011 revolts, which began with great hopes for the middle class. However, the consequences have been devastating in some countries, where conflict has wiped out decades of development gains.

Regionally, factoring in the conflicts in the Syrian Arab Republic and Yemen, the middle class contracted to 37 per cent of the Arab population in 2011; this report estimates that it would have otherwise remained at about 45 per cent. Currently, nearly 53 per cent of the regional population is considered poor or vulnerable to slipping into poverty.

The economic cost of the unrest in the Syrian Arab Republic alone was estimated to have reached \$140 billion by the end of 2013. Including losses incurred by Egypt, Libya and Yemen could bring the regional cost to double that amount. In terms of the human cost and long-term implications, in the Syrian Arab Republic, where education was once widely accessible, a growing number of children in conflict zones have reached 8 years of age without a single day of schooling.

These trends are disquieting on many fronts. Not only do they destabilize the middle class in the short-term, but they also undercut its innate capacity to steer transition in more productive directions and to moderate destructive social elements. The region's longstanding governance gap complicates the situation; there is a legacy of institutions badly equipped for easing tensions, fostering social consensus and driving development.

This report shows that, using various measures of institutional quality and governance, Arab countries fare badly compared to other countries at the same income level. Development indicators are deteriorating, with strikingly negative trends in political stability and control of corruption, for example. As expected, declining political system quality is more pronounced in countries that have witnessed unrest.

On a positive note, the region has reached a tipping point. The middle class wants a socioeconomic system founded on merit and the rule of law, where entry into business activities or the public sector is based on efficiency and qualifications, rather than political connections.

The middle class generally values individual liberties and democratic institutions. For example in contrast to the affluent class, it is far more likely to prefer democracy to a strong leader, experts or army rule. Moreover, the World Values Survey results show that the majority of the Arab middle class is interested in politics and this interest is increasing over time.

These beliefs, however, are struggling against the current difficulties posed by transition in many countries, causing the middle class to choose maintaining order over freedom of speech and more voice in important government decisions. Thus, although the importance of democracy is frequently professed, when ranking concepts by order of importance, the middle class still values stability and low inflation twice as much as participating in important decision-making processes and protecting freedom of speech. Moreover, preferences for a strong leader are increasing. Is it possible that a preference for the authoritarian bargain remains? Or is it that stability is now seen as a precursor to successful democracy?

### Stable and socially inclusive development is within reach

Despite the wrenching consequences of transition, there are enormous possibilities in a region with a rich history and tremendous human resources. Hopes for growth, comprehensive development and political stability can be restored by empowering the middle class through a new inclusive social contract, which must

be grounded in a development model that provides equitable opportunities for well-being, ensures stability and meets citizens' aspirations. Progress requires both economic and political reforms, resulting in decent jobs, social protection and good governance.

This report argues that a new model should unite the middle class with the poor and vulnerable in a grand democratic alliance, with a clear and pragmatic agenda. The slogan "subsidies for the poor and decent jobs for the middle class" provides a starting point for this transformation. An overriding aim should be to prevent members of the middle class from slipping into poverty, while expanding the middle class by upwardly mobilizing the poor and vulnerable.

No single set of policies can be applied across all Arab countries, but none of the changes proposed in this report can succeed without political reform. A brighter future for the Arab region depends on a governance revolution to undo the old authoritarian bargain. Development policies must no longer be used primarily as political tools.

Where the role of the State remains prominent, as is likely given the region's history, the primary focus must be on providing decent jobs and services, revitalizing economies and advancing social justice, by drawing upon the successful experiences of other developing countries.

### **The middle class today: empowerment, not handouts**

Today, Arab middle class citizens no longer need traditional handouts, such as subsidies. Instead, they want good quality jobs and business opportunities that empower them to flourish on their own, requiring policy choices and investments aimed at increasing economic productivity by revitalizing

manufacturing, fostering high-value industries and services, and effectively using human capital. Targeted measures should raise living standards in rural areas and help establish an environment for businesses to compete on the basis of efficiency and effectiveness, not patronage.

Public investment should be concentrated in sectors that produce the greatest number of high-quality jobs. Grand public projects might need to give way to smaller scale initiatives that are more conducive to development, especially in rural areas. Credit policies should back the efforts of businesses, especially small and medium sized enterprises, which provide employment opportunities as they grow. Funds for research and development could spur much needed innovation and raise private sector confidence.

More balanced industrial and trade policies are also important. Given that many Arab countries are still developing they should take advantage of extensions before restrictions on intellectual property rights set in. Moreover, trade in services could be explicitly favoured as an area of rapid growth for many countries.

Changing the Arab region's status as the least integrated in terms of trade and investment could place it in a stronger position vis-à-vis the rest of the world. Regional economic integration needs to prioritize Arab investment projects and jobs, and reduce disparities in development. It has been estimated that initial steps to secure greater economic integration could bring about huge gains, such as a 3.1 per cent increase in gross domestic product (GDP) between 2013 and 2020.

### **The middle class of tomorrow: social protection**

Social packages that still currently target the middle class – particularly through

expensive subsidies – need to be redirected towards the poor and vulnerable, allowing them to develop economically and socially to become the middle class of tomorrow. A social protection floor, a starting point towards economic justice, should ensure that no person falls below a basic living standard. It should encompass, as a minimum, benefits for children and the unemployed, pensions, disability insurance and essential health care.

Social protection can be good for growth and lead to a cycle of social and economic development. For it to make the greatest contribution, it must be universal, comprehensive and grounded in human rights. It should be understood not just as a way of buying off constituencies, but as an investment in growth and justice, and as the foundation of durable stability. This report estimates that a basic social protection package would cost Arab countries between 4.6 per cent and 9.5 per cent of their GDP.

### **Choosing to invest in development**

Additional funds for social protection and inclusive development could easily be found in the budgets of most Arab countries.

An obvious starting point would be to phase out energy subsidies, which mainly benefit people who are not poor. The amount spent on fuel subsidies alone would be enough to fund basic social protection. Since subsidy reform can be a risky process, politically and economically, success largely depends on the quality of governance and institutions that guide the process. Institutional checks and balances, effective communication with citizens and depoliticized price-setting are among the prerequisites for undertaking subsidy reform.

Tax reform can increase revenues, ensure that tax burdens are fairly shared and

enhance accountability. Arab countries currently collect very little in taxes as a share of GDP. Increasing taxation could boost economic output, the number of jobs and household consumption. However, reforms should ensure that the middle class is protected and has room to flourish.

Finally, the Arab region spends more than the world average on education, but the same applies to military expenditures. Had the region adjusted its military budgets to European levels in 1990, and maintained them, its economies would be significantly larger and more productive at present.

### **Reforming governance**

Good governance underpins effective reforms. It should fully embrace principles such as inclusiveness, equity, participation and accountability. This report stresses the following four essential points for ensuring good governance. Firstly, political agreements and peaceful solutions should be the first choices in resolving conflicts and ensuring stability. Secondly, the rule of law must be upheld as the foundation of justice, accountability and transparency. Thirdly, the public sector needs to deliver quality basic services and recruit on the basis of merit. Fourthly, policies and regulations must cultivate a diverse and healthy private sector.

A starting point for any socially conscious developmental State is to transcend traditional pro-State and pro-market divisions. The State must continue to have an important economic role, but its budget must not be used to fund patronage networks. It should rather embrace its position as the provider of public services that facilitate social mobility and provide a qualified and capable workforce that businesses can tap for productive growth. The private sector must also reinvent itself and lead demands for dismantling crony capitalism.

Today's elites and their more established middle-class allies will strongly resist such moves. They understand - and are willing to exploit - deep middle class fragmentations that were superficially transcended by revolutionary slogans such as "the people want". States should seek to establish a collective class consciousness to drive forward changes benefitting the middle class, in particular, and the Arab region as a whole.

### **Crises usher in opportunities**

In summary, a revitalized and vibrant economy that promotes efficiency and competition within a just social and political system is the only way to offer acceptable economic opportunities and human dignity to the evolving middle class and the increasing number of educated young people who join the job market every year. Reincarnations of the old order are not likely to have the resources needed to continue with the authoritarian bargain by absorbing the youth population into the public sector, nor are the youth willing to trade their voice and social justice for economic gains. Hence, the middle class is likely to have an important role in moving towards more open political systems and development; demands that ignited the Arab uprisings in the first place.

Lastly, crises provide opportunities for trying new approaches, as evidenced throughout history. The current Arab crises and political transitions, while difficult and at times seemingly intractable, are no exception. Development gains have been lost, but deep reservoirs of human talent and capability remain, waiting to be unleashed as a force for development and transformation.

# Introduction

The Arab uprisings glaringly highlighted the deep flaws in the development models that have existed in most Arab countries since the early 1970s. The emphatic demands of demonstrators revealed deeply entrenched dissatisfaction with their quality of life and governance systems. The uprisings have generated much interest among political economy experts and academics, who were completely blindsided by their outbreak. Regional and international organizations and development specialists have also struggled to explain why and how the waves of popular discontent managed to cut across regional and national divides: from the relatively more affluent Bahrain to upper middle-income Libya and Tunisia, through middle-income Egypt and the Syrian Arab Republic to relatively low-income Yemen. Such questions outline the difficulties and complexities of the titanic political economy shifts taking place in the Arab region.

Fortunately, answers to some basic questions already exist as a result of various studies, notably a number of recent reports by international organizations that followed the publication of the first Arab Human Development Report in 2002 that, along with its sequels, excelled in describing the following three major developmental deficits: political freedom, women's empowerment and knowledge. In addition to reports by United Nations agencies, scores of books and journal publications have been written that attempt to address the root causes of the Arab uprisings from social, economic and political perspectives.<sup>1</sup> The main conclusions that emerged from these studies and publications can be summarized as follows.

Firstly, rising human capabilities in Arab societies, particularly among young people and women, are reflected in development indicators on health and education across all countries, albeit with a significant lag in least developed countries; although the quantity and quality of investment in public social services became strained in most non-oil middle-income countries after the 1990s because of declining fiscal space.

Secondly, even with an educated labour force, opportunities for decent employment were curtailed after the implementation of structural adjustment programmes and a general freeze on public sector recruitment in the 1990s. The private sector could not fill this void, leading to the proliferation of informal jobs, mainly in low value-added service sectors. Consequently, there were insufficient economic transformations, which meant that productivity dropped and real wages froze. Arab youth with higher education qualifications, in particular, became disenfranchised and increasingly sought to migrate, considering it their only employment option. However, such opportunities were significantly cut after the 1990s when Gulf Cooperation Council countries changed their immigration policies.

Thirdly, governance has generally been quite poor in the Arab region. Rentier States disburse, mainly to their elite constituencies, windfall oil and oil-related revenues in exchange for little or no public policy accountability. Not surprisingly, poverty rates have stagnated while GDP has grown relatively fast, indicating growing inequalities poorly captured in official survey statistics.

In essence, these development facts suggest that four decades of Arab development policy resulted in the creation of more socially capable societies. However, these societies witnessed rising social and economic injustice indicators, particularly affecting young people and women. These stylized facts are also substantiated by the most up-to-date assessment of development contained in the Arab Millennium Development Goals Report, which shows that Egypt, the Syrian Arab Republic and Tunisia had the highest Goal progress rates over the period 1990-2010 in the Arab region, although they were three of the five countries that witnessed demands for transition.

The present report argues that these facts are better understood by examining the profile of the Arab middle class, particularly its youth, and the welfare changes they encountered over the decade leading up to the uprisings. Understanding why the middle class took to the streets facilitates the process of assessing their demands and concerns. Furthermore, given that the success of any transition hinges on its support network, studying the middle class is imperative to establishing a new regional development framework, sorely needed since the implementation of deep economic reforms in many Arab countries in the 1990s, and to evaluating the far reaching social and economic implications of such reforms.

Beyond understanding the middle class connection to the Arab uprisings, there are other reasons why this report focuses on the situation of the Arab middle class. To begin with, the middle class has been the main driving force behind all successful development experiences in the Arab region. Successful development requires a transition from a predominantly rural, low value-added economy with mass poverty to a predominantly high value-added industrial and service-based economy

with low poverty, which hinges on an empowered middle class.<sup>2</sup> Policies that bolster the middle class therefore also boost overall economic growth and contribute to poverty reduction, thus assisting the poorest segments of society.

As Polyani noted seven decades ago, for a class to act as an effective historical agent for progress in society, it must represent interests beyond its own.<sup>3</sup> In this regard, the middle class arguably played an important role in the promotion of good governance in Western societies. In general, the rich need not rely on the rule of law to influence policy for their benefit and the poor are alienated. Therefore, it is often the middle class that has the most vested interest in greater accountability. According to Stiglitz, “the middle classes have traditionally been the group that has pushed for the rule of law, that has pushed for universal public education, that has pushed for the creation of a social security.”<sup>4</sup>

An integral component of successful development is the promotion of redistributive social policies that benefit the poor, thereby pulling them upwards into the ranks of the growing middle class. As eloquently stated by the IMF, “countries must provide their citizens with a ladder so that they can climb out of poverty and into the middle class – and indeed, keep on climbing even after that point.”<sup>5</sup> As the middle class generally consists of entrepreneurs, it creates employment and drives growth. Middle class citizens tend to value human capital accumulation and increased savings, critical to economic development. They have the capacity to pay for higher-quality domestic products, which drives demand for consumer goods and encourages firms to invest, thus raising overall income levels. Irrefutably, income elasticity for consumer durables and insurance services, among other things,

rises as societies move from agriculture to industry and service-based economies, i.e. when the middle class is expanding. Furthermore, with many formerly poor countries now joining the middle-income rank, the effect of middle class consumer influx on global development has become a subject of academic interest.<sup>6</sup>

The middle class can also be a driving force for better governance and accountability since it is the main tax-paying class and tends to have higher levels of political participation. Middle class enlargement should therefore lead to greater demands for government accountability and democratization.<sup>7</sup> Part Four of this report devotes itself to the vital political role of the middle class given that the outcome of the presently tense relationship between the middle class, particularly its youth, and the State in many Arab countries will determine the course of the “new deal” between citizens and the State.

Any study on the middle class should begin by defining and measuring them, but this population segment does not lend itself easily to quantifiable analysis. Therefore, any single definition and measurement approach, including the one adopted by this report, is unlikely to generate consensus among all readers. This is not surprising given that the concept of the middle class is politically charged, historically controversial, sociologically ambiguous and, more often than not, little understood, especially from regional and global perspectives.

A brief review of the historical evolution of the term clarifies why it causes such controversy and confusion. It is believed to have been introduced by Aristotle (350 BC), who argued at length that people had different preferences and interests depending on their level of wealth, thus creating conflicts of interest between wealthier and poorer

groups. However, these conflicts could be mediated by the large middle group. Clearly, Aristotle preferred a large middle class since he also argued that revolutions often occurred when the rich and the poor were equally balanced in number around a small or non-existent middle class.<sup>8</sup>

In 1776, Smith<sup>9</sup> referred to distinct classes that contributed to the creation of a country’s wealth, among them land owners, cultivators, farmers, labourers, artificers, manufacturers and merchants, who were situated in the middle of the wealth ladder. In 1887, Marx<sup>10</sup> took up the topic of class as a central theme in his critique of capitalism, defining it in terms of ownership of the factors of production (labour and capital). In his analysis, the “petty bourgeoisie” represented the middle class; they were a small, independent group of entrepreneurs and bureaucrats who had the skills, knowledge and education to gain economic power. In 1899, Veblen<sup>11</sup> presented a fascinating essay on the consumption patterns of various American social and economic classes, arguing that the upper class engaged itself in “conspicuous consumption” and leisure, while the middle and lower classes supported society by working in the industrial sector and consumed in a way that benefitted the country. It should be noted that this notion of different class consumption behaviours plays a central role in the conceptualization of class demarcation in Arab societies and hence provides the foundation of this report’s new measurement approach.

In 1964, Weber<sup>12</sup> analysed social stratification in terms of class, status and power. Around the same time, many others within the emerging field of development economics showed that the middle class was the key driving force behind the phenomenal industrialization and economic development in Europe in the nineteenth century.<sup>13</sup>

Armed with a large pool of household surveys conducted since the 1980s and easily propagated following the internet revolution, modern day economists have used specific money metric expenditure or income definitions to measure the middle class. Some researchers use relative measures, such as middle income quintiles<sup>14</sup> or individual earnings relative to a society's median per capita income.<sup>15</sup> Others use absolute measures, such as individual daily per capita expenditures.<sup>16</sup> Many have combined relative and absolute measures; for instance, Birdsall<sup>17</sup> defined the middle class as individuals who consume the equivalent of \$10 or more per day, but fall below the 90<sup>th</sup> percentile in an income distribution.

Sociologists, however, use other datasets, such as those provided by national censuses, to define class socially rather than purely economically. They may take into account a number of variables such as education, employment type, family size, housing type and the level of engagement with civil society organizations to differentiate between social classes. Some sociologists even argue that it is important to distinguish between groups within the middle class on the basis of their positions in the market, work and status. For example, Goldthorpe distinguishes between upper-level professional officials, such as high-level managers; and lower-level professionals, such as teachers, clerical workers, secretarial workers, on the one hand, and small business owners, on the other hand.<sup>18</sup> Goldthorpe's definition is more comprehensive than the purely income based definition, but it does not readily lend itself to empirical analysis.

This snapshot of the main competing analytical perspectives highlights important intellectual divergence within the vast domain of social and economic research concerned with studying inequality, in general, and the

notion of class, in particular. On the one hand, it could be argued that social historians and sociologists view class as a historical process – a concept that evolves over time – defined by the ways in which people live their lives under given conditions. Class formation, therefore, is not an accidental affair. This view has its roots in the Marxist tradition, in which history is explained through the concept of class, and the inequality, conflict, political processes and social movements that it generates.<sup>19</sup> Therefore, an understanding of the present condition of any class must stem from the study of the history and trajectory of class formation.

Of central importance to this conceptualization is the idea that class exploitation is the central force underlying social formation.<sup>20</sup> Exploitation produces a clear trade-off; the gains of one class come at the expense of another. Class formation is therefore inherently prone to conflict. Clearly, this view does not concede to the conventional economic definition of class as an a-historical entity almost exclusively understood in terms of income differentials; a definition which fails to specify the exact nature of the relationship between classes and does not recognize the relevance of the middle class to any political process.<sup>21</sup>

However, it is also important to realize that the above theoretical approaches were formulated in the light of the historical experiences of Western societies, where the State had a relatively limited role in the process of class formation. The contemporary debate on the definition of the middle class thus carries an implicit notion of the Western middle class as champions of universal modernity, thus posing difficulties when used to describe Arab societies. It is therefore important to acknowledge the shortfalls of relying on a largely imported conceptual framework to analyse an intricate and complex indigenous phenomenon.

Although this report acknowledges the importance of the process that shaped the middle class, it does not examine its historical evolution in the Arab region; which is a subject that has been heavily debated elsewhere. Instead, it focuses on the State's role in economic class formation after 2000.

Any plausible narrative on a controversial issue, such as the middle class, should employ a multidisciplinary approach – economic, social and political – given that their nexus offers deeper insight into the underlying dynamics that led to the formation and erosion of the Arab middle class. The challenge, however, is to construct a narrative where these analytical perspectives complement rather than compete with each other.

Given this pre-analytical position, and building on a recent ESCWA paper by Abu-Ismaïl and Sarangi,<sup>22</sup> this report sets out two definitions of the middle class. The first definition, derived from an economic perspective, assigns middle class status to those whose level of income or expenditure lies between two specific money-metric thresholds, regardless of their social characteristics. From this angle, individuals are classified in terms of the degree of freedom they have to consume. More specifically, the middle class is defined as the group of individuals whose total expenditure lies above an appropriately defined poverty line but whose expenditure on non-essential goods and services is less than the value of that poverty line.<sup>23</sup> This report reserves the term “middle class” for individuals who fall under this economic definition. By extension, the more affluent members of society are those who can afford to allocate a higher share of their income to items that are deemed non essential (relative to the basket of goods and services consumed by the more needy lower classes) or as Veblen<sup>24</sup> eloquently put it, they are engaged in “conspicuous consumption”

The second definition, a sociological perspective, views the middle class through a set of social attributes, regardless of their level of material welfare, income or expenditure. More specifically, the middle class encompasses individuals who are employed within the private or public sectors, under white collar occupational categories, and who possess secondary or higher education qualifications. In line with the literature, these characteristics are considered integral to the social identity of the Arab middle class. This report refers to this social category as the skilled workers or the professional class.

The present report builds on the above definitions using recent household data from nine Arab countries, which differ significantly in terms of population size and levels of development, but that contain the majority of the region's population. Part One of this report estimates the size of the middle class in these countries and its evolution over the past decade. It also examines middle class methodological and measurement issues, highlighting deficiencies in existing measurement methodologies, and argues why a new approach to measuring the middle class is needed. Part Two makes use of household data to present new evidence on the profile and characteristics of the middle class, mainly in terms of education, occupation, living conditions, level of economic welfare and class changes over the period 1990-2010. The first two parts of this report therefore provide the bulk of the empirical evidence needed to construct a set of basic stylized facts on the size and characteristics of the “economic” and “social” middle class that serve as a basis for the analysis in the remainder of the report.

As noted earlier, there are good reasons why this report specifically focuses on the 1990s and 2000s. Major shifts occurred in the economic and social structures of Arab

societies during this period as a result of the rapidly deteriorating public services offered by States and the economic pressures experienced by the middle and lower classes. This in turn led to the proliferation of marginalized informal settlements on the outskirts of major cities and to greater inequality between rural and urban areas, as the case of Egypt glaringly demonstrates. Where possible, results are disaggregated in this report to highlight conditions that are particularly relevant to middle class youth and women.

The present report then tackles the question of why the Arab middle class revolted, which cannot be understood without comprehending economic and social macro-level dynamics. With this in mind, Part Three uses other national-level economic and social data to argue that the social contract used by Arab States since the mid-twentieth century to gain legitimacy is crumbling, especially in countries that witnessed the fiercest uprisings. Over that period, rulers subsidized products that were more widely consumed by the middle class, such as fuel. Regimes also lowered tax rates, benefiting the richer and middle classes. In the ensuing social order, the elite capitalists and the middle class therefore served as coalition partners.<sup>25</sup> As noted in a recent ESCWA paper,<sup>26</sup> the middle class entered a social contract in which political support for the ruling regime granted them preferential social policies – the authoritarian bargain. This helps explain why they were socially empowered in terms of higher levels of human development and had relatively better social protection, especially access to formal sector jobs.

This clarifies why the middle class eventually withdrew its State support. Since the middle class was the main beneficiary of such policies, they were the main losers when the State no longer upheld its side of the authoritarian bargain. As argued in

Part Three of this report, despite relatively acceptable overall growth in the 2000s, the economic conditions of middle class youth in most Arab countries were becoming dire. Given this increasing inequality and poverty, a lack of progress and opportunities, malnutrition and high unemployment in the Arab region, social unrest and instability were inevitable. The question was not if but when the revolts would take place. From this perspective, the Arab uprisings can be seen as the result of deteriorating economic and social conditions, a rollback of the State, increased repression by those in power and a rise in crony capitalism. Frustrated and marginalized, the middle class withdrew their support for the authoritarian coalition.<sup>27</sup>

In Egypt, this shift becomes obvious when tracing the middle class from independence, through different rulers, to the Egyptian uprisings in 2011. President Gamal Abdel Nasser (1956-1970) cultivated a middle class of land-owners and bureaucrats and President Anwar Sadat (1970-1981) focused on the middle class business elite. President Hosni Mubarak (1981-2011) ushered in an era of privatization and deregulation, increasing monopoly and predatory capitalism. The resulting economy provided for the disproportionately large consumption of the top 10 per cent of the population, leaving breadcrumbs for the masses.<sup>28</sup> This new economic order under President Mubarak ignored top bureaucrats, middling landowners and small business owners. The size of the middle class began declining, pushing increasing numbers of the population towards the ranks of the poor. In short, Mubarak's policies alienated the Egyptian middle class,<sup>29</sup> prompting a group that had colluded with the ruling regime for decades to lead the demonstrations calling for its demise.

This report shows that the Arab middle class, if bought by subsidies and

favourable social policies, will support the regime in power. However, when the terms of this social contract are broken, the middle class, faced with increasing economic hardships, will change its allegiances. Finding itself slipping towards the vulnerable or poor groups, a shrinking middle class will call for reform, no longer passively supporting its once benevolent rulers. However, when the doors of political participation are closed, no channels exist to voice such concerns, and accountability also disappears. Without voice and accountability, there are no mechanisms to alter the course of public policy. The middle class therefore had no recourse but to shift allegiance, leading to the uprisings in 2010 and 2011.

With this in mind, Part Four of the present report attempts to unmask the complex relationship between the Arab middle class and the political and governance systems adopted by regimes. It analyses governance trends in the region and examines the political behaviour of the Arab middle class, deducing that State hostility to democracy resulted in a region-wide governance deficit, despite Arab countries moving up the socioeconomic development ladder. It also uses survey data to unmask the ambiguous relationship between the middle class and Arab regimes. It concludes that Arab middle class interest in politics is increasing, especially following the uprisings. The deteriorating quality of the region's political systems played a role in the demise of the old social contract and encouraged middle class participation in the uprisings. Although the middle class stresses the importance of accountability and democracy, data reveal that political participation and freedom of expression come second to stability and economic prosperity. The lesson that emerges is that political transitions must be properly managed, otherwise people will readily compromise democratic values for their economic and social well-being.

Although providing some insights on gender, this report does not contain detailed analysis of the middle class from a gender perspective, mainly owing to a lack of sex disaggregated data in the household expenditure surveys used in this report. However, Part Two of this report contains a sex disaggregated analysis of the occupations of middle class women. Moreover, Part Four sets out, to the extent possible, gender disaggregated labour market data. This is a complex issue that requires more specialized studies.

The present report does not claim to put forward a novel theory of why the Arab middle class revolted in many countries; rather, it confirms the findings of many earlier studies that highlighted the redundancy of the traditional social contract.<sup>30</sup> However, it places new emphasis on the middle class by attempting to present the Arab uprisings from their viewpoint and, more importantly, by offering a new pro-middle class perspective of development policy. To this end, Part Five of this report focuses on two specific questions. Firstly, how can the Arab middle class be prevented from slipping into poverty? Secondly, how can the poor and vulnerable populations be empowered to become the middle class of tomorrow? To answer these questions, this report follows the principles of economic justice for the poor, decent jobs for the middle class and good governance for all.

The report concludes on a positive note. The Arab uprisings, like all other major social protests, have presented major challenges to the region's political stability, economic welfare and territorial integrity. Many Arab countries have recently returned to authoritarian and paternalistic rule. However, these social upheavals could bring about enormous opportunities for long-term economic growth, development and political stability if the demands of the middle class and young people are taken seriously and acted upon by those in power.



The middle class is the largest economic segment in the Arab region, constituting nearly half of the population. Its size remained largely unchanged over the period 2000-2011, but it began to shrink thereafter owing to the crises that have affected several countries in the region.

# Part One

## Counting the middle class

As its title suggests, Part One of the present report is concerned with measuring the middle class in the Arab region in terms of its economic and social attributes, and estimating its size. Empirical findings on middle class size were derived from applying this report's measurement methodology to micro-level data from the household budget surveys of nine Arab countries,<sup>31</sup> namely the Sudan and Yemen among least developed countries (LDCs); Egypt, Iraq and the Syrian Arab Republic among middle-income countries (MICs); Jordan, Lebanon and Tunisia among upper middle-income countries (UMICs); and Oman among high-income countries (HICs).<sup>32</sup> It should be noted that these nine countries contained approximately two-thirds of the Arab population in 2011.

### I. Definition problems

Economists have consistently defined the middle class using relative or absolute measures. Relative measures count middle class members as those whose income lies between the second, third and fourth quintiles of income distribution,<sup>33</sup> or individuals earning between 75-125 per cent of a society's median per capita income.<sup>34</sup> Absolute measures provide more comparable estimates across countries by identifying middle class members as those whose expenditure lies within a specific range, in terms of purchasing power parity (PPP). Ravallion<sup>35</sup> suggests a range between \$2 a day per person (the median poverty line for 70 developing countries) and \$13 a day per person (the poverty line in the United States of America) in 2005 PPP.

Other regional studies have proposed alternative thresholds consistent with the mean income in their developing regions. For example, the Asian Development Bank (ADB)<sup>36</sup> applied a range of \$2-20 per day per capita (2005 PPP) to measure the Asian middle class.<sup>37</sup> The African Development Bank (AfDB) applied a range of \$2-10 for low income countries and \$10-20 for middle income countries.<sup>38</sup> Ferreira and others,<sup>39</sup> in their study on Latin American and the Caribbean, applied a range of \$10-50 per day per capita (2005 PPP), consistent with the higher level of income per capita. Kharas<sup>40</sup> suggested a per capita per day expenditure or income range of \$10-100 (2005 PPP) as a suitable threshold for the "global middle class"; a threshold later applied in the 2013 Human Development Report.<sup>41</sup>

Others suggested a combination of both absolute and relative definitions: middle class individuals were defined as those who consume the equivalent of \$10 or more per day but fall below the 90th percentile of the income distribution in their own country.<sup>42</sup> The \$10 threshold represents an absolute global threshold below which people are too poor to be middle class in any society, while the 90th percentile threshold represents a relative and local threshold above which people are considered "rich"; at least in their own society.

Figure 1 plots the estimated size of the middle class for Arab countries and other developing regions. The main observation is that the results vary quite significantly, from

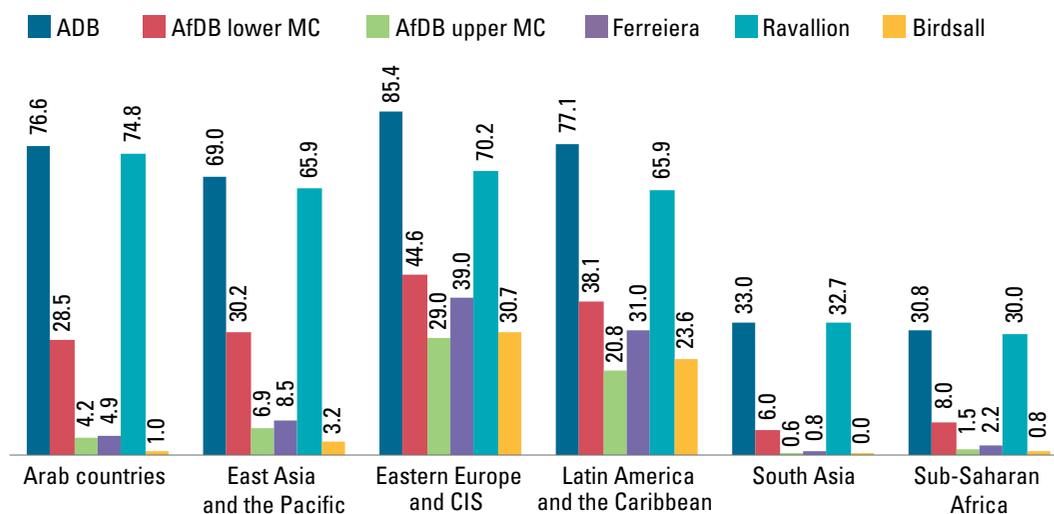
approximately two thirds of the population if we apply the thresholds by Ravallion and the Asian Development Bank, to slightly less than one third when using the \$2-10 threshold of the African Development Bank. Other definitions identify less than 5 per cent of Arab population as middle class (MC). According to Ali,<sup>43</sup> the middle class in five Arab countries, namely Egypt, Jordan, Morocco, Tunisia and Yemen, made up nearly 79 per cent of the total population in the mid-2000s; a share that has been stable since the mid-1990s.<sup>44</sup> His estimations used the national poverty line (converted into PPP\$) as a lower threshold and \$13 per day as an upper threshold to classify the middle class. As expected, by considering the national poverty line as a lower middle class threshold, a large section of the middle class population falls just above the poverty line but is vulnerable to slipping into poverty following any economic shock.

The main problem with such measurement methods is that a fixed threshold to

measure welfare should not be used across countries.<sup>45</sup> The \$1.25 PPP a day poverty line, for example, may serve as a good proxy for national poverty rates in the poorest developing countries, but does not represent actual deprivation in many countries, especially in Arab countries.<sup>46</sup> Similarly, the fixed \$2 PPP per day as the lower middle class threshold is not appropriate for the vast majority of Arab countries, where national poverty lines are higher than \$2 PPP per day, whereas the \$10 per day lower threshold of the global middle class is too high for Arab countries.

A major flaw in fixing a poverty line as a global poverty benchmark is the reliance on purchasing power parity (PPP) exchange rates that, for a variety of reasons, do not accurately reflect PPP adjustments across countries. Deaton<sup>47</sup> argued that the use of PPP suffers from weak theoretical foundations and other empirical problems, such as the assessment of housing, government service productivity rates

**Figure 1.** Different ways of measuring the middle class (percentage)



Source: Abu-Ismael and Sarangi, 2013.

and urban bias in pricing. Furthermore, Reddy<sup>48</sup> questioned the representativeness of PPP because of the problems associated with its overall weighting. Therefore, any international fixed line based on PPP tends to provide biased estimates of the middle class or any other economic group. For example, the equivalent of \$1.25 in 2005 PPP\$ in today's Egyptian currency is below the value of the national food poverty line. Hence, using this measure in Egypt would derive the population share of the poorest of the poor. However, the equivalent of \$1.25 in 2005 PPP\$ in the national currencies of most sub-Saharan African countries would yield a good proxy for the value of their lower national poverty line. Therefore the same threshold would measure different levels of poverty and would yield biased results by grossly underestimating deprivation in middle-income countries.<sup>49</sup>

These problems, among others discussed in more depth in the paper by Abu-Ismaïl and Sarangi, show why setting middle class thresholds has remained contentious and relatively arbitrary, with some measures more suitable for certain regions or country contexts than others. Therefore, any attempt to answer the question of who middle class members are must begin with a fundamentally different measurement approach; one which recognizes the middle class within a national context, but also allows for comparability across countries.

## II. An alternative approach

### A. Expenditure-based middle class measure

The present report defines the middle class as a group of individuals whose level of consumption expenditure lies above an appropriately determined upper poverty line but whose level of expenditure on non-essential goods and services is equal to or less than the value of a lower

poverty line. The middle class can thus be distinguished from the following three other economic groups: the poor, or those whose expenditure lies below an appropriately defined lower poverty line; the vulnerable, or those whose expenditure places them between the lower poverty line and the upper poverty line; and a third group of more affluent consumers, whose expenditure on non-essential goods exceeds the value of the lower poverty line.

It should be noted that this report assigns equal weight to both the quantity and quality of consumption in defining the middle class as an economic group. In contrast to the affluent class, middle class members do not adopt frivolous consumption habits; however, compared to the poor and vulnerable classes, they enjoy a higher degree of authority over their consumption choices and higher economic status. This distinguishing feature, though implicitly recognized in the literature, has seldom been scrutinized in previous empirical work on the middle class.

To identify the middle class, this report's research methodology first addressed the challenge of isolating the poor. Fortunately, the topic is extensively covered in theoretical and empirical work on the Arab region and elsewhere. Therefore, following the standard methodology applied by most Arab countries in their national poverty assessment reports,<sup>50</sup> the present report applied a household-specific cost-of-basic-needs approach to define the food and non-food components of the poverty line.<sup>51</sup> A household whose total expenditure is less than the poverty line is thus considered "poor".

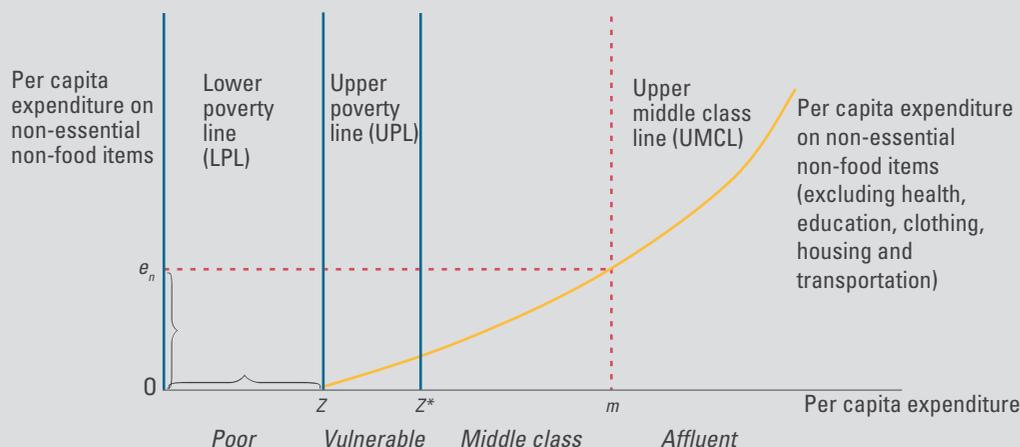
The second step is to estimate the value of the threshold for households vulnerable to falling into poverty or households with expenditure levels above the value of

## Box 1. Estimating a middle class threshold

The expenditure patterns of the four consumer groups (poor, vulnerable, middle class and affluent) are illustrated in the figure below. The horizontal axis is the per capita expenditure and the vertical axis is the average expenditure on non-food non-essential items. Expenditure on non-food non-essential items is an increasing function of average household income.<sup>a/</sup> The scope of "oz" is the lower poverty line, which measures the minimum income or expenditure per capita of households to meet basic needs.  $oz^*$  is the upper poverty line, which captures the vulnerable group; those who have a level of income or expenditure per capita between  $z$  and  $z^*$ . If household per capita expenditure on non-essential non-food items is equivalent to the lower poverty line (between  $o$  and  $z$ ), which is the same as  $oe_n$ , then households between the  $z^*$  and  $m$  levels of expenditure per capita are middle class. This category of consumers are those who meet the basic necessities of food expenditure and have an additional level of expenditure on non-essential non-food items.

Any household whose expenditure lies above the  $m$  level of per capita expenditure belongs to the affluent group. The function representing the relationship between per capita expenditure and per capita non-essential non-food expenditure should have an intercept to indicate that any level of consumption of non-essential goods and services is initiated, albeit meagrely, only as households approach middle class status. Large budget households tend to spend relatively more, in per capita terms, on non-essential items than lower budget households.<sup>b/</sup> Taking this into account, the shape of the function in the figure below implies that a 1 per cent increase in expenditure per capita increases average per capita consumption of non-essential items by more than 1 per cent.

### A middle class threshold based on expenditures



**Source:** Abu-Ismaïl and Sarangi, 2013.

**Notes:** a/ This report uses household consumption expenditure patterns to identify the thresholds for the four consumer groups. Household expenditure patterns indicate that food share is a declining function of a household budget and that non-food consumption share, especially for non-essential items, is an increasing function of a household budget. Large budget households tend to spend relatively more, in per capita terms, on non-essential items than other households. The expenditure per capita on non-essential items, therefore, can be written as an exponential equation, such as:

$$x_n = e^{\beta_0 y^{\beta_1}} e^u \dots (1)$$

where  $x_n$  is non-food non-essential expenditure per capita and  $y$  is total per capita expenditure. Transforming equation (1) into logarithms gives the following equation:

$$\ln(x_n) = \beta_0 + \beta_1 \ln(y) + u \dots (2)$$

Taking the derivatives in equation (2) will give the coefficient  $\beta_1$  as the elasticity of per capita non-food (non-essential) expenditure ( $x_n$ ) with respect to total per capita expenditure ( $y$ ). If  $\beta_1=1$ , it implies that a 1 per cent increase in average per capita consumption expenditure leads to, on average, a 1 per cent increase in non-food non-essential consumption. If, with respect to total expenditure,  $\beta_1>1$ , this implies that a 1 per cent increase in total expenditure per capita increases average per capita consumption of non-food items, including comforts and luxuries, by more than 1 per cent. The figure in box 1 shows that the expenditure elasticity of consumption of non-food is elastic ( $\beta_1>1$ ).

b/ Empirical studies indicate that expenditure elasticity of consumption of non-food and luxury items is elastic (Agbola 2000; also see Deaton and Muellbauer (1980) for the Almost Ideal Demand System Model).

a lower poverty line (LPL) but below an upper poverty line (UPL). Although unable to meet all their basic needs, this second group of households are not as deprived as the poor.<sup>52</sup>

The third and final step is to identify the threshold for separating the middle class from the affluent. Middle class consumers are located between the upper poverty line and what is referred to as the upper middle class line (UMCL), where a household's non-essential non-food consumption per capita reaches a value equivalent to that of the poverty line. Households whose expenditure per capita on non-essential non-food items is higher than the value of the lower poverty line are considered "affluent".

In this way, middle class size is defined as the residual of the total population after deducting the size of the poor, vulnerable and affluent groups. The thresholds for defining poor and vulnerable groups are derived from existing normative standards in poverty measurement literature,<sup>53</sup> applied to specific national situations. The real innovation is in fixing UMCL to separate the middle class from the affluent. To do so, the authors of this report constructed a non-essential non-food basket, excluding non-food expenditure on essential items, such as health, education, clothing, housing and transportation, set out in box 1, with an illustration of the functional form of non-essential household expenditure. This approach differs from other middle class measurement approaches in two ways.

Firstly, as noted earlier, it considers both the quantity and quality of household consumption in determining the size of the middle class, because the poorest households seldom have any other choice than to spend their entire income

on food. Non-food expenditure choices, especially non-essential ones (such as air conditioners, washing machines and telephones), are a main expenditure feature of better-off households.<sup>54</sup> Therefore, the degree of choice that households have over how they spend their budget is a critical factor in deciding their social class.

Secondly, Abu-Ismaïl and Sarangi's measurement approach overcomes the limitations of using PPP exchange rates, since it relies on household consumption behaviour assessed in national currency. From a policy point of view, this approach also tends to be more practical for Governments, given that it applies nationally defined lines consistent with the level of expenditure per capita. Results are therefore equally relevant for international comparisons and national policymaking purposes.

### **B. A sociological perspective: the middle class as professionals**

Households or individuals generally perceive themselves as belonging to a particular class by virtue of their social characteristics, such as education and occupation, irrespective of their levels of consumption expenditure. Some studies have tried to combine economic and social measures in identifying the middle class, such as the study conducted by Booz and Company in Egypt, Morocco and Saudi Arabia.<sup>55</sup> Such research has shown that descriptions of the middle class mostly revolve around the concept of a comfortable life (fulfilling household needs, receiving a good salary and enjoying growing living standards) generally secured through white collar jobs.

According to Mohieddine,<sup>56</sup> the middle class in Arab countries has two essential features. Firstly, it is comprised of working

professionals, described as individuals with a high level of education and, therefore, high social status. Secondly, they are typically employed in the formal public or private sectors. The Arab public sector has been a dominant middle class employer, especially in oil-rich countries, given that many Governments offer jobs to their nationals as a means of redistributing oil revenues.

Based on these criteria, the middle class, as a social category, is defined in this report as a group of formal sector professionals who have completed their secondary education as a minimum and are employed in white collar occupations, including as administrators, government officials and senior technicians; and as permanent non-manual employees, supervisors and the lower strata of technicians.

### III. Middle class size

Given that Part One of this report is mainly concerned with numbers, a cautionary remark on data reliability and comparability is necessary. An accurate cross-country comparison of poor, vulnerable and middle class populations requires harmonized household expenditure surveys, and the application of a standard guideline in setting lower and upper poverty line thresholds. If expenditure surveys are not comparable in terms of survey design, coverage, seasonality, periodicity and calculating expenditure items; and if the methods for setting lower and upper poverty line thresholds do not follow one standard guideline across countries, then the results of the comparison tend to be questionable.<sup>57</sup>

The present study is aware of these difficulties (particularly regarding data from least developed countries) that can only be resolved by adopting a unified pan-Arab household expenditure survey.

Fortunately, however, most Arab countries employ very similar surveying techniques and apply relatively close methodologies in computing household welfare-adjusted expenditure. It should therefore be noted that, although standard cross-country comparability guidelines were not applied to arrive at the results contained in parts one and two of this report, those results capture preconceived figures of middle class size and closely reflect their education and employment characteristics, relative to other groups.

#### A. Middle class stability and retrenchment

The middle class in the Arab region was largely stable until 2011. However, following the popular uprisings, crisis-ridden countries witnessed a retrenchment in middle class numbers. Prior to the uprisings, the size of the middle class population was in the range of 32-43 per cent in least developed countries; and 55-60 per cent in middle-income countries and upper middle-income countries, except in Egypt where only 44 per cent of the population was middle class, although it is a middle-income country.

In Oman, a high-income oil exporting country, the majority of the population can be considered affluent, and middle class size is about half that of the affluent group, at around 30 per cent (figure 2). Interestingly, the Arab middle class size estimated in this report is quite close to the size derived from individuals in the Arab region who were asked to place themselves within one of several economic categories (box 2); this similarity reinforces the present report's methodology.

It should be noted, however, that estimates in figure 2 do not include projections on the impact of the crises in the Syrian Arab Republic and Yemen. In the former, armed conflict is estimated to have increased

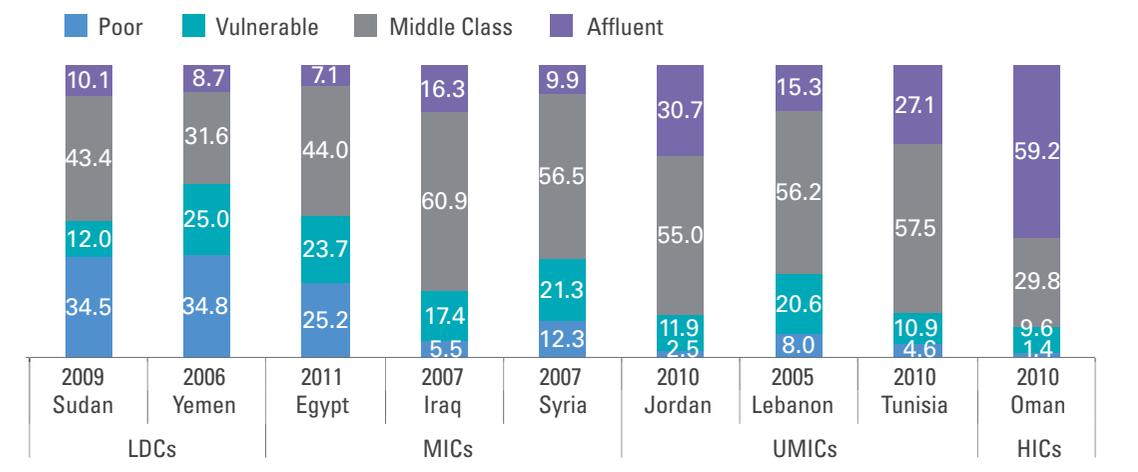
poverty from 12.3 per cent in 2007 to 43 per cent in 2013. In the latter, the prolonged recession has raised poverty from 34.8 per cent in 2006 to 54.4 per cent in 2011.<sup>58</sup> Both countries also witnessed a rise in vulnerable population size and, as a consequence, a significant decline in the middle class (figure 3).

Yemen, however, is different from the Syrian Arab Republic in that it was hit by a significant economic downturn before 2011. The country faced severe hardships in terms of rising unemployment, dwindling fiscal deficits, stagnation in per capita income and declining social development indicators from 2006 to 2010. Poverty increased from 34.8 per cent in 2006 to about 42 per cent in 2009. In 2011, the public uprisings and armed conflict resulted in significant disruption to the supply and production chains, further exacerbating the situation with an 11 per cent contraction in economic activity.<sup>59</sup> This, in turn, sharply increased poverty to around 54 per cent

in 2011, accompanied by a significant increase in food insecurity from 32 per cent in 2009 to 45 per cent in 2012, and acute child malnourishment. Under these circumstances, the vulnerable population share increased from 25 per cent in 2006 to 30 per cent in 2011. Correspondingly, the estimated middle class size declined from 31.6 per cent in 2006 to 8.4 per cent in 2011 (figure 3).

The regional aggregate, based on the latest household surveys of the nine above-mentioned countries, indicates that the middle class constituted nearly half, precisely 47.3 per cent, of the Arab population in 2011. The poor and vulnerable constituted around 40 per cent and the affluent made up approximately 12 per cent of the population in 2011. Adjusting these estimates to reflect the impact of the crises in the Syrian Arab Republic and Yemen, the average size of the middle class in the Arab region was estimated at 42 per cent of the population in 2011, while about 47 per cent

**Figure 2.** Middle class percentage share varies widely across Arab countries



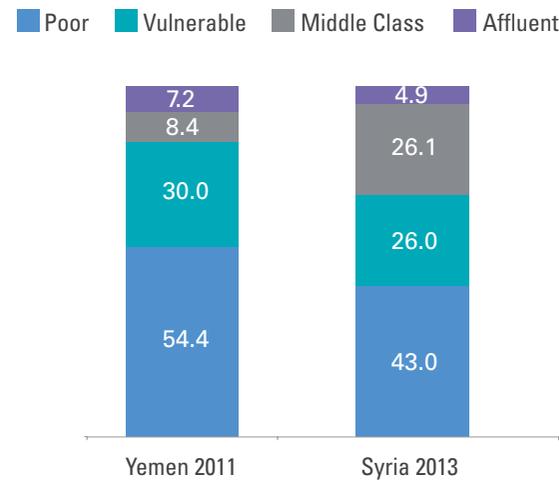
**Source:** ESCWA estimates based on Abu-Ismaïl and Sarangi, 2013.

**Note:** Data are from latest available household expenditure surveys of respective countries.

was poor or vulnerable and only 11.4 per cent was affluent (figure 4).

Of these nine Arab countries, only six, namely Egypt, Jordan, Oman, the Syrian Arab Republic, Tunisia and Yemen, have data at two points in time. Data for Iraq, Lebanon and the Sudan are not available for the earlier year closest to 2000. Figure 5 shows the comparable estimates for the six countries from 2000 to 2011, with and without taking into account the impact of the crises in the Syrian Arab Republic and Yemen.

**Figure 3.** Crisis has pushed the majority of Syrians and Yemenis into poverty and vulnerability (percentage)

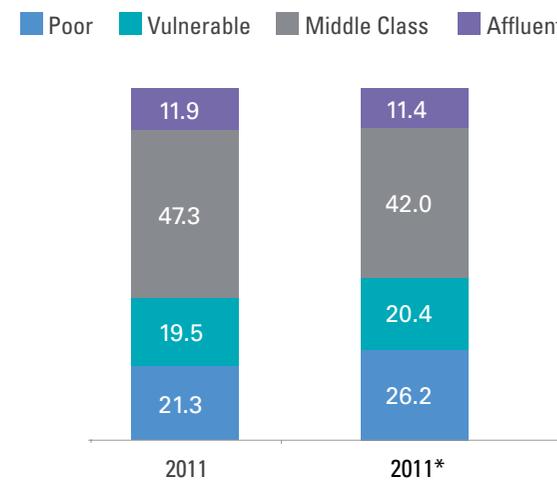


Source: Ibid.

Notes: The figures for the Syrian Arab Republic are ESCWA estimates for 2013. Middle class size measurements are based on the lower poverty line (43 per cent of the population) and upper poverty line (69 per cent of the population). Furthermore, this report assumes that most of those who can afford to emigrate are from the affluent class, thus reducing affluent class size by 50 per cent. The residual becomes the middle class size (26 per cent). The 2011 figures for Yemen are based on World Bank estimates (Engelke, 2012): poverty increased by 45 per cent in 2006 to reach 54.4 per cent in 2011.

On average, the middle class share of the Arab population has remained largely stable,<sup>60</sup> declining only slightly from 47.3 per cent in 2000 to 45.1 per cent in 2011 (figure 6), mainly owing to a shrinking middle class in Egypt that had a higher population weight in the sample. Aggregate poverty estimates increased from 18.3 per cent in 2000 to 21.8 per cent in 2011, which can again be attributed to the rise in poverty in Egypt and its population effect. However, if we take into account the impact of the crises in the Syrian Arab Republic and Yemen, then the estimated middle class size shows a steep decline from 47.3 per cent in 2000 to 36.7 per cent in 2011, accompanied by an increase in the share of the poor and vulnerable populations, from 39.5 per cent in 2000 to 52.9 per cent in 2011. Correspondingly, the size of the affluent group also shrunk.

**Figure 4.** The percentage share of the middle class is shrinking owing to the impact of crises



Source: ESCWA estimates.

Note: Regional aggregate based on latest household surveys, weighted by population for 2011.

\* Indicates adjusted figures by taking into account the impact of the crises in the Syrian Arab Republic (based on 2013 estimates) and Yemen (based on 2011 estimates).

## Box 2. Expenditure-based middle class size versus self-reported middle class size

As the figure below shows, middle class size is generally slightly bigger when membership is self-reported. The self-reporting of class by individuals in the World Value Survey (WVS) is another measure that can be compared with this report's expenditure-based measure of class, to understand people's aspirations regarding social status vis-à-vis aspiration realization, through their level of expenditure on comforts and luxuries. The WVS question on social class asked people to identify themselves as belonging to one of the following five categories: upper class, upper middle class, lower middle class, working class or lower class. For the purpose of analysis, this report aggregated the upper middle class and the lower middle class to make one "middle class" category.

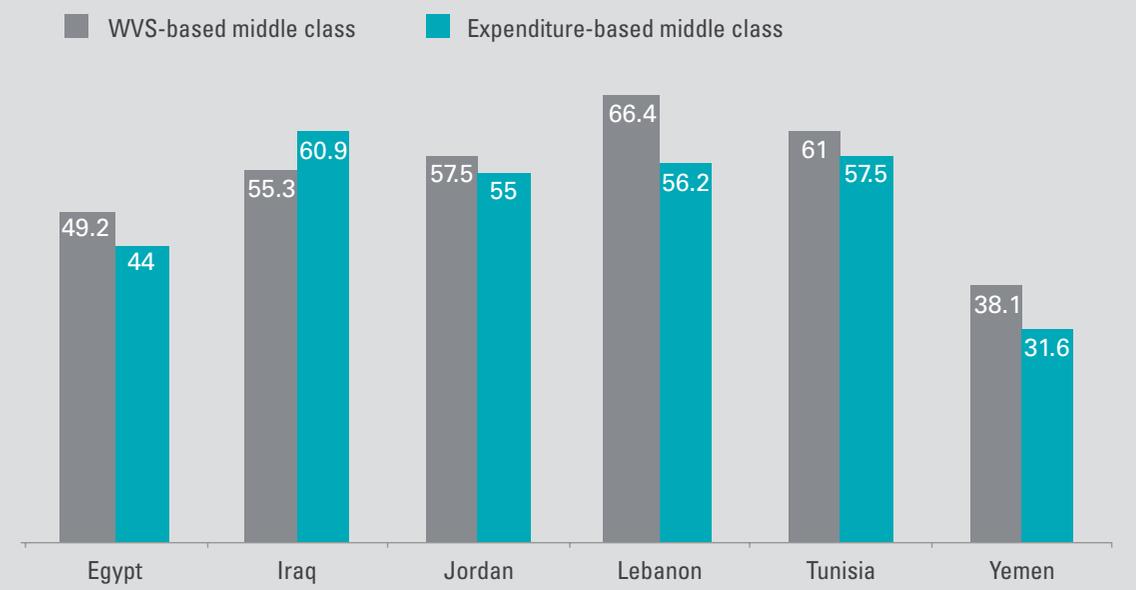
A close look at the association between middle class size in the WVS self-assessment of individuals and the expenditure-based measure of middle class used by this report indicates how Arabs perceive themselves by class and the reasoning behind the need for an alternative to the global absolute and relative measures.

In all the selected countries, except Iraq, the self-reported middle class size is slightly higher than that estimated by this report.<sup>a/</sup> This should be read in conjunction with the numbers for the self-reported upper class size in WVS, which are much lower than the affluent size estimated by this report. A downward bias in upper class size is expected from self-selected answers as people tend to identify themselves as upper middle class rather than upper class.<sup>b/</sup> This may also be explained by the urban bias in the WVS sample, whereas the household consumption expenditure surveys are more representative of national populations. Since inequality is higher in urban areas, people often place themselves in a lower position relative to the very rich. These factors explain the slightly higher self-reported figure of the middle class and lower figure of the upper class.

**Notes:** a/ The largest relative gaps are in the cases of Lebanon and Yemen, but this is most likely because these two countries do not have consumption surveys available for a recent year (closest to 2011), so the calculations were done using data from 2006 and 2005, respectively, whereas the other countries' latest consumption data is closer to the latest WVS data, ranging from 2010 to 2014 (wave 6).

b/ See Ferreira and others, 2013.

### Comparison between expenditure-based and self-reported middle class size (percentage)



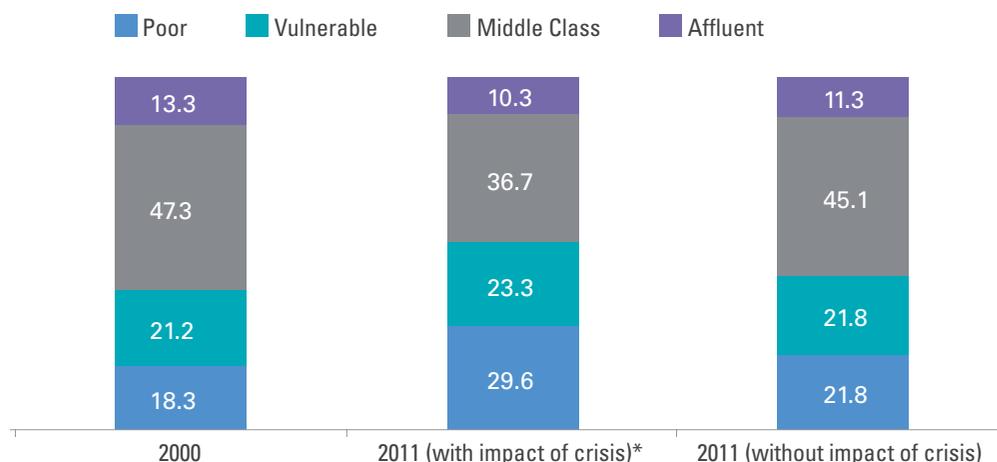
Source: ESCWA estimates.

Changes in population class size across countries show a striking pattern. Egypt saw a decline in middle class population size, falling from 48 per cent in 2000 to 44 per cent in 2011, at an annual average of 0.7 per cent (figure 6). This decline was accompanied by a significant increase in poverty from 16.7 per cent to 25.2 per cent and a decline in affluent class population from 9.7 per cent to 7.1 per cent over the same period; despite an average economic growth of about 2 per cent. Therefore, neither the poor nor the middle class benefited from this growth.<sup>61</sup> However, Syrian expenditure survey data from 2000 to 2007 shows almost no change in middle class size; neither does Yemeni expenditure survey data from 1998 to 2006. The conflict in the Syrian Arab Republic had a devastating impact, effectively halving the size of the middle class to reach 26 per cent in 2013 from 56.5 per cent in 2007 (an

average annual contraction of 9 percentage points). The crisis in Yemen effectively wiped out the middle class.

The situation in a second group of Arab countries, including Jordan, Tunisia and Oman, is more optimistic. In Jordan, middle class size declined from 57.2 per cent in 2002 to 55 per cent in 2010, but affluent group size increased from 28.3 per cent to 30.7 per cent. Poverty also declined in Jordan during the same period, although it has always been low. A similar trend is observed in Tunisia, where middle class size declined from 59.5 per cent in 2005 to 57.5 per cent 2010, but affluent group size rose from 23 per cent to 27 per cent and poor population size declined. However, the size of the vulnerable group increased marginally in both Jordan and Tunisia. It can therefore be inferred that the decline in middle class size in those two countries

**Figure 5.** Until 2011, the percentage share of the middle class was relatively stable (percentage)



**Source:** ESCWA estimates.

**Note:** Aggregates for six countries, as available from household expenditure surveys for years closest to 2000 and 2011 (Egypt, Jordan, Oman, the Syrian Arab Republic, Tunisia and Yemen), weighted by population.

\* Indicates adjusted figures by taking into account the impact of the crises in the Syrian Arab Republic (based on 2013 estimates) and Yemen (based on 2011 estimates).

could be the result of middle class mobility towards the affluent group, while the majority of those who were just below the lower middle class threshold remained trapped in the vulnerable category. Oman is the only country in the sample that has seen a clear increase in middle class size, from 18.2 per cent in 2000 to 29.8 per cent in 2011, accompanied by a decline in poverty and vulnerable population size. This indicates upward poor and vulnerable population mobility to the middle class category. However, the middle class failed to catch up with the affluent, as the size of the latter shows no change over time.

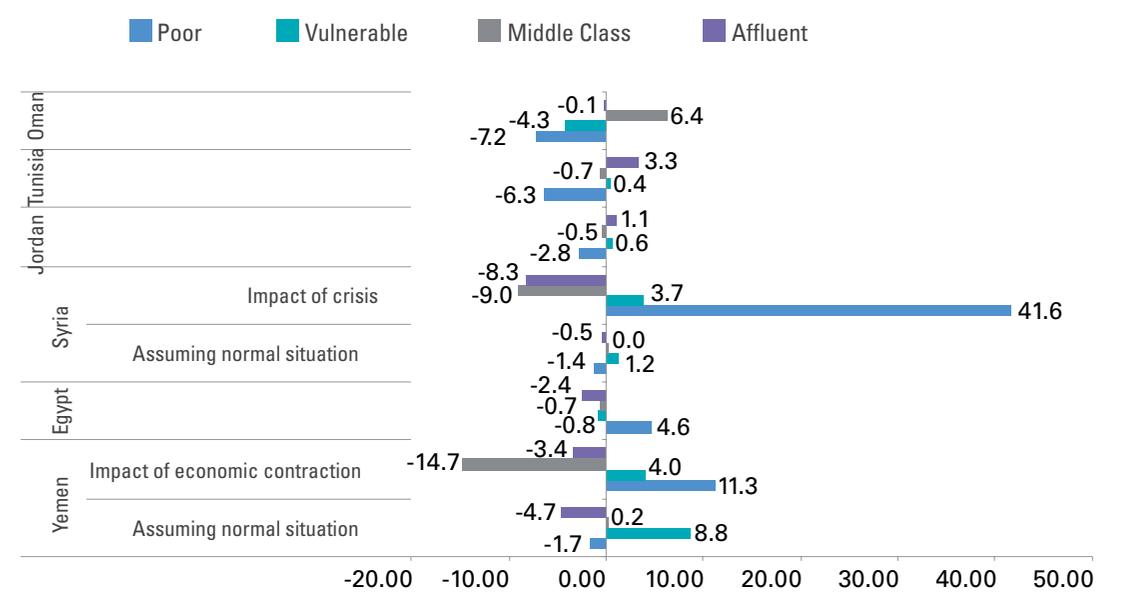
Unfortunately, of the five Arab countries covered in that survey, only three were common to this report's sample and, of those three, data over time exists for only two countries, namely Egypt and Jordan. Regardless, trends are consistent with this report's findings for both countries, since

the WVS data revealed that middle class size declined in Egypt (from 64 per cent in 2002 to 49 per cent in 2013) and in Jordan, albeit to a lesser extent (from 68.5 per cent to 57.5 per cent over the same period).

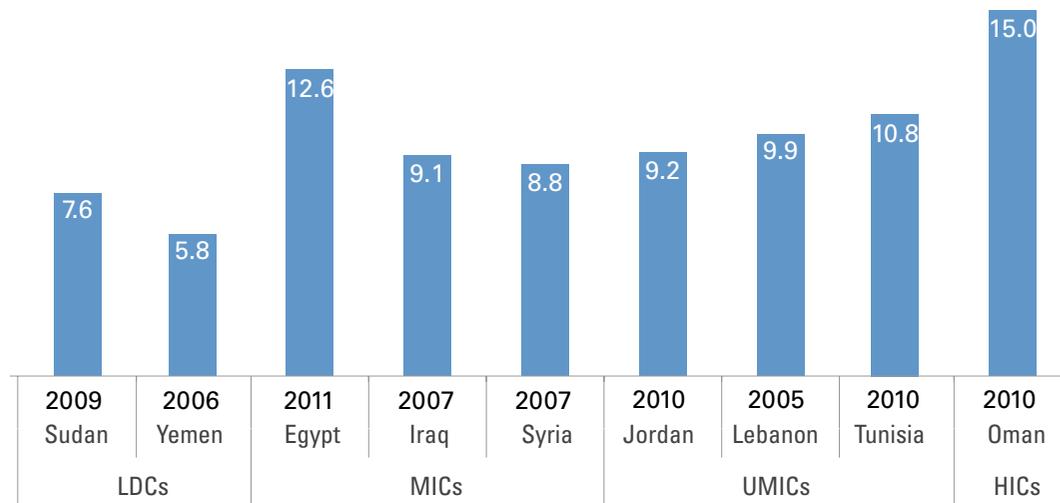
## B. Professional classes

This report found that the affluent group has the most professionals, followed by the middle class. Professional group size varies from 5.8 per cent of the population in Yemen, to 15 per cent in Oman (figure 7). Egypt has a fairly large professional group, constituting 12.6 per cent of the population aged 15 and above, because it has a large government sector and higher levels of educational attainment. In other middle income countries and upper middle income countries, professional group size varies between 7 per cent and 10 per cent. Professional group size in least developed countries is low, ranging between 5 per cent and 8 per cent.<sup>62</sup>

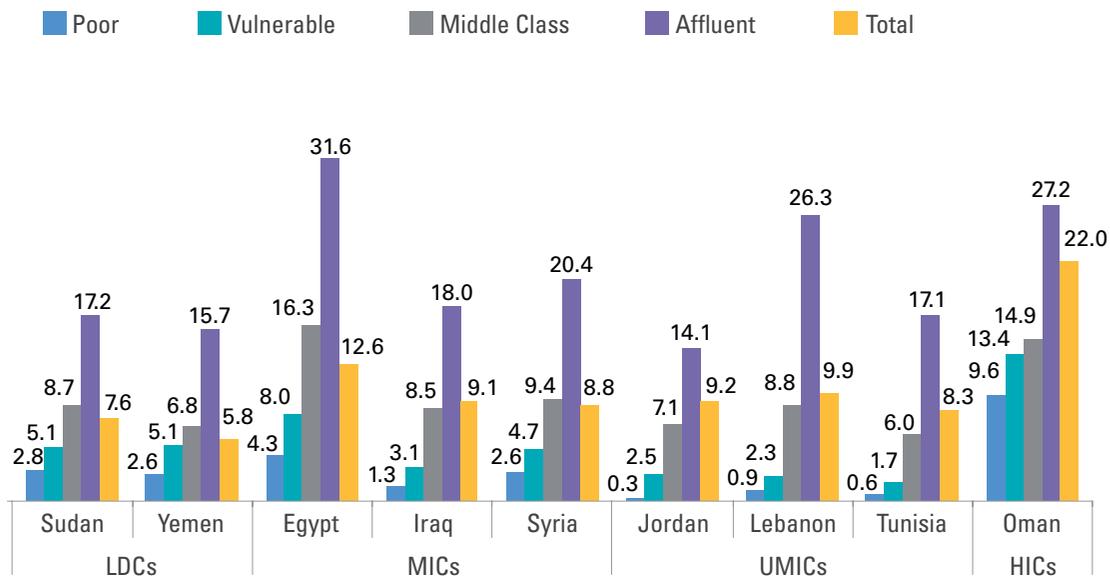
**Figure 6.** Annual average percentage change in economic class size, 2000-2011



Source: ESCWA estimates.

**Figure 7.** Percentage share of professionals aged 15 and above

Source: ESCWA estimates.

**Figure 8.** Percentage share of professionals within expenditure-based population classes

Source: ESCWA estimates.

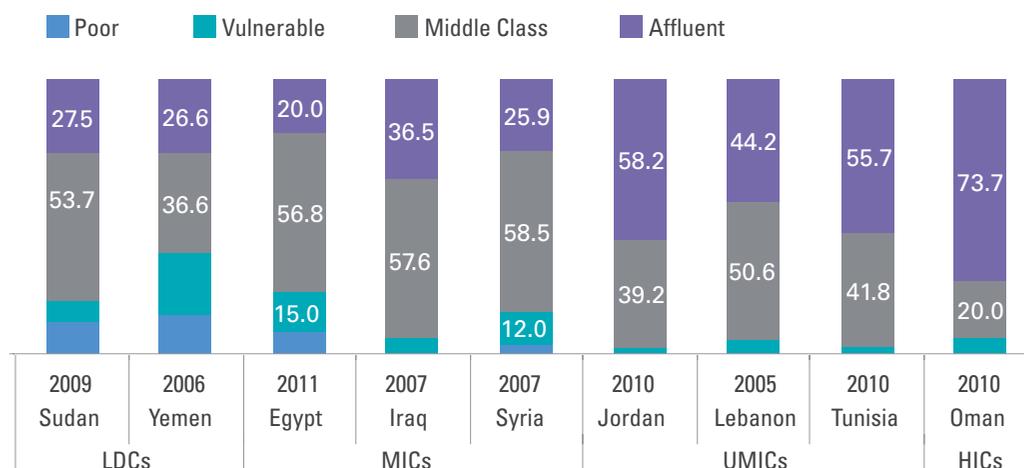
The incidence of professionals within population classes is the highest among the affluent group and the next highest among the middle class. This pattern is expected, given that professionals possess high human capital and thus enjoy high social status. In Egypt, about 32 per cent of the affluent population are professionals, 26 per cent in Lebanon and 27 per cent in Oman (figure 8). Professionals, as a share of the middle class, range between 6 per cent and 17 per cent across countries, comprising a similar share in least developed countries, middle income countries and upper middle income countries, with the highest percentages in Egypt and Oman.

The majority of professionals in Jordan, Oman and Tunisia belong to the affluent class. In middle income countries, such as Egypt, Iraq and the Syrian Arab Republic, the major share of professionals belongs to the middle class, ranging between 57 per cent and 59 per cent. A considerable

share of professionals also belongs to the vulnerable class in these countries; 15 per cent in Egypt and 12 per cent in Syria (figure 9). Similar trends are noted in the Sudan and Yemen. Such characteristics reflect a significant structural feature of the economies in these countries; despite higher levels of education and employment in the formal sector, a significant portion of the professional group remains vulnerable to poverty, and a small number of professionals are poor.

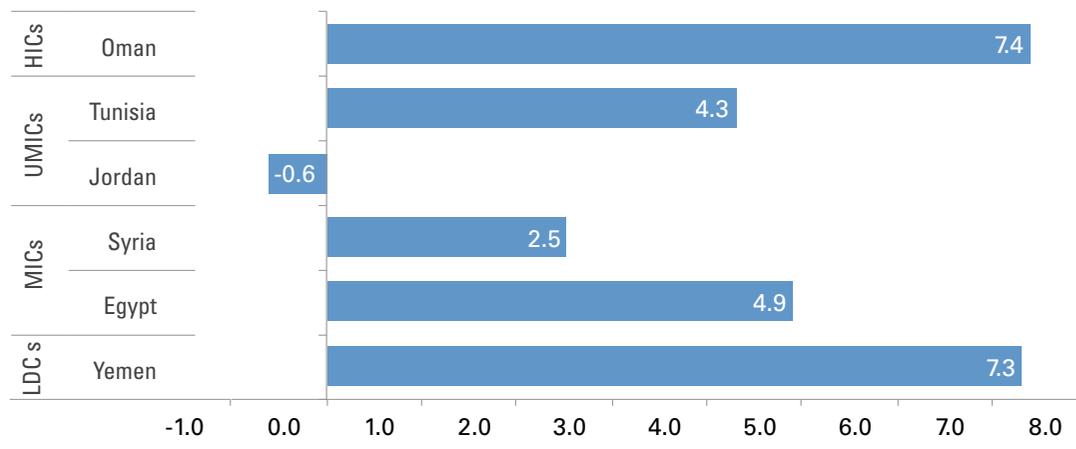
As figure 10 shows, five of the six countries in the sample (except Jordan) witnessed an increase in professionals to varying degrees between 2000 and 2011; the highest in Oman and the lowest in the Syrian Arab Republic. Oman had the highest average increase in professionals, at a rate of 7.4 per cent per annum, increasing from 12.7 per cent in 2000 to 22 per cent in 2010. In Yemen, professional group size in 1998 was only 3.7 per cent of the total population, the

**Figure 9.** Distribution of professionals across expenditure-based population classes (percentage)



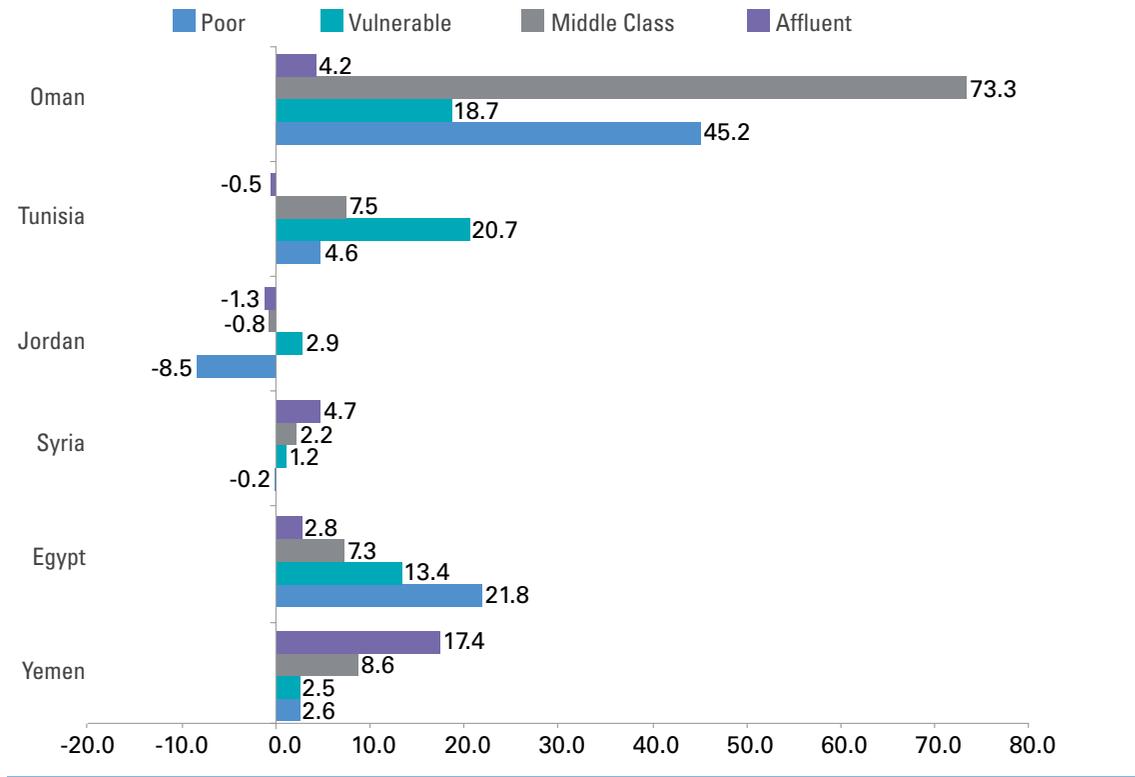
Source: ESCWA estimates.

**Figure 10.** Annual average growth in professional group size (percentage), 2000-2011



Source: ESCWA estimates.

**Figure 11.** Annual average percentage change in professional share within each population class, year closest to 2000 and 2011



Source: ESCWA estimates.

lowest among all countries in the sample, increasing to 5.8 per cent by 2006, which explains a higher average percentage change owing to the low base effect. Egypt and Tunisia also witnessed a noticeable increase in professionals between 2000 and 2011. Other countries had relatively low growth in professional numbers over the same period, and Jordan showed a slightly negative trend.

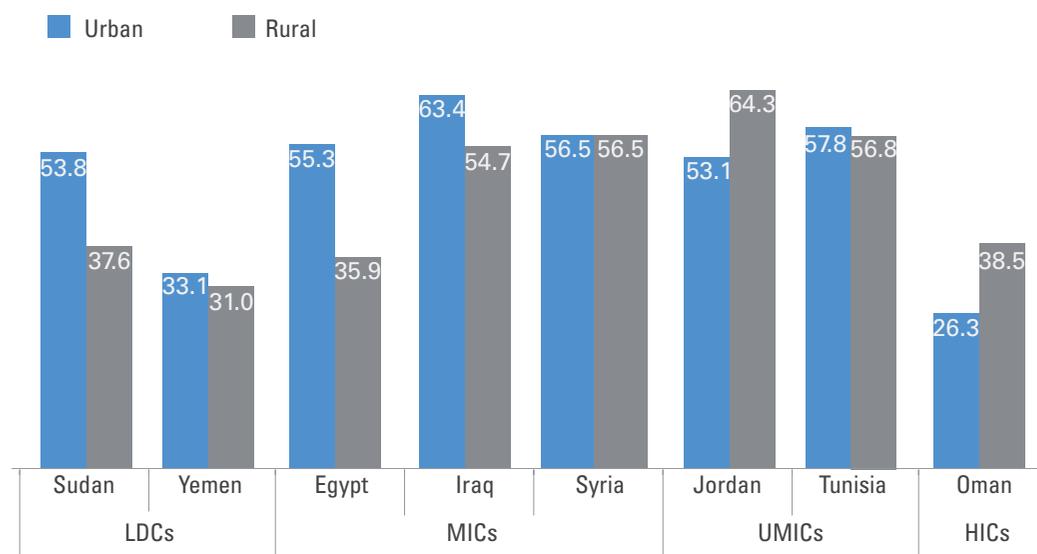
As figure 11 shows, within middle class households, Oman noted the highest increase in the share of professionals, from 1.8 per cent in 2000 to 15 per cent in 2010, resulting in a 73 per cent annual average change. The share of professionals increased modestly in middle class households in Egypt, Tunisia and Yemen, but declined slightly in Jordan. It should be noted that the share of professionals also increased among the poor and the vulnerable categories in most countries, except among

the poor in Jordan; steep increases are noticeable in Egypt and Tunisia.

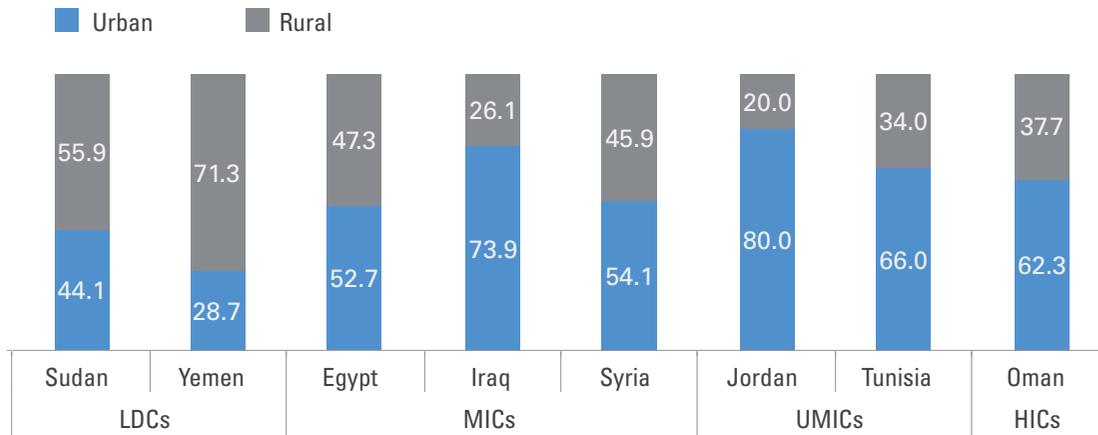
### C. Rural-urban divide

A large majority of the urban population in most Arab countries is middle class, as seen in Egypt, Iraq, Jordan, the Sudan, the Syrian Arab Republic and Tunisia. As shown in figure 12, it comprises between 53 per cent of the urban population in Jordan and 63 per cent in Iraq. Over half the rural population in Iraq, Jordan, the Syrian Arab Republic and Tunisia is also middle class. The majority of the Jordanian urban and rural populations are either middle class or affluent, both forming around 86 per cent of each population. In Jordan and Oman, middle class percentage is lower in urban areas than in rural areas. The Syrian Arab Republic and Tunisia had an equal distribution before the crises. Middle class distribution between rural and urban areas across selected countries reveals an

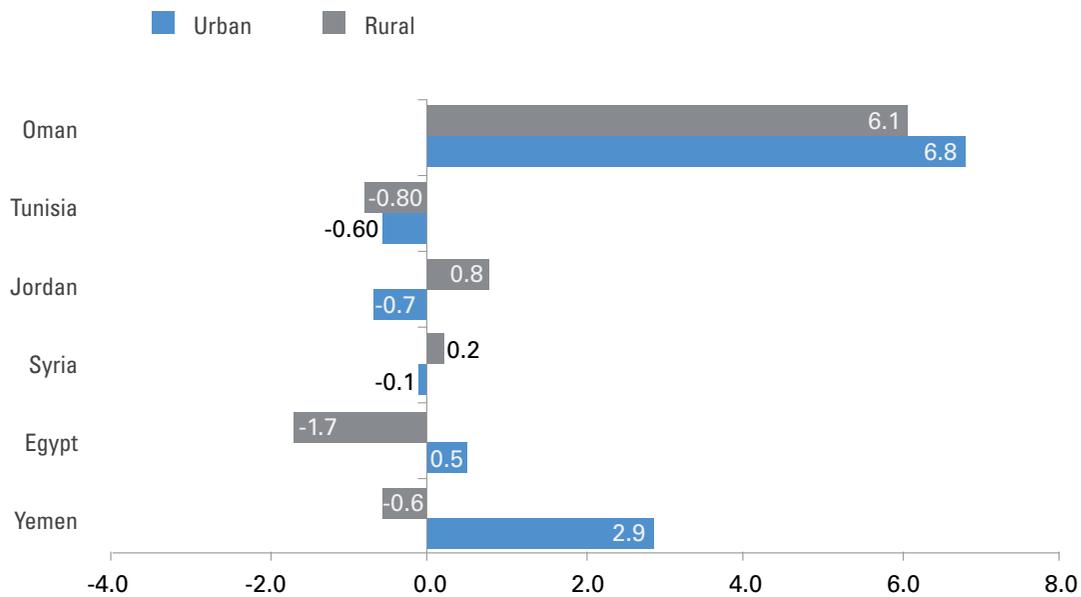
**Figure 12.** Percentage share of the middle class in rural and urban areas



Source: ESCWA estimates.

**Figure 13.** Middle class rural-urban distribution (percentage)

Source: ESCWA estimates.

**Figure 14.** Annual average percentage change in middle class size in rural and urban areas, 2000-2011

Source: ESCWA estimates.

interesting pattern. Figure 13 shows that cities and towns host the majority of the middle class population in middle-income countries, upper middle-income countries and high income countries. The share in urban areas is the highest in Jordan at 80 per cent, followed by 73.9 per cent in Iraq, 66 per cent in Tunisia, 62 per cent in Oman, 54.1 in the Syrian Arab Republic and 52.7 per cent in Egypt. In some countries, such as Iraq, the urban share among the middle class is higher than the population share. In least developed countries, however, the middle class share is higher in rural areas, which is plausible since their economies are predominantly agriculture-based and the urban non-farming sector is less developed. For example, 71.3 per cent of the middle class resides in rural areas in Yemen and almost 56 per cent in the Sudan.

Over the past six decades, Arab countries have shown impressive urban growth. The available data on urban and rural populations in Arab countries show that, at least since 1980, urban populations have been growing at the expense of rural populations, because of significant urban migration. While 56.1 per cent of the Arab population still resided in rural areas in 1980, by 2010 the situation was entirely reversed, with 57.4 per cent living in urban areas compared to 42.6 per cent in rural areas.<sup>63</sup> Some Arab countries, notably the Gulf countries, are witnessing a process of “rural depopulation”, almost eliminating the Bedouin population. In fact, most of these countries, with the exception of Saudi Arabia and Oman, exhibit levels of urbanization comparable to those prevalent in Western Europe and the United States of America. All other Arab countries exhibit the same trend, but to a lesser extent, except Iraq, where the process of urban population growth has stalled since 1990, and its relative share of the urban population is expected to decline further by

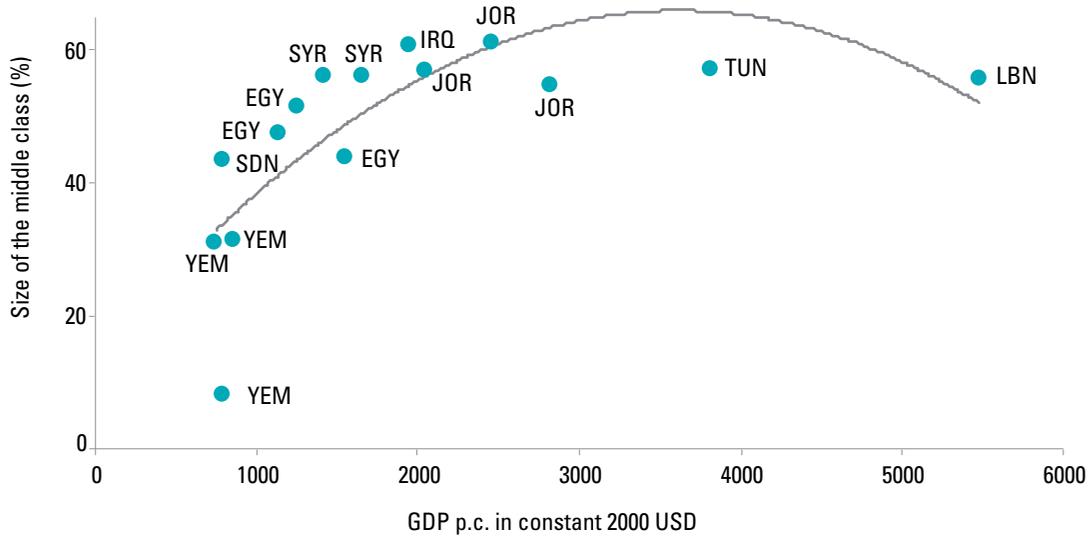
2020 because of war and political instability (Mohiedin, 2014).

Landless peasants have historically migrated to work in the urban centres of Arab cities, in the formal and informal sectors, and their offspring have tried to escape informal jobs by improving their educational attainment and joining urban bureaucracies,<sup>64</sup> leading to a large increase in urban middle class size. However, this report’s sample shows a modest increase in the urban share of the middle class in some countries, but not all. For example, as shown in figure 14, between 2000 and 2011, in Egypt and Yemen, middle class size moderately increased in urban areas, accompanied by a decline in rural areas. In Jordan, the opposite happened; urban middle class size decreased, accompanied by rural middle class size expansion. In the Syrian Arab Republic, middle class share in both rural and urban areas almost stagnated. In Oman, middle class size increased in both urban and rural areas, although the middle class increased at a faster rate in urban areas. Tunisia, however, experienced contraction in both urban and rural middle class shares in 2005 and 2010. Changes in urban and rural shares are derived using two components: change owing to movements between classes within urban or rural areas; and change in population shares of urban and rural areas because of population growth or migration.

#### **D. Middle class correlations with income and inequality**

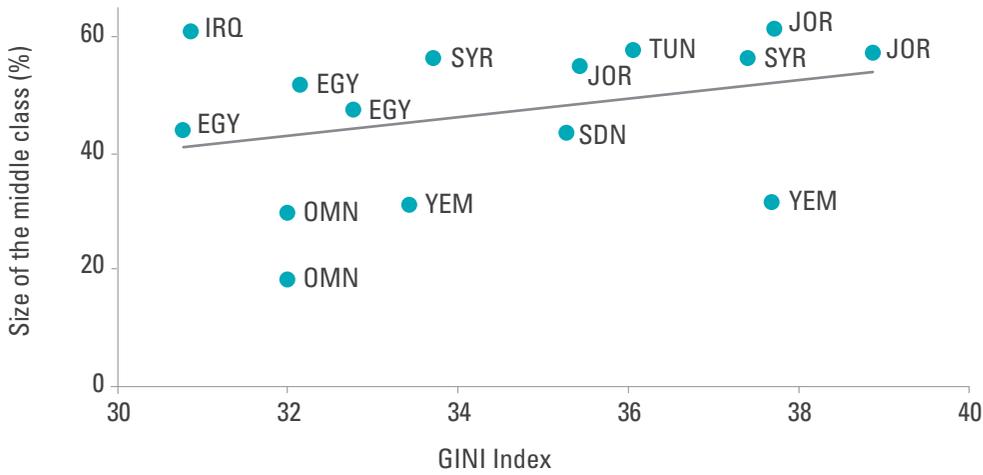
The correlation between middle class size and other indicators, such as GDP per capita and income inequality measured by the Gini index, shows an interesting pattern. It is to be expected that higher GDP per capita and lower inequality are positively correlated with a large middle class. Figures 15 and 16 present two scatter plots, plotting middle class size as a population share

**Figure 15.** A larger middle class means higher national income



Source: ESCWA calculations and the World Bank (2014b).

**Figure 16.** Middle class size and income inequality



Source: ESCWA calculations and the World Bank.

on the vertical axes and GDP per capita in current United States dollars or Gini index on the horizontal axes.<sup>65</sup>

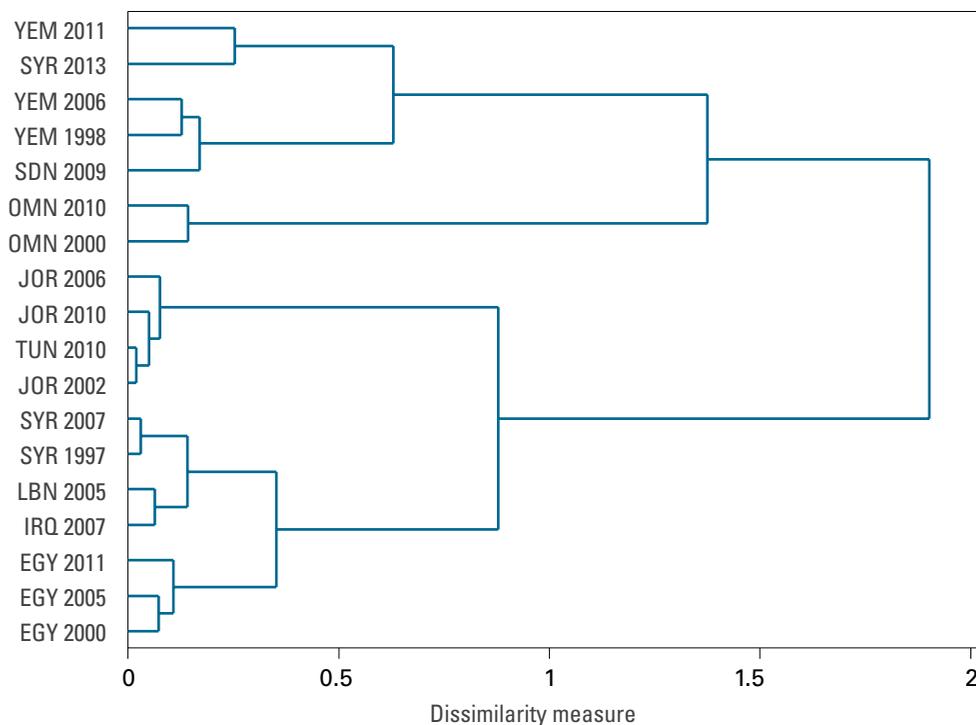
Graphs 15 and 16 confirm that middle class size is correlated positively with income. In figure 15, although the relationship is graphically concave, the linear based Pearson correlation coefficient between size and income is strong at 0.53 and is statistically significant. However, the notion that a larger middle class coincides with lower income inequality cannot be confirmed, as the scatter plot shows no linear relationship between the two in this report's sample and the Pearson correlation coefficient is not significant. This may be

a consequence of the diverse countries included in the sample and the fact that only unconditional correlations are being examined, without taking into account other middle class determinants, owing to sample constraints.

### E. Clustering countries by middle class population

Another way of grouping Arab countries, other than by income, is using statistical clustering on the basis of poor, vulnerable, middle and affluent class sizes. Clustering is a multivariate method that allows researchers to cluster similar observations in terms of middle class size to form homogenous groups. The aim is to achieve

**Figure 17.** Dendrogram of clustering solutions



Source: ESCWA calculations.

maximum homogeneity within groups and maximum heterogeneity between groups. This report employs hierarchical clustering with the Euclidean metric and Ward's error sum of squares method.

The dendrogram in figure 17 shows the clustering solution; the closest country year observations are clustered together on the first level, the resulting closest clusters are merged on the second level and so on, until all observations are in the same cluster. The length of the horizontal axis represents the dissimilarity between groups; the longer the line between two clusters, the more dissimilar they are. The dendrogram implies several possible clustering solutions, namely into two, three or four clusters. The three cluster solution is examined further because it has the best balance between cluster size and cluster characteristics. In the dendrogram, cluster 1 consists of only Oman that has a very specific structure of classes, with a small middle class but a huge affluent class. Cluster 2 consists of Yemen, the Sudan and the Syrian Arab Republic in 2013; these countries have a very large poor class in common. Finally, cluster 3 has the largest middle class at 55 per cent and includes Egypt, Iraq, Jordan, Lebanon, the Syrian Arab Republic (before the conflict) and Tunisia.

Comparing a cluster of countries with similar middle class sizes against those in other clusters reveals differences in other country characteristics. The most striking difference is that cluster 3, the largest middle class cluster, has a much smaller share of labour working in agriculture and a much larger share working in industry when compared to cluster 2. Of the three clusters, cluster 1 has the lowest share of poor people and the highest level of human development, as measured by the Human Development Index. It is followed closely

by cluster 3, while cluster 1 lags far behind both on all development variables.

#### IV. Conclusion

Part One of this report questions the relevance of international absolute and relative middle class measures to the Arab region, and uses a new approach to measure the Arab middle class that is country-specific and takes into account expenditure levels and patterns. This approach has the advantage of stratifying households into four groups: poor, vulnerable, middle class and affluent. It also examines "professionals" as a social class, i.e. one defined by educational and employment characteristics.

The results show that nearly half the Arab population is middle class, but middle class size varies across country groups. Middle and upper middle-income countries in the region are host to a higher share of the middle class population, while the least developed countries are host to a major share of the poor and vulnerable populations. Middle class population share is high in rural areas in countries where the economy is predominantly based on agriculture and where the urban non-farming sector is less developed.

From 2000 to 2011, the middle class share among the Arab population remained largely stable, only slightly declining from 47 per cent in 2000 to 45 per cent in 2011. Adjusting the estimates to include negative impacts of the crises in the Syrian Arab Republic and Yemen, middle class size in the region declined sharply by 10 percentage points, from 47 per cent in 2000 to 37 per cent in 2011. This decline was accompanied by an increase in the poor and vulnerable populations.

Professional group size in the Arab region varies from 5.8 per cent of the population

in Yemen to 15 per cent in Oman. Its share is the highest among the affluent population and the next highest among the middle class population. In middle-income countries, such as Egypt, Iraq and the Syrian Arab Republic, large shares of the professional group belong to the middle class, ranging between 57 per cent and 59 per cent. From 2000 to 2011, most countries showed a modest increase in professional group size. However, some middle class professionals are slipping into the poor or vulnerable categories in most countries, except in Jordan.



The middle class has increased its human capital through education over the past three decades, but its opportunities have been capped, resulting in low returns on education. Consequently, the share of professionals (those with secondary qualifications and above and employed in the formal sector) increased among the poor and the vulnerable populations in most countries in the region over the period 2000-2011.

## Part Two

# How the middle class is faring

Part Two of this report examines the middle class from an economic and sociological perspective to assess whether it has characteristics that distinguish it from other population groups; how these characteristics (education levels, occupation and standard of living) have been affected over time and in relation to other groups; whether inequality is on the rise; and whether there are special features that distinguish middle class youth and women from those in other social groups.

These questions are explored using the information available from household surveys at two points in time, a base year that is closest to 2000 and the most recent year closest to 2011. Since there are no household expenditure surveys for the Syrian Arab Republic and Yemen after 2007 and 2006, respectively, the impact of the crises on middle class profiles in both countries could not be examined. Therefore, the analysis is confined to the key characteristics of the middle class in relation to other economic groups in the decade leading up to the uprisings.

### I. Education

The Arab region has shown impressive progress in school enrolment over the past five decades, with several countries, namely Algeria, Bahrain, Egypt, Kuwait, Morocco, Oman, Qatar, Tunisia and the United Arab Emirates, almost reaching universal primary school enrolment.<sup>66</sup> This is not surprising since most Arab countries invested heavily in mass education

systems after independence. The average years of schooling for adults (15 years and above) grew from 1.3 years in 1960 to 5.4 in the 2000s, and illiteracy rates were halved over the same period.<sup>67</sup> There was also significant improvement in higher education attainment. In 1940, there were only 10 universities in the Arab region. Today, there are close to 1,000 higher education institutions.<sup>68</sup> Higher education, because of its close links to the labour market, is an important mechanism for upward economic and social mobility and is thus particularly pertinent to poverty reduction and increases in middle class size.

What has happened to the educational profile of the middle class in Arab countries? Based on data on adult educational attainment (aged 25 and above) from household expenditure surveys, this report categorizes individuals into the following five groups: no formal education; basic education; secondary education; above secondary and below university degree; and tertiary education and above.

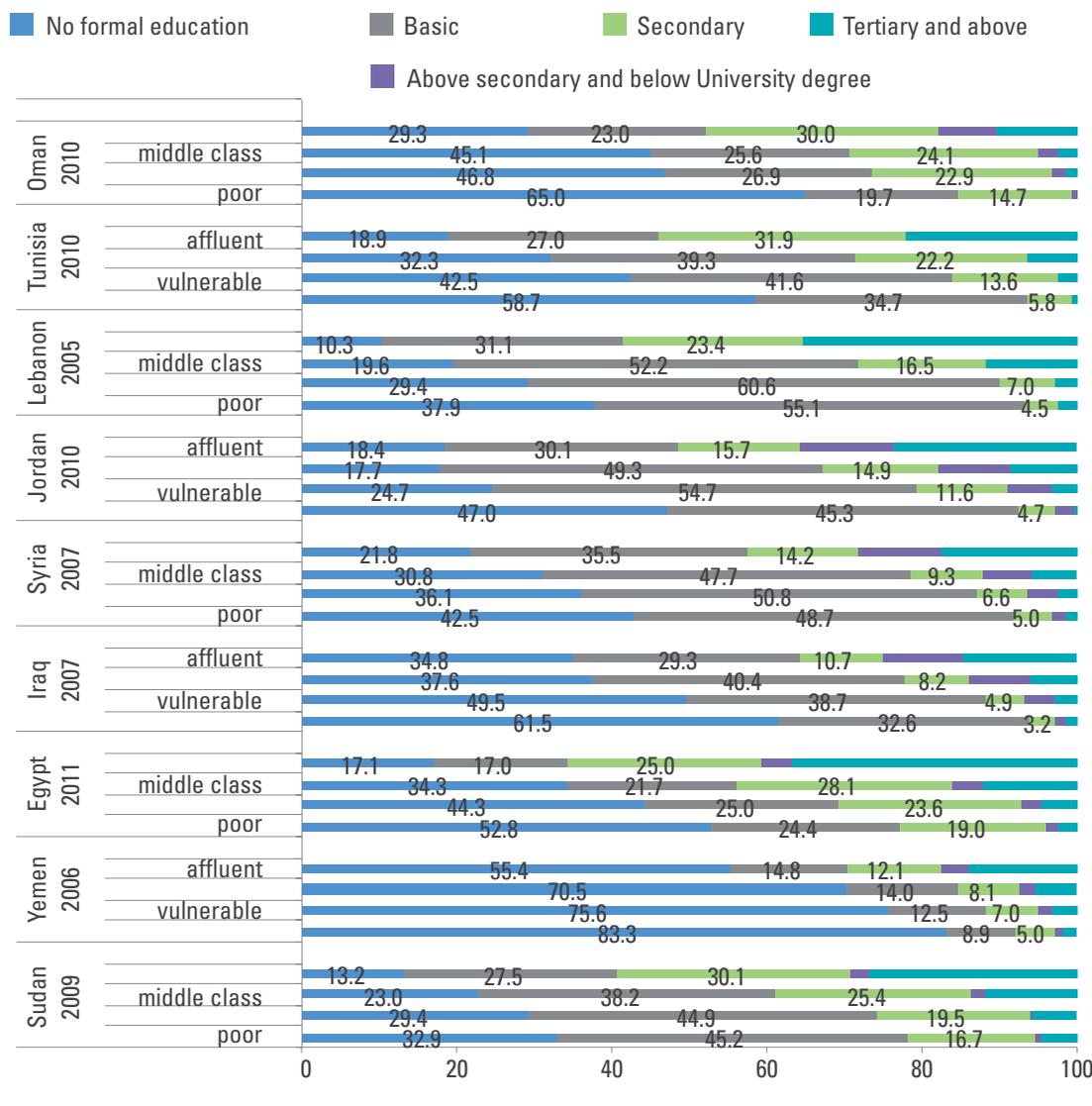
Generally, as individuals' income levels increase, they tend to invest more in higher education and vice versa. Wealthier households therefore tend to have an educational advantage over those at the lower end of the income distribution. This pattern is easy to depict since the share of individuals with secondary or higher qualifications tends to be greater among better-off households in all countries

(figure 18). The affluent class thus has the highest share of individuals with secondary and higher education qualifications, followed by the middle class, then the vulnerable and poor.

However, there is wide variation in educational attainment among middle class

adults across countries. For example, in Yemen, over two-thirds of middle class adults have no formal education, while 14 per cent have only basic education and the remaining 15 per cent have either a secondary or higher education qualification. In the Sudan, however, nearly three-quarters of middle class adults received

**Figure 18.** Adult educational attainment levels among different groups (percentage)



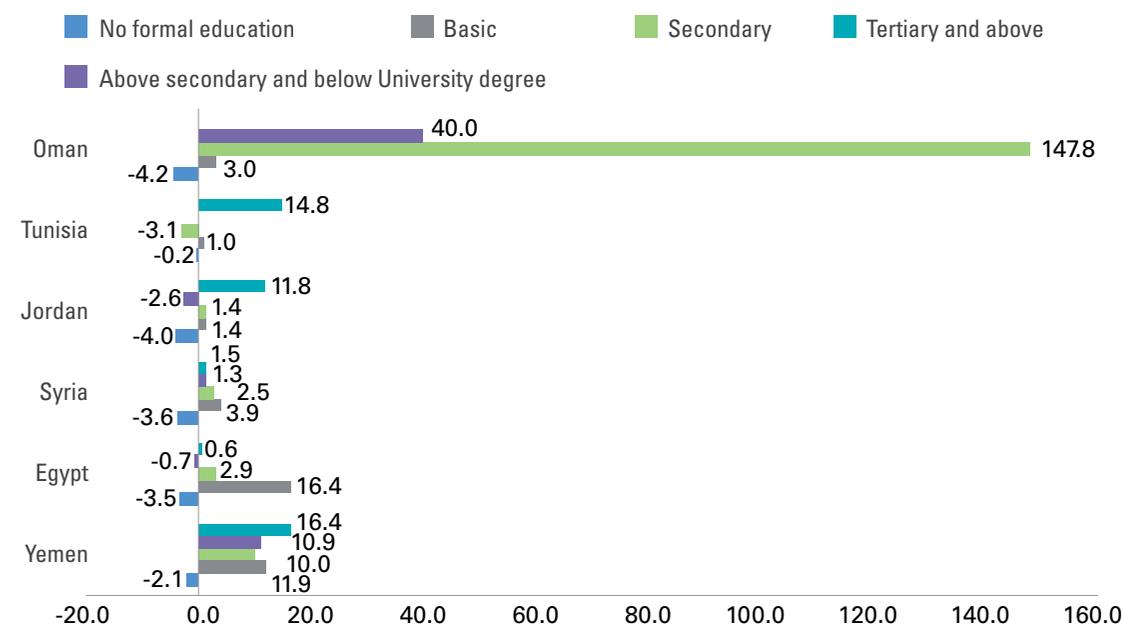
Source: ESCWA calculations.

formal education, and almost 40 per cent of them hold secondary and higher education qualifications (figure 18). This puts Sudan ahead of many middle-income countries, such as Iraq and the Syrian Arab Republic, and almost on a par with Egypt, where almost 40 per cent of middle class adults possess secondary and higher education qualifications. Similarly, between a quarter and a third of middle class adults in Jordan, Lebanon, Oman and Tunisia have secondary and higher education qualifications.

A larger share of the affluent population in Arab countries holds secondary and higher education qualifications: around 50 per cent in Egypt, Jordan, Lebanon, Oman, the Sudan and Tunisia, with Lebanon and Egypt leading on tertiary education, in particular. In contrast, a large majority of poor

adults have no formal education in most Arab countries. These differences in adult education attainment levels across Arab countries and between economic groups explain disparities in capabilities. They also explain why poverty is a structural problem that perpetually reinforces societal inequalities if left unchecked by State policies. Nevertheless, educational attainment has improved for the Arab middle class, with a decline in the share of adults without formal education and a notable rise in higher education attainment (figure 19). In addition to confirming the improvement in overall indicators related to education, this trend also suggests a middle class with higher expectations for decent employment. In the following section we investigate whether these expectations are met.

**Figure 19.** Annual average percentage change in middle class share across education levels, 2000-2011



Source: ESCWA calculations.

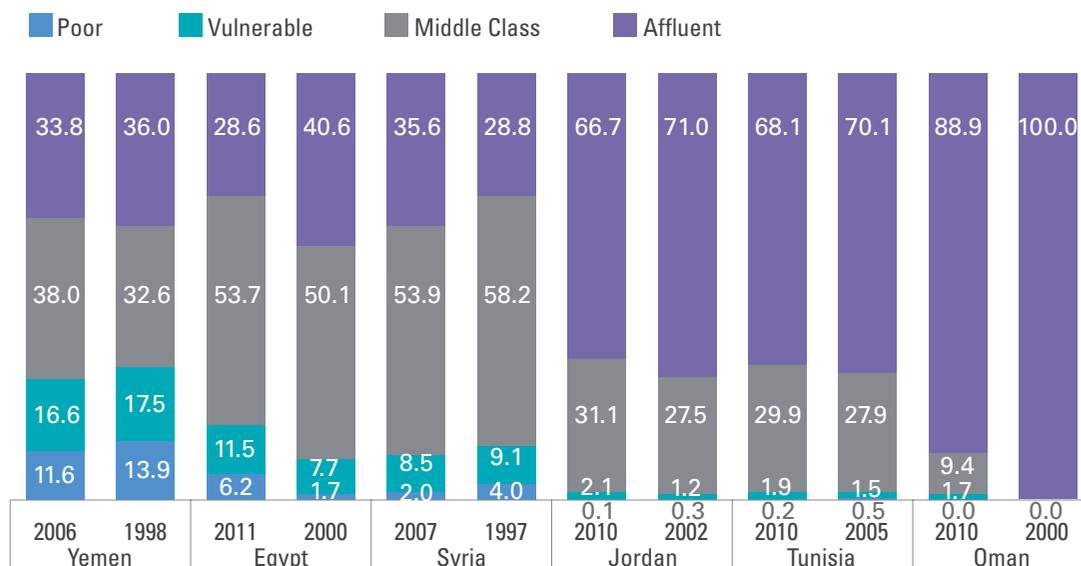
Figure 18 also shows that, within poor and vulnerable population groups, many adults possess a secondary and higher education degree. In Egypt and the Sudan, this is clearly pronounced. Of all the adults with university education, nearly 18 per cent were poor or vulnerable in Egypt in 2011 (figure 20), an increase of 11.4 per cent since 2000. Nearly a third of university graduates in Yemen are poor or vulnerable. It is almost certain that the share of the poor population with advanced university degrees has risen in the Syrian Arab Republic and Yemen since 2010, because of the crises and loss of household income. This has far reaching implications, since family resources directly affect schooling. For example, a recent study by Assaad shows that, in Jordan and Tunisia, household wealth seems to significantly influence secondary education attainment.<sup>69</sup> In Egypt, the lower wealth quintiles have less opportunities

to reach secondary school compared to the higher wealth quintiles.<sup>70</sup> In the Syrian Arab Republic, there is evidence that the poorest families are far more affected by education disruption, with many children in conflict zones reaching the age of 8 without having gone to school. This no doubt will have strong ramifications on poverty and inequality in a country that, until recently, held the lowest level of inequality in health and education indicators between economic classes.

## II. Employment

In Arab economies, where oil and other natural resources are dominant factors, there are essentially two main economic sectors: mining and utilities; and services. This makes Arab economies highly dependent on imports and results in a mismatch between educational attainment and the generation of wealth and

**Figure 20.** Percentage distribution of adults with university education across economic groups



Source: ESCWA calculations.

employment. With the bulk of economic growth being generated to cater for the demands of increasingly consumer-oriented rentier States, it is heavily reliant on imports and activities that fall at the low end of the value-added chain, thereby contributing little to the expansion of local knowledge and skills. This economic growth model has significant implications on the occupational characteristics of the middle class and other economic groups.

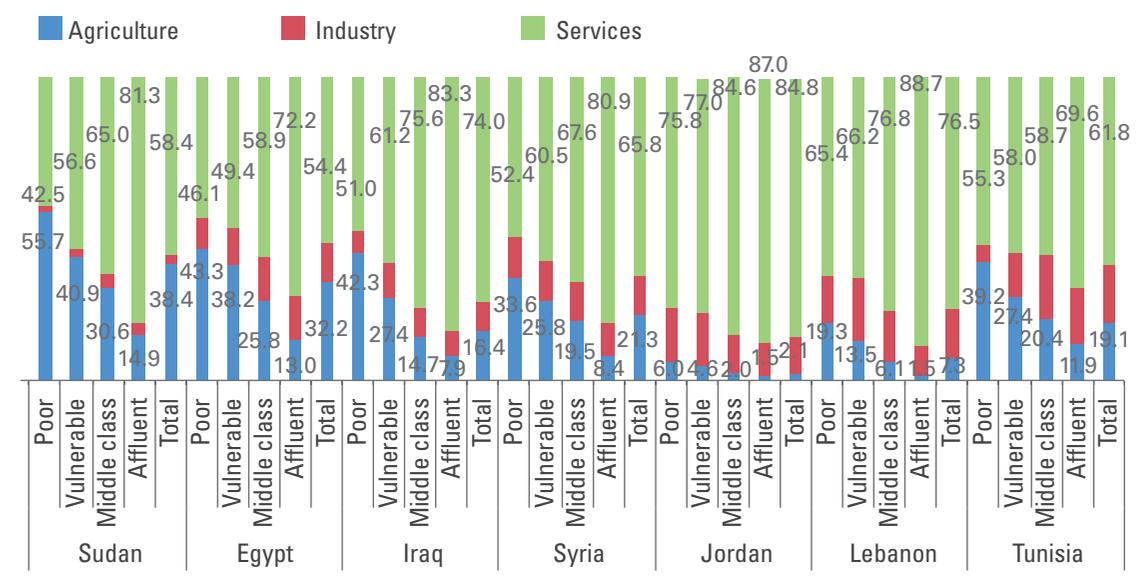
### A. Middle class employment profile in relation to other economic groups

In the seven Arab countries with comparable data on economic sectors from household expenditure surveys (year closest to 2011), the majority of middle class workers were employed in the service sector. This concentration was most evident in middle-income and upper middle-income countries. In Jordan, for example, 85 per

cent of the middle class was employed in the service sector. The middle class workforces in Egypt and Tunisia, however, showed more occupational diversification in 2011. Around 20 per cent of Tunisian middle class workers were employed in agriculture, another 21 per cent in industry and the remaining 59 per cent in services (figure 21). Similarly, in Egypt, 26 per cent of middle class workers were employed in agriculture, 15 per cent in industry and the remaining 59 per cent in services. In the Sudan, the only least developed country in the sample, the majority of the middle class was also employed in the service sector.

In general, the poor hold a higher share of agricultural sector jobs than other economic classes. Mobility to the middle and affluent classes from the poor and the vulnerable classes is associated with moving from the agricultural to the service sector, rather than

**Figure 21.** Employment distribution by economic groups across main economic sectors (percentage)



**Source:** ESCWA calculations.

**Note:** Data are from latest available household expenditure surveys.

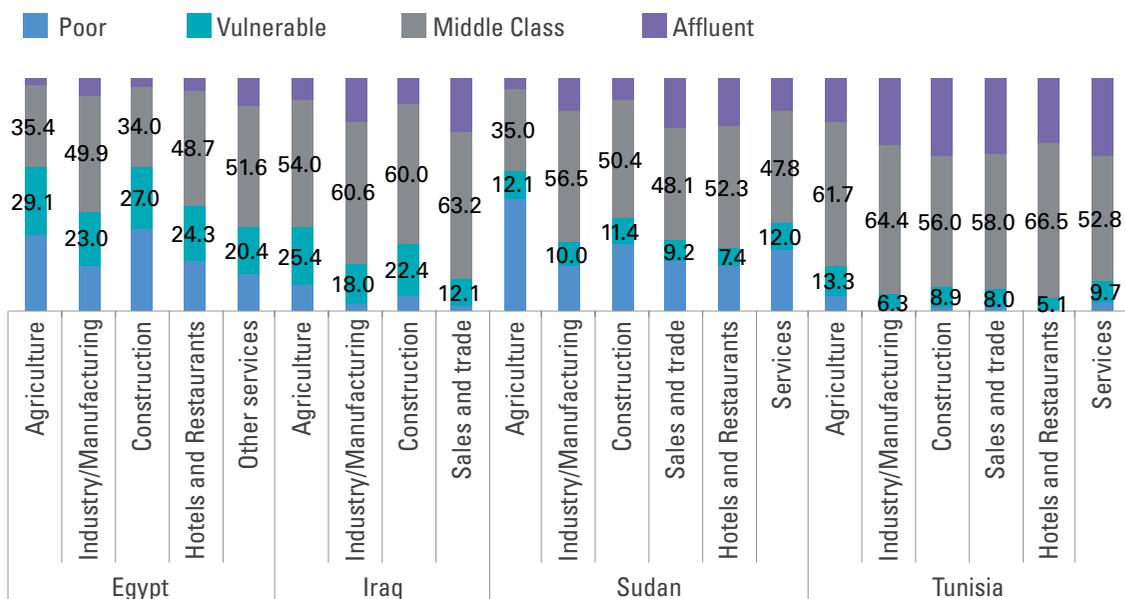
to the manufacturing or industrial sectors, which do not provide many jobs. The share of total employment in the industrial and manufacturing sectors ranged from 3 per cent in the Sudan to a maximum of 19 per cent in Tunisia.

In the Arab region, the shift from agriculture to service sector jobs is often associated with oil-led economic growth. Industrial activities are generally concentrated in the production of lower value-added petroleum-related goods, food, chemicals, rubber and plastic products, which represent nearly 60 per cent of total manufacturing output. The choice of jobs in the service sector is also at the lower end of the value chain, given that the Arab region has been unable to keep pace with the development of modern information technology and financial services that have led growth in other developing countries. Arab service sectors are driven by oil

revenues and have mainly resulted in the creation of jobs in hotels and restaurants and the transport and construction sectors, where a large share of the workforce earns low wages and the activities are informal in nature. Therefore, a considerable share of the poor population is employed in the service sector, even in least developed countries such as the Sudan.

In Egypt and the Sudan, agricultural workers often belong to the poor or vulnerable classes, with only 35 per cent of the population working in agriculture belonging to the middle class (figure 22), thus highlighting the less economically rewarding nature of this sector. In these two countries, manufacturing, hotel and restaurant, sales and trade sector jobs, and occupations in “other services”, largely belong to the middle and affluent classes.<sup>71</sup> In Iraq and Tunisia, manufacturing and service sectors mostly employ the

**Figure 22.** Employment distribution for economic groups by economic sector (percentage)



Source: ESCWA calculations.

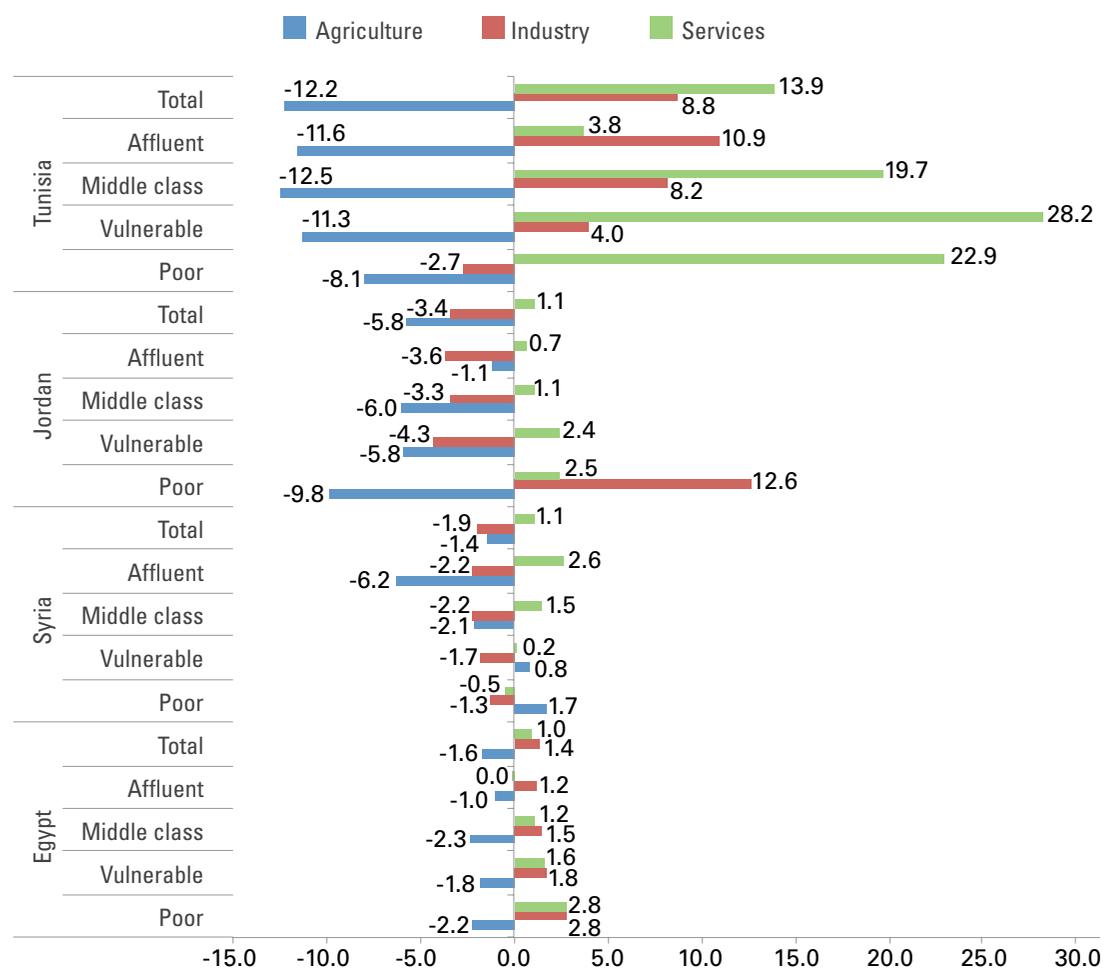
middle and affluent classes; the poor or the vulnerable classes represent an insignificant share. In these two countries, a large share of people engaged in agriculture also belongs to the middle class (61.7 per cent in Tunisia and 54 per cent in Iraq).

### B. Changing middle class occupations

Comparable data on occupations by economic sectors over time are only available for Egypt, Jordan, the Syrian

Arab Republic and Tunisia (figure 23). In all four countries, the middle and affluent classes are moving away from agriculture-based occupations to service sector and industrial jobs. In Jordan and the Syrian Arab Republic (pre-crisis), the middle class share of agricultural and industrial sector employment declined in favour of the service sector. In more occupationally diversified Egypt and Tunisia, however, the middle class increased their employment share in both the service and industrial

**Figure 23.** Economic group occupational changes by economic sector (percentage)



Source: ESCWA calculations.

sectors, with the highest shift from agriculture reported for Tunisia between 2005 and 2010.

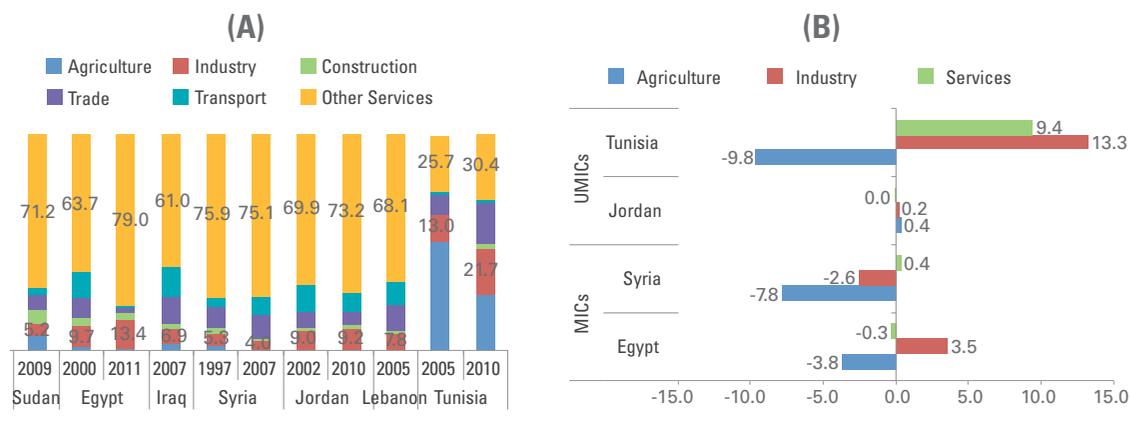
With regard to the Egyptian poor, their share of agricultural jobs declined, but increased in industrial and service sector jobs. However, most service sector jobs in Egypt are in the “other services” category, rather than in modern high value-added service sectors. This is a particularly worrisome trend since the “other service” category includes many low value-added activities that are typically associated with the informal sector. In the Syrian Arab Republic, contrary to the trend in Egypt, there was an increase in the share of agricultural jobs among the poor at the expense of industrial and service sector jobs, which declined from 1996 to 2007. There was also a sharp increase in service sector jobs for the affluent class; an annual average of 2.6 per cent; consequently, their share in agriculture and industrial sector employment declined steeply. The Tunisian poor, however, witnessed a declining share

in industrial employment as they shifted from agriculture to services in mainly low-paid informal jobs.

The story is broadly similar for the professional group. The occupational classification of professionals shows a concentration in service sector jobs (figure 24 A). Within the service sector, most are employed within the “other services” category. Tunisia, however, shows greater diversification, with nearly half of professionals employed in agriculture and industry, while the other half is employed in the service sector, mainly in trade or in the “other service” category. In line with this report’s middle class employment and education profile, in 2010, the share of industrial professionals was almost 22 per cent in Tunisia, compared to 13.4 per cent in Egypt. All other countries show low numbers of industrial professionals.

There has been an increase in industrial jobs for Tunisian and Egyptian professionals over the last decade, at an average of 13.3

**Figure 24.** Professional distribution across economic sectors (A) and annual percentage change over time (B)



**Source:** ESCWA calculations.

**Note:** Services in figure 26 B include construction, trade, transport and other services.

per cent and 3.5 per cent, respectively. Tunisia also witnessed an increase in overall service sector professionals at an average of 9.4 per cent, which slightly declined in Egypt (figure 24 B). A closer look at the service sector shows a sharp decline in the share of jobs in the trade, transport and construction sectors during that period, while the share of the “other service” category increased in Egypt. Similarly, in Jordan, the share of jobs for the professional class in “other services” increased sharply against a decline in the share of jobs in trade, construction and transport. This pattern of increasing jobs in the “other service” category in Egypt and Jordan indicates a growing informalization of professional occupations. This might not be the case for Tunisia, however, which experienced a significant growth in trade professionals within the service sector.

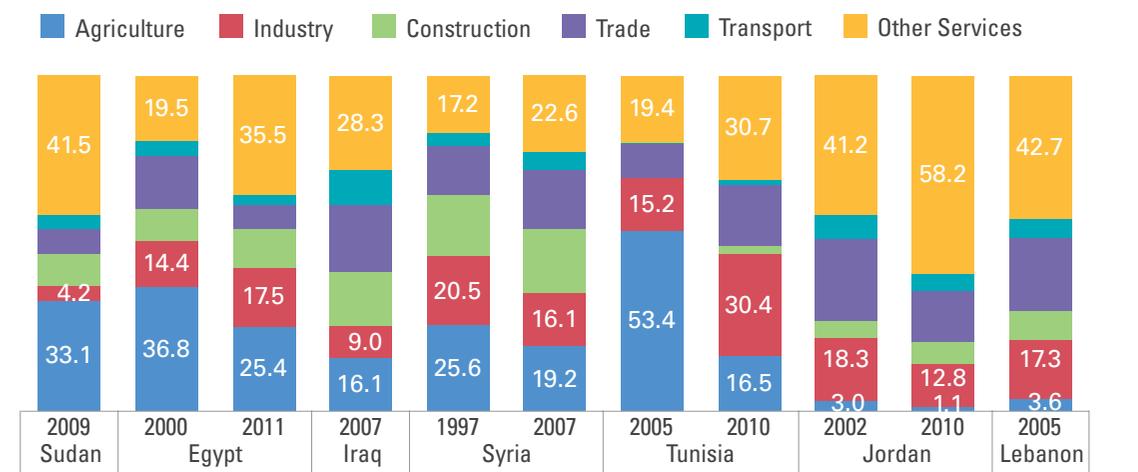
### C. Job prospects are dim for middle class youth and women

Young people fall under the population group aged between 15 and 24. Their

economic opportunities are more diversified than those of the overall middle class population in Arab countries. Currently, young people are employed in the non-agricultural sector, but a significant number of them are absorbed in “other services” (figure 25). For example, 35.5 per cent of youth occupations in Egypt in 2011 were in “other services”; 22.6 per cent in Syria in 2007, around 58 per cent in Jordan in 2010 and 30.7 per cent in Tunisia in 2010.

The structure of economies across countries explains the diversity of youth occupation sectoral profiles. For example, in Egypt (2011) and the Sudan (2009), agriculture absorbed a quarter to a third of young people, but in the Syrian Arab Republic (2007) and Tunisia (2010), agriculture only absorbed between 16 to 19 per cent. The share of youth occupations in industrial jobs varied from 4.2 per cent in the Sudan (2009) to 30.4 per cent in Tunisia (2010). In Egypt (2011), Jordan (2010), Lebanon (2005) and the Syrian Arab Republic (2007), the share of young people in industrial jobs hovered at 12-18 per cent.

**Figure 25.** Youth occupations in middle class households (percentage)



Source: ESCWA calculations.

This pattern shows that countries with a more diversified economic structure have a higher share of non-agricultural jobs, compared to those with relatively greater reliance on agriculture.

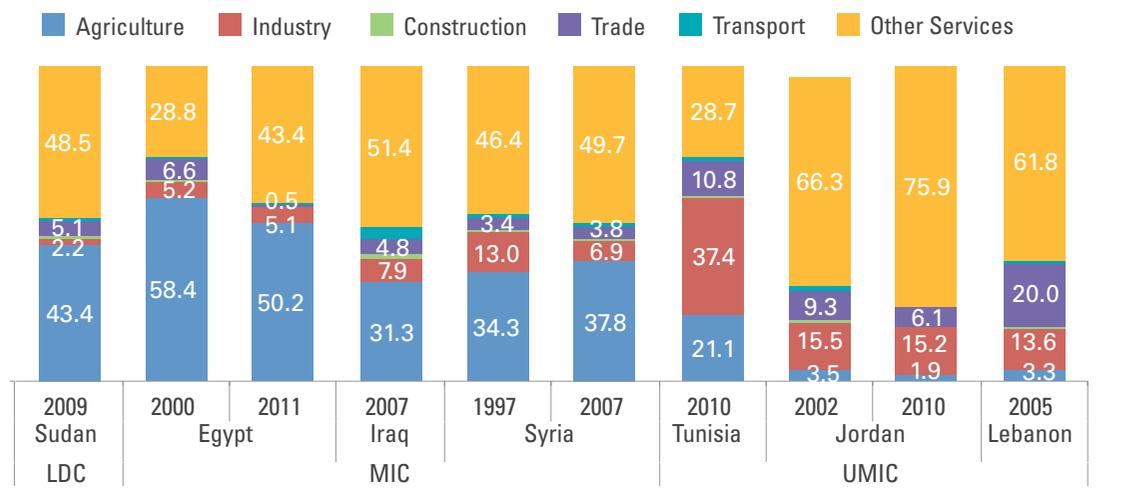
Between 2000 and 2011, there was a dramatic shift from agricultural to non-agricultural occupations among young people, a trend that is distinctly noticeable across the four countries with available data on changes in youth occupations, namely Egypt, Jordan, the Syrian Arab Republic and Tunisia (figure 25). The share of industrial jobs increased in some countries, such as in Egypt and Tunisia, although they remained low, while trade and transport sector occupations increased in the Syrian Arab Republic but not in Jordan. Importantly, construction jobs and “other services”, which are mostly low value-added in nature, increased in all four countries.

This dramatic shift from agricultural to non-agricultural occupations could be the result of education expansion in the region,

especially higher education. The greater diversification of occupations in Tunisia can be attributed to its successful shift from an agricultural to a non-agricultural economy in the post-reform era that began in the 1990s. However, a lack of industrial development and modern high value-added service sector development in most Arab countries has increased service sector jobs, mostly in the “other services” category that tend to be informal in nature. Other than employment in jobs in the low value-added sector, the main problem facing young people in the region is high unemployment, despite advancements in education.

Women’s participation in the labour market is lowest in Arab countries, at almost half the global average. Furthermore, they hold less than 20 per cent of paid jobs outside the agricultural sector, compared to a global average of 40 per cent. What are the occupations of middle class women and how are they changing? The pattern across countries, such as Egypt, Iraq, the Sudan and the Syrian Arab Republic, indicates that most women are either in agriculture-based

**Figure 26.** Women’s occupations in middle class households (percentage)



Source: ESCWA calculations.

occupations or in “other services” within the service sector. In Jordan (2010) and Lebanon (2005), 60-76 per cent of employed women held jobs in “other services”. Only in Tunisia (2010) was there a reasonably large share of women in jobs in the industrial, trade and transport sectors (figure 26). It is therefore reasonable to conclude that women in the Arab region, barring specific countries, are engaged in jobs that are largely informal in nature.

As figure 26 shows, in Tunisia, 37.4 per cent of women worked in the industrial sector and around 12 per cent were employed in trade and transport in 2010. In Jordan (2010) and Lebanon (2005), around 15 per cent of women held industrial jobs and 6-20 per cent were employed in trade and transport. In other countries in the sample, industry and trade occupations are a marginal share of total occupations. Therefore, despite significant advancements in higher education for both boys and girls in many Arab countries, women are still mainly concentrated in low value-added activities.

The trend in women’s occupations in Egypt, Jordan and the Syrian Arab Republic, for which information is available at two points in time, indicates a mixed picture. There has been a slow shift from agricultural to non-agricultural jobs in Egypt and Jordan. In Egypt, women’s share in agricultural jobs dropped from 58.4 per cent to 50.2 per cent between 2000 and 2011. In Jordan, their share of agricultural jobs was low in 2002 but declined further. In the Syrian Arab Republic, the share of women workers in agriculture increased from 34.3 per cent to 37.8 per cent between 1997 and 2007. These patterns therefore do not offer any conclusive evidence on the transfer of women from agricultural to non-agricultural jobs. Furthermore, women’s concentration in low-value added jobs, either in agriculture or in “other services”

within the non-agricultural sectors, raises concerns over their well-being and implies the existence of a declining opportunity structure facing women in the labour market, as argued by Assaad<sup>72</sup> when analysing the Egyptian labour market.

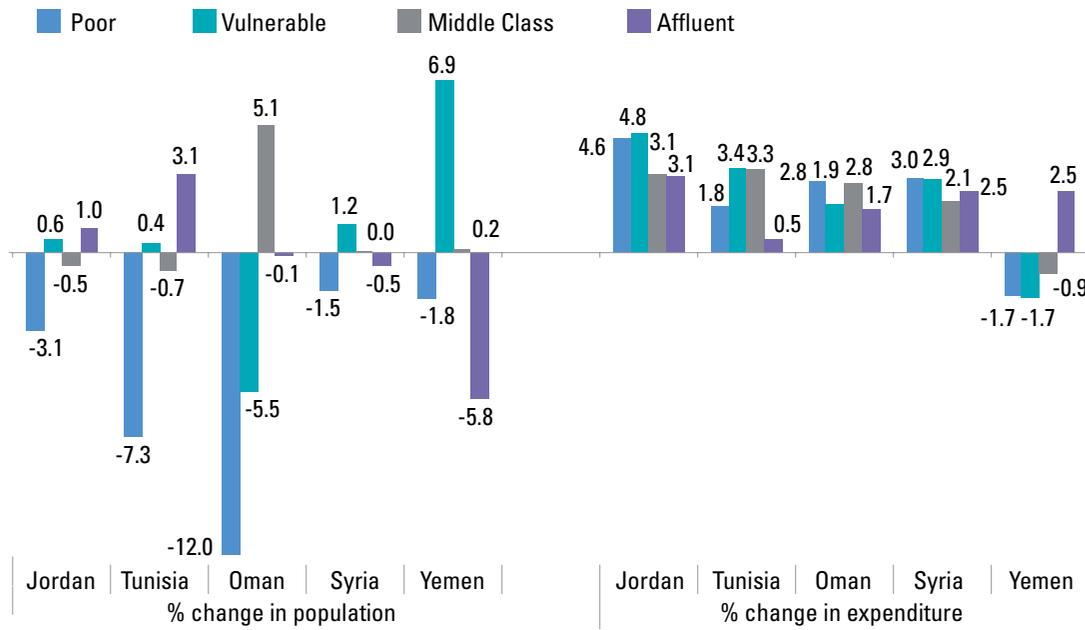
### III. Economic well-being

#### A. Growth in real expenditure

Per capita expenditure in real terms grew across all Arab countries, except Yemen, in the 2000s. In Jordan, Oman, the Syrian Arab Republic and Tunisia, real expenditure per capita growth was positive for all population classes, including the poor, vulnerable, middle and affluent classes (figure 27). Correspondingly, poverty declined in these countries over the same time period, as shown by the percentage change in the poor population (figure 27). The size of the middle class slightly declined in Jordan and Tunisia but their real expenditure per capita grew at a rate equal to or higher than that of the affluent. As a result, there was an increase in affluent class size in both countries. Oman witnessed a large increase in middle class size and a huge decline in the numbers of the poor, associated with the sharp increase in real per capita expenditure for both population groups. However, the decline in real expenditure for most population groups in Yemen increased the size of the vulnerable class, although poverty declined over the same period.

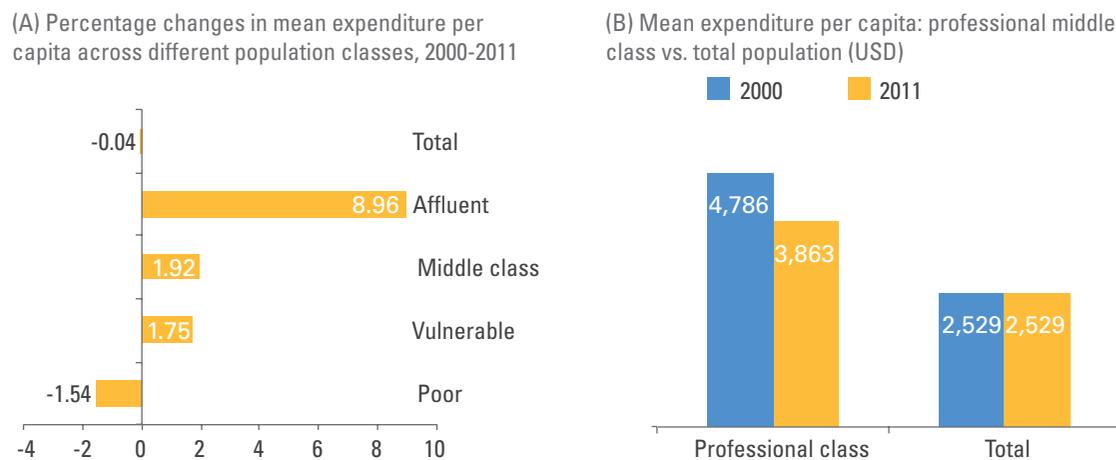
Egypt, on the other hand, was one of the few countries in the world that witnessed an increase in poverty over the period 2000-2011, despite experiencing an average annual per capita GDP growth rate of 2 per cent. As argued by Abu-Ismaïl and Sarangi,<sup>73</sup> the shrinking middle class base was mainly the result of a rise in the share of the poor and vulnerable populations, as a consequence of anti-poor and anti-middle class economic growth processes.

**Figure 27.** Annual percentage change (compounded) in population classes and average per capita consumption expenditure in 2005 prices



Source: Sarangi and others, 2014.

**Figure 28.** Expenditure trends confirm disparities in Egypt, 2000-2011



Source: Abu-Ismael and Sarangi, 2013.

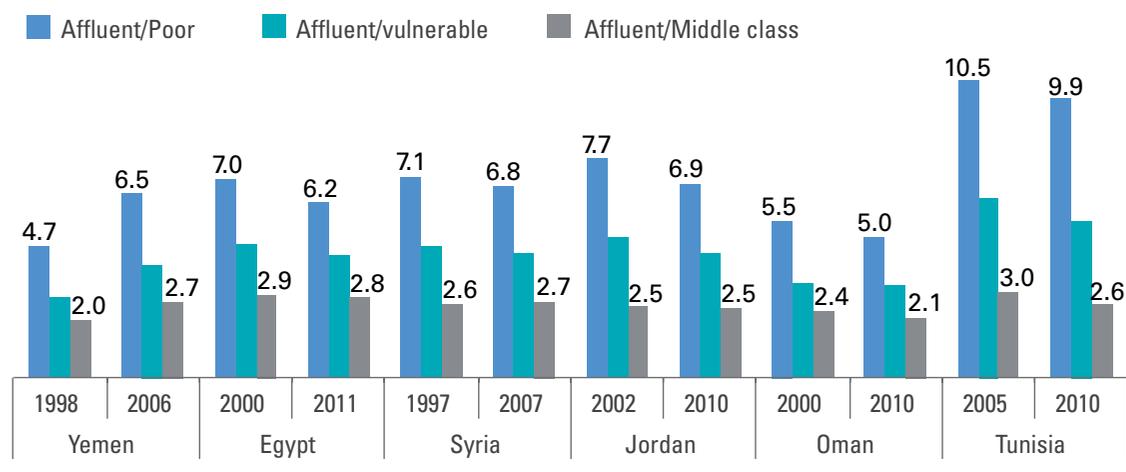
Note: Real expenditure per capita (in 2005 USD prices) is based on the deflators derived from the differences in thresholds over time for each class. Assuming no change in the basket of goods over time for each group of consumers, the differences in thresholds over time then imply the price level differentials across surveys, as obtained from the survey responses. Calculations are based on Egyptian Household Income, Expenditure and Consumption Survey (HIECS) for various years.

Therefore, in 2011, 49 per cent of the Egyptian population was either poor or vulnerable. Between 2000 and 2011, poor Egyptian households witnessed a decline in average real expenditure per capita by 1.5 per cent, compared to an 8.9 per cent increase for the affluent. Vulnerable and middle class expenditure per capita increased by 1.75 per cent and 1.92 per cent, respectively (figure 28 A). These results indicate the growing disparity between population classes in Egypt. Surprisingly, the professional group witnessed a decline of 19 per cent in average mean real expenditure per capita, compared to a negligible decline in that of the total population (figure 28 B). As most professionals are salaried formal sector employees, this finding may be explained, to some extent, by a declining trend of real worker earnings, especially after 2008. For example, average median real earnings in Egypt declined by a significant 12.3 per cent between 2008 and 2009 among workers aged 25 to 60.<sup>74</sup>

## B. Inequalities are worse than expected

The conventional wisdom is that income inequality, measured in terms of the Gini index, is relatively moderate in the Arab region and has changed little over the last two decades. A recent study of Egyptian household survey data by Hlasney and Verme<sup>75</sup> suggested low and stagnant inequality in Egypt, and related the reasons behind the Egyptian uprisings to perceptions of inequality rather than actual experienced inequality. However, this interpretation is not consistent with realities on the ground in Arab countries; disparity in income and wealth across classes is expected to have increased significantly over time, given the vivid evidence of wealth concentration in the hands of the few elites with good connections to the State. Moreover, the large and growing divergence between the official growth narrative and the one actually experienced by households also substantiates this hypothesis.

**Figure 29.** Ratio between mean per capita expenditure of the affluent and other population classes



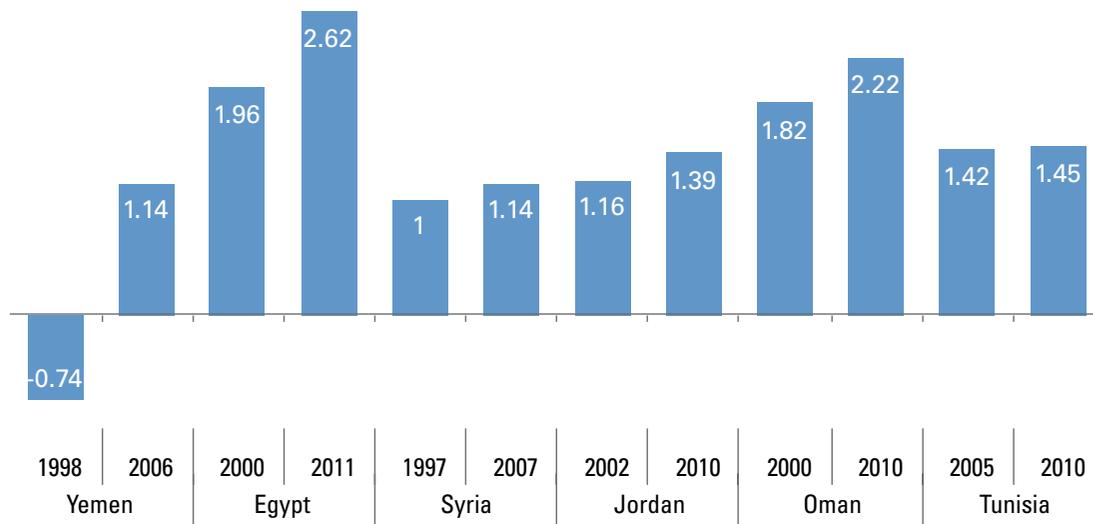
Source: Sarangi and others, 2014.

This report examined the disparity between population groups in various ways. Firstly, it measured disparity as the ratio between the average expenditure per capita of the affluent in relation to other population groups in the 2000s. The disparity between the affluent and the middle class hovered in the range of 2-3 (figure 29). The ratio of the average expenditure of the affluent and the poor was the highest again in Tunisia; the affluent have 10 times higher per capita expenditure than the poor. These inequality levels have barely changed over the years. Such trends might partly explain the recent uprisings in Tunisia and other Arab countries, as people feel trapped between their capabilities and capped opportunities.

Secondly, this report examined the difference between national accounts household final expenditure per capita and survey-based household consumption expenditure per

capita, and their trends over time (figure 30). For all countries in the sample, the results show high levels of disparity between the two. For example, in Egypt (2011), the national household final expenditure per capita was 2.6 times higher than that reported by the survey-based household consumption expenditure per capita. Similarly high levels of divergence were noted in Jordan, Oman and Tunisia. Furthermore, the gap between the two measures increased over time for all countries. Empirical exercises from several countries, as well as conceptual analyses, provide a basis to argue that the widening divergence between the two measures indicates increased inequality over time,<sup>76</sup> even when taking into account that household expenditure surveys might miss some consumption items and that national household final expenditure includes some components that household consumption surveys do not cover.

**Figure 30.** Ratio between per capita expenditure from national household final expenditure and survey-based household expenditure per capita



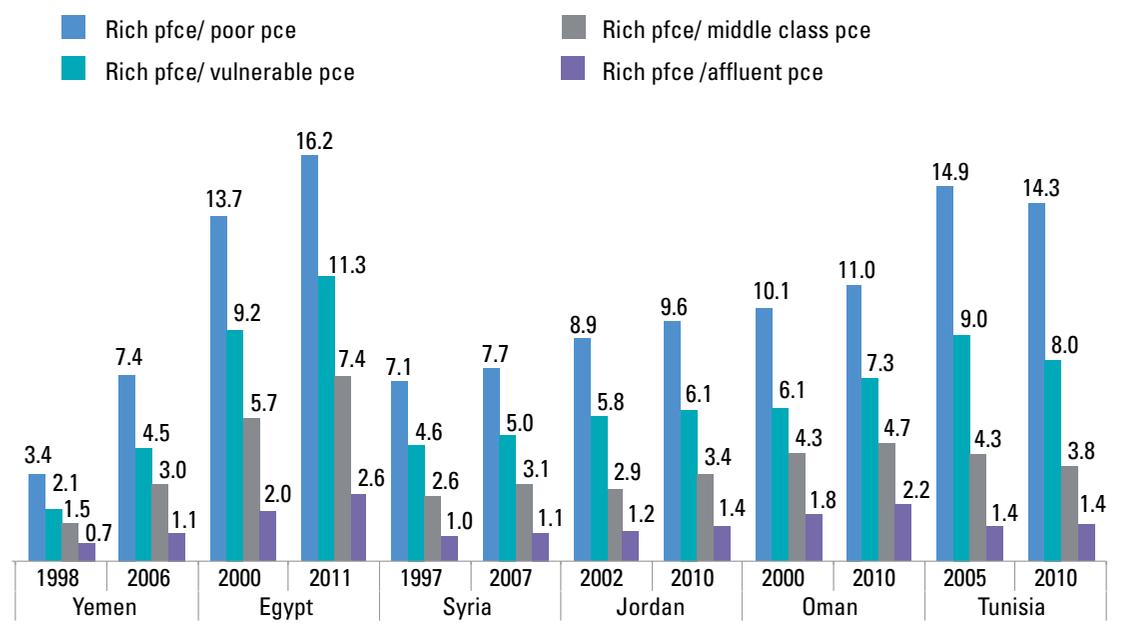
Source: Sarangi and others, 2014.

Extending this argument, this report estimated the disparity between the average expenditure of the “rich” and that of the four population classes, on the basis of survey-based household consumption expenditure. This report combines information from household surveys and national accounts to estimate the mean consumption of the “rich”, which is often not captured by household expenditure surveys. To calculate the average expenditure of the “rich”, the underlying assumption was that the distribution of the mean of household final expenditure per capita across economic classes was the same as that of household survey-based consumption expenditure per capita. Conceptually, the survey-based consumption mean observed a lower

variation across the distribution than that of final household expenditure from national accounts. Therefore, assuming the same variation of mean in both distributions, the average expenditure of the “rich” tends to be lower than that of national accounts.

The ratio of per capita expenditure of the “rich” to per capita expenditure of other population classes from survey-based consumption data is presented in figure 31. The results are striking. For example, in 2011, the “rich” in Egypt had a per capita expenditure over 16 times higher than the poor, 11 times higher than the vulnerable class, 7 times higher than the middle class and 2.5 times higher than the affluent class. A similar high level of divergence was also noted in Tunisia in 2010. The ratio between

**Figure 31.** The expenditures of the rich are increasing at far faster rates than for other groups (percentage)



**Source:** Sarangi and others, 2014.

**Note:** Pfce stands for per capita final consumption expenditure from national accounts, and pce for per capita expenditure.

average expenditure of the “rich” and the middle class ranged from 3 in Jordan (2010), the Syrian Arab Republic (2007) and Yemen (2006), to 7.4 in Egypt (2011).

The ratio between average expenditure of the “rich” and other consumption-based population classes increased significantly in all countries, except Tunisia. For example, in Yemen, the ratio of average expenditure of the “rich” to average expenditure of the middle class doubled between 1998 and 2006; in Egypt, the ratio increased from 5.7 to 7.4 over the period 2000-2011; in Jordan, it increased from 2.9 to 3.4 from 2000 to 2010 and so on. In Tunisia, that ratio is relatively stable at around 4, from 2005 to 2010.

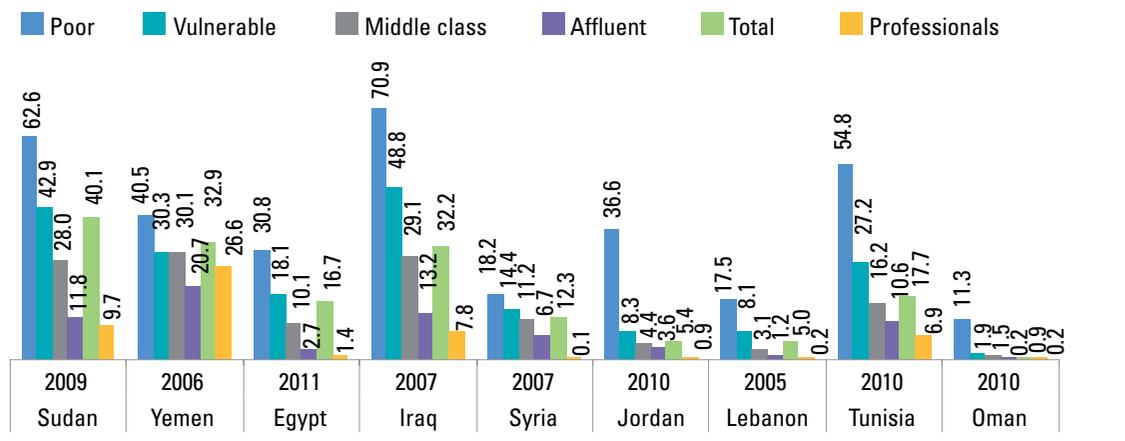
This disparity analysis helps strengthen the argument that inequality in Arab countries widened in the 2000s. In other words, the share of national income commanded by the middle class, the poor and the vulnerable declined over time. Ali<sup>77</sup> argued that inequality trends have been increasing in the Arab region since the 1990s, based

on his estimations using the quintile observations for selected Arab countries, with the Gini coefficient increasing at an annual rate of 1 per cent. The notion of low and stagnant inequality in the region, derived from survey-based expenditures, is therefore questionable, given that availability and access to survey data; the quality of data collection and consistency across countries; and systematic research on poverty and inequality have been very limited in the region.<sup>78</sup> Diwan<sup>79</sup> argued that the rise in inequality and the relatively low performance of Arab economies in terms of job creation could be related to the type of State-business relations that have developed over time in the region.

### C. Human deprivation index

This report developed a human deprivation index, measuring deprivation from a basic living standard using a set of education and living standard indicators. The indexing followed the same methodology as that of the global multi-dimensional poverty index, but adjusted to available indicators from the

**Figure 32.** Population class deprivation as measured by the human deprivation index (percentage)



Source: ESCWA calculations.

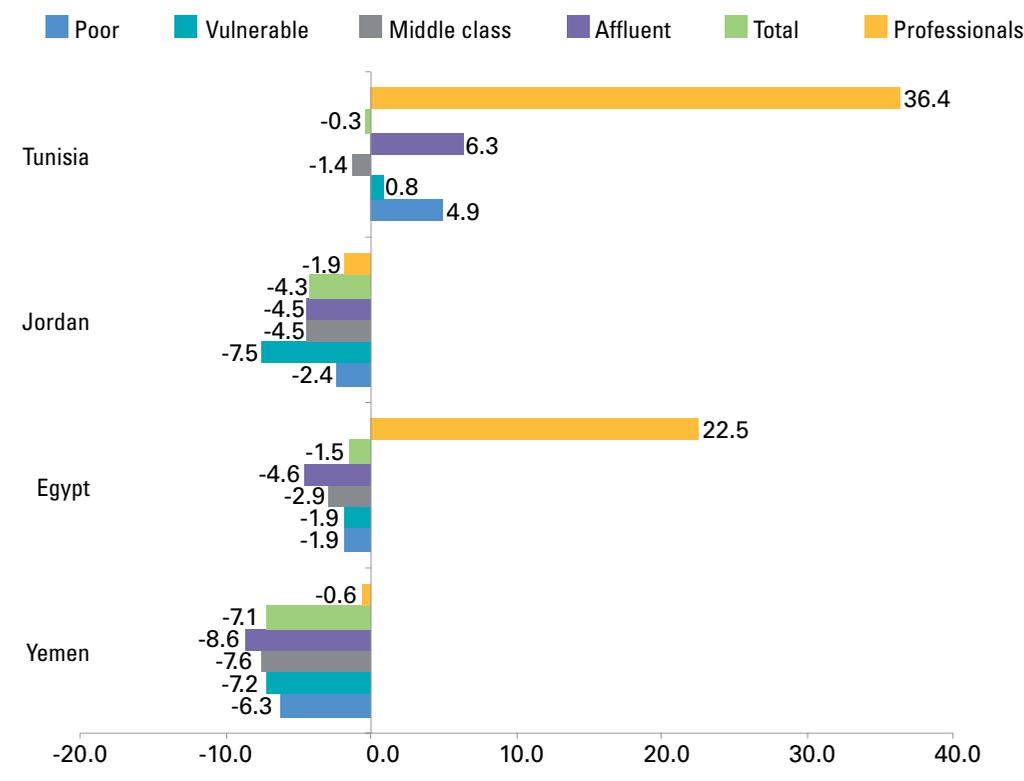
household expenditure surveys. For example, lack of available data on health indicators from the household expenditure surveys required dropping the health dimension (box 3). The aim is to understand the incidence of deprivation from a basic living standard across economic classes in any society.

The results are striking. The incidence of deprivation from a basic living standard among the expenditure-based poor class is as high as 63 per cent in the Sudan, 71 per cent in Iraq and 55 per cent in Tunisia. In Egypt and Jordan, about a third of the poor lack a basic living standard (figure 32). The human deprivation index indicates that the economically poor in Iraq, the Sudan and Tunisia, irrespective of the level of country

development, face high levels of multiple deprivations.

The incidence of deprivation is highest among the poor, followed by the vulnerable, then the middle class across countries. In Egypt, the Syrian Arab Republic and Tunisia, around 10-16 per cent of the middle class faces deprivation in living standards; in Iraq, the Sudan and Yemen, the share rises to around 30 per cent. Among professionals in Yemen, over a quarter are deprived of a basic living standard. Iraq, the Sudan and Tunisia also show a high incidence of deprivation among professionals of around 7-10 per cent. The human deprivation index trend for the overall population shows a declining incidence of deprivation in all four

**Figure 33.** Annual average percentage change in incidence of deprivation



Source: ESCWA calculations.

### Box 3. How the human deprivation index was calculated

The human deprivation index was calculated using the same methodology employed in the Global Human Development Report.\* However, lack of available data on health indicators in the consumption expenditure surveys required dropping this dimension from the index calculation. Therefore, the dimensions were reduced to two: education and living standards, each with equal weights of 1/2.

The indicators, thresholds and weights of each of the two dimensions are as follows:

The education dimension has two indicators: having no household member who has completed five years of schooling; and having at least one school-age child (up to grade 8) who is not attending school. Each indicator is assigned a weight of 1/4.

The living standard dimension has 6 indicators: not having electricity; not having access to clean drinking water; not having access to adequate sanitation; using “dirty” cooking fuel (dung, wood or charcoal); having a home with a dirt floor; and not owning a car, truck or similar motorized vehicle while owning, at most, one of the following assets: bicycle, motorcycle, radio, refrigerator, telephone or television. Each indicator is assigned a weight of 1/12.

Persons are assigned a deprivation score according to their deprivations in the component indicators. The deprivation score of each person is calculated by taking a weighted sum of the deprivations experienced, so that the deprivation score for each person lies between 0 and 1. The score increases as the number of deprivations increases and reaches its maximum of 1, meaning that the person is deprived in all eight indicators. A person who is not deprived in any indicator receives a score of 0.

$$c_i = w_1 I_{11} + w_2 I_{12} + \dots + w_d I_{1d}$$

where  $I_i = 1$  if the household is deprived in indicator  $i$  and  $I_i = 0$  otherwise, and where  $w_i$  is the weight attached to indicator  $i$  with

$$\sum_{i=1}^d w_i = 1$$

To identify the poor using the human deprivation index, the deprivation scores for each household are summed to obtain the household deprivation score,  $c$ . A cut-off of 33.3 per cent, which is the equivalent of one third of the weighted indicators, is used to distinguish between the poor and non-poor. If  $c$  is 33.3 per cent or greater, that household (and everyone in it) is poor by the human deprivation index.

The headcount ratio,  $H$ , is the proportion of the population that is poor by the human deprivation index.  $H = q/n$ , where  $q$  is the number of people who are poor, and  $n$  is the total population.

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\* Alkire and others, 2011.

countries (figure 33). Except Egypt and Tunisia, the trend is consistent across all expenditure-based population classes. Interestingly, deprivation among the poor, vulnerable and affluent classes increased in Tunisia between 2005 and 2010. More importantly, contrary to the trend in other countries, Egypt and Tunisia had an increasing incidence of deprivation among professionals in the 2000s of 22.5 per cent and 36.4 per cent, respectively. However, these high rates can be attributed to low base levels. In Egypt, 1.4 per cent of professionals were deprived of a basic living standard in 2011, increasing from 0.4 per cent in 2000. Similarly, the corresponding figure for Tunisia was 6.9 per cent in 2010, up from 2.4 per cent in 2005.

#### IV. Conclusion

The results in Part Two of the present report provide important findings that clarify middle class characteristics, which can facilitate and generate economic and social policy discussions. In terms of education, the number of individuals with secondary or higher education qualifications tends to increase as the population gets more affluent. Therefore, the affluent class encompasses the highest percentage of the population with secondary or higher education qualifications, followed by the middle class. However, a difference in patterns was noted across country groups. The majority of university educated individuals falls within the middle class in Egypt and the Syrian Arab Republic, while the majority of university graduates in Jordan, Oman and Tunisia belongs to the affluent group.

In terms of occupation, the poor depend the most on agricultural sector jobs compared to other economic classes, while the middle and affluent classes prefer service sector jobs, given that they have higher levels of education. However, the lack of development of industrial and modern high value-added service sectors has led to an increase in service sector jobs that are mostly in the “other services” category, even among professionals, which tend

to be low value-added or informal in nature. Furthermore, the concentration of women in low value-added jobs, either in agriculture or in “other services”, indicates a declining opportunity structure facing women in the labour market.

Growth, especially in per capita expenditure, has not proportionately benefited the poor and middle classes in some countries, such as Egypt. Moreover, conflict and economic recession have severely affected the poor and the middle class in the Syrian Arab Republic and Yemen. In other countries, such as Tunisia, real expenditure has grown but this growth is highly disproportionate across population groups. Furthermore, between 2000 and 2010, inequality between the “rich”, calculated using national final household expenditure, and other population classes, based on household consumption expenditure, increased in Arab countries. This implies that the share of national income commanded by the middle class, the poor and the vulnerable declined over time.

Finally, the incidence of deprivation, as measured by the human deprivation index, declined for the Arab population as a whole over time, but increased sharply among professionals in Egypt and Tunisia. These trends may partly explain why middle class professionals were a visible component of the uprisings in both countries.

A close-up photograph of a hand in a white glove moving a small black chess piece on a dark board. The hand is positioned on the left side of the frame, with the index finger and thumb gripping the piece. The chessboard is dark and reflective, showing the pieces and the hand. In the background, several other black chess pieces are visible, including a king, a queen, and a pawn, all slightly out of focus. The lighting is dramatic, highlighting the texture of the glove and the smooth surface of the chess pieces. The overall color palette is dominated by dark blues and blacks, with the white glove providing a strong contrast.

The authoritarian bargain began to collapse in the 1990s, following the onset of economic reforms that affected the middle class the most. Development policy was no longer geared towards economic progress, but rather towards securing short-term political support for existing regimes. Flourishing patronage networks favoured some groups over others, undercutting social cohesion and encouraging significant disparities.

## Part Three

# Social progress without economic empowerment

The stylized facts in the previous two parts of the present report present a simple analysis. On the one hand, data on education and human deprivation show significant improvements in middle class capabilities, confirming that Arab countries have achieved impressive human development gains. This was also affirmed, albeit over a longer period from 1970 to 2010, by the global Human Development Report, in which five Arab countries were among the top ten global achievers, headed by Oman and Tunisia.<sup>80</sup>

On the other hand, social progress indicators have belied the quality of services provided by Governments, particularly in recent years. This report argues that real inequality is much higher in the region than reported by the Gini coefficients and has risen over the past decade. However, some countries, notably where severe uprisings were avoided, such as Jordan and Oman, are believed to be on a more sustainable pathway to social and economic development: the middle and affluent classes in these countries have expanded and human capabilities have improved. In a sense, therefore, there are two Arab middle class economic storylines: Egypt, the Syrian Arab Republic and Yemen form one narrative; and Jordan, Oman and Tunisia offer another. On the social development front, however, quantitative achievements in health, education and living conditions were observed for both groups, although to varying degrees.

These socioeconomic dynamics are undoubtedly rooted in the social contract put in place by the regimes that came to power after independence in the 1950s and 1960s, which used social policies to gain legitimacy and increase nation-building efforts. The result was the creation of a middle class whose function in the developmental State model of the 1960s, particularly in Egypt, the Syrian Arab Republic and Tunisia, was to transform their nations from backward rural economies to industrial economies. This role, however, was altered dramatically with changes in modes of production following the regional oil boom and the Arab region's increasing reliance on oil-related revenues and transfers. Nevertheless, in both Arab middle class storylines, the middle class remained a State-dependent socioeconomic entity. However, this does not imply that the Arab middle class originated in the post-independence era. Even as early as the turn of the twentieth century, a diversified middle class existed in metropolitan urban centres, such as Cairo, Beirut and Damascus, in terms of its activities, given that the notion of class was not yet firmly embedded in the socioeconomic fabric of Arab societies; the concept of class overlapped with other more established notions of kinship and ethnicity. In the tribal areas, for example, kinship formed the basis of socioeconomic stratification.<sup>81</sup>

Understanding the political economy of the development of the Arab middle class in this complex historical context is

crucial to grasping how and why it became disenfranchised with regard to State policies long before 2000 (the base year for this report's empirical analysis in parts one and two). However, such a historical assessment is an exhaustive exercise, which has been the subject of extensive socio-historical analysis.<sup>82</sup>

## I. A fading social contract

When most Arab countries became independent in the 1960s, development was driven by visionary strategies aimed at effecting structural transformation, with Governments assigned a central role in planning and programming for such a process. Thus, the "government of a developmental State was to promote capital accumulation, utilize reserves of surplus labour, undertake policies of deliberate industrialization, relax the foreign exchange constraint through import substitution and coordinate the allocation of resources through programming and planning".<sup>83</sup>

This economic policy orientation emerged because there was very little industry and widespread illiteracy and poverty in the Arab region. After assuming power, some of the new regimes also made efforts to redistribute wealth (particularly in Egypt and the Syrian Arab Republic) and invested heavily in education; a major avenue for collective upward social mobility.<sup>84</sup> This was reinforced by State policies of guaranteed employment for all. The ultimate result of such policies was twofold: they expanded the size of the middle class and diversified the social roots of the economic middle class.

The middle class thus originated with the establishment of the modern State and was the result of an externally funded process, whether as part of an overt colonial system (for example, the British and French mandates) or following formal independence and alliance with other

political blocks, and the external support implied by that process – a clear example is how the British controlled the Egyptian monarchy, undermined traditional feudal structures and nurtured a middle class of public officials, small farmers and merchants (box 4). The ranks of the middle class were thus expanded throughout the Arab region. This was accompanied by the deliberate growth of the public sector and the absorption of most university and secondary school graduates into public service.

By the 1970s, with the advent of oil-led growth, there was a dramatic shift in the mode of production. Increasingly, rentier economies in most Arab countries did not facilitate the growth of an entrepreneurial capitalist class of small and medium productive enterprises. Rather, even those in the private sector derived their incomes and privileges by virtue of political connections. This explains the lukewarm support the affluent and upper middle classes had for the revolutionary forces in most Arab countries before 2010.

Development policies in the Arab region were therefore used as political tools and benefits were offered in the form of social contracts to silence critics,<sup>85</sup> rather than as part of a broader plan to build productive economies. These contracts guaranteed citizens certain services and privileges in exchange for their loyalty. The terms and design of contracts varied from country to country but were, for the most part, as highlighted by the World Bank,<sup>86</sup> interventionist in nature, with a preference for:

- a. The State managing national economies, instead of markets;
- b. The adoption of import-substitution industrialization and the protection of local markets from global competition;
- c. A reliance on State planning in determining economic priorities and the provision of welfare and social services;

- d. The political arena as an expression of organic unity rather than a site of political contest.

As noted earlier, these policy preferences were not implemented in a historical vacuum. They are reflections of the ideology, economic capacity, social and political struggles and international environment of the time in which they were created. There was rampant poverty in most Arab countries during the 1940s, inequality (stemming from skewed land distribution) was high and the international economic order collapsed during the Great Depression that began in 1929.<sup>87</sup> A weak private sector led international institutions to recommend a heavy State presence in economic activities and single parties emerged in many countries to consolidate power.<sup>88</sup> Reflecting the times, development policies, even in advanced economies, focused on citizens' rights and full employment, as demanded by the working class.

As of the 1960s, Arab rulers were attempting to determine the future of their newly independent countries. Post-independence regimes in the Arab region focused on the following two points: nation-building and legitimacy of rule. National development policies became a means to achieving both. The European social welfare system was popular among nationalist movements within the region and rulers considered it an attractive option.<sup>89</sup> Subsidies were used to buy the support of the working and middle classes. Providing these services was, and remains, integral to the legitimacy of Arab regimes. Despite various problems and setbacks, the traditional social contract delivered results. According to the World Bank, "the social payoffs from these policies have been enormous, with dramatic reductions in mortality and increases in

life expectancy, school enrolment rates, and literacy levels."<sup>90</sup> Large segments of the population benefited from redistributive mechanisms and the middle class emerged as the prominent beneficiary, particularly benefitting from public employment. The most recent Arab Millennium Development Goals report,<sup>91</sup> which monitored Arab development progress from 1990 to 2012, also confirmed this hypothesis, stating that significant improvements in the health and education profiles of most Arab countries indicated that much progress had been achieved for the average family. However, acknowledging that the middle class was the main beneficiary of Government largesse in the Arab region raises questions as to why it participated in the uprisings in 2010 and 2011.

For a variety of reasons (declining oil prices, shrinking demand for migrant labour and reduced remittance flows), fiscal space for development expenditure became increasingly constrained in resource-poor and labour-abundant countries, such as Egypt, Jordan, Lebanon, Morocco, the Syrian Arab Republic and Yemen. By the early 1990s, it was clear that the traditional social contract was becoming untenable. Across the region, its foundations were being shaken by reductions in public expenditure and employment, the privatization of State-owned enterprises and the liberalization of trade.

The impact of these policies on macroeconomic performance and human development indicators in Arab countries in the 1990s and 2000s was extensively reviewed in the Arab Development Challenges reports<sup>92</sup> and in other UNDP-led reports on macroeconomics and poverty in the Sudan, the Syrian Arab Republic and Yemen.<sup>93</sup> These reports and other publications revealed that most Arab countries did not witness growth during or

#### **Box 4. Formation of the Egyptian middle class**

In contrast to most other Arab countries, even as early as the turn of the twentieth century, Egypt had a diversified middle class (including non-Egyptians who migrated from Europe to escape war). The origins of this middle class date back to Mohamed Ali, the founder of modern Egypt and governor of Egypt and the Sudan under the Ottoman Empire, who confiscated all land and effectively created a new class of land lords.<sup>a/</sup>

A fiscal crisis, after the death of Mohammad Ali, led to several decrees that gradually established partial private property of land. Village sheiks (later known as omdas) benefited partly from these legal changes as did other Egyptians who were sent on educational missions to France. A rural middle class thus emerged over the period between 1805 and the British occupation in 1881. It was this class that supported the Urabi revolt, a nationalist uprising that began in 1879 with the aim of evicting the foreign land owning upper class.<sup>b/</sup>

When the British entered Egypt, they found a fully-fledged modern State system in operation. They occupied the top administrative positions but the running of daily affairs was in the hands of the middle and lower echelons of the Egyptian bureaucracy.<sup>c/</sup> It was the children of those lesser notables and effendis, the better educated class of society, that formed the embryo of the Egyptian twentieth century middle class.

Under the military regime, after the 1952 revolution, the upper classes were stripped of their land, but its members were able to make successful transitions to commercial and industrial enterprises.<sup>d/</sup> The confiscation and sequestration of land were political moves intended to mobilize popular support for the new regime. Furthermore, the regime took major strides in expanding education and making it free for all. In 1952, there were only three universities in Egypt but by the mid 1970s there were 16 universities, with about 500,000 students. During the 1950s and 1960s, education was a major avenue for collective upward social mobility.<sup>e/</sup> This was reinforced by State policies of guaranteed employment for all. The spread of universities into rural towns opened the door for the lower strata of the middle class to move up the educational ladder and obtain a university education. As a result of these varied social backgrounds, the middle class became increasingly diversified, both socially and ideologically.

In the 1970s, the Egyptian political economy witnessed a dramatic change in direction. In 1974, an official "open door" policy was initiated, under which Egypt gradually liberalized foreign trade, attracted more private foreign investment and became more open to modern technology. Therefore, by the mid-1970s, the State started to relieve itself from the implicit obligations of the traditional social contract, although it was not willing to relinquish its strong hold on political power or undertake necessary economic and democratic reforms.<sup>f/</sup> More importantly, these new economic policies led to the rise of a "new middle class" at the expense of the traditional "more professional" middle class and encouraged State bureaucracy members to become involved in business.

Egyptians from other classes did not capture the benefits of these new policies and therefore had to find alternative ways to supplement their income. Migration thus replaced education as the mechanism for upward social mobility.<sup>g/</sup> Inflation, meagre wages and new policies made it difficult for Governments to fulfil their commitment to hiring new university graduates. Moreover, the declining quality of university education led to a drop in the value of education. The structural adjustment and stabilization policies of the 1990s and the privatization policies that followed dealt further blows to the traditional middle class.<sup>h/</sup> The end result of these developments, as revealed by those who took to Tahrir Square during the Egyptian uprisings, was an increasing heterogeneity of the Egyptian middle class, both in its economic base and ideologies.

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**Notes:** a/ Ayubi, 1995.

b/ Essa, 1972.

c/ Al Beshry, 1974.

d/ Richards and Waterbury, 1990.

e/ Reid, 2002.

f/ Mohieddin, 2011.

g/ Ayubi, 1995.

h/ Mohieddin, 2011.

after those reform years. On the contrary, such policies had a negative impact on countries' social dimension, especially on the quality of public service delivery, without any commensurate improvement in productivity.

Faced with a discontented population, it became clear that policies aimed at strengthening economic growth would cause social unrest and create political instability. As a result, certain difficult reforms were postponed and the public sector remained large to avoid laying off a significant number of workers. Additional cosmetic reforms were undertaken in the 1980s and 1990s to further liberalize trade, which only benefited a tiny minority of the population. These policies resulted in patched economic systems in most Arab countries; they were neither free market nor State-led. Only Tunisia completely implemented a transition to export-driven growth.<sup>94</sup> Countries such as Algeria, Egypt and Iraq avoided a complete reform and a restructuring of their economies by using aid and oil and gas revenues to continue funding import-substitution industrialization.<sup>95</sup> Reduced import tariffs increased the volume of imports but created a trade deficit because exports did not increase at the same pace. Countries then increased their debt by borrowing to fund this deficit.

Although this brief narrative cannot summarize nearly two decades of economic policy in an economically diverse region, it does offer hints as to why the implicit social contract between the middle class and the State fractured. The following three specific aspects are crucial to understanding the disenfranchisement and eventual fury of the Arab middle class.

Firstly, a lack of broad based economic growth and decent employment

opportunities created a fear of slipping into poverty. Oil revenues supported a service-led pattern of economic development at the expense of productive sectors, rendering the Arab region the least industrialized developing region, with increasingly import-oriented and low-value added service-based economies. This, in turn, contributed little to local knowledge development, dynamic returns to scale and technological change. More importantly, the absence of dynamic industries impeded the development of highly-skilled labour forces and, therefore, had a direct bearing on the employability of the well-educated middle class. As noted by Von Arnim and others,<sup>96</sup> provided that oil revenues were sufficient, there were few incentives to invest in high productivity jobs. Consequently, real wages remained commensurate with low levels of productivity, and the incidence of poverty stagnated or increased. Periods of oil-price collapse and a strong reliance on low productivity, often informal, service sector jobs underlined this issue.

Secondly, decent social protection was only enjoyed by a few, mainly a select minority employed in the formal sectors, especially the public sector. For the majority of middle class families, poor and ineffective social protection mechanisms, such as low pension schemes, were daunting. Furthermore, with the deteriorating quality of public health and education services, many middle class families were experiencing rising out-of-pocket expenditures on health and education, adding pressure to their already fragile economic status.

Thirdly, economic reforms did not lead to sustainable or equitable gains. By failing to distinguish between "markets" and "unfettered markets"; denationalization, privatization and apparent deregulation

led to rent seeking activities and quick private returns in sectors such as banking, real estate, telecommunications and trade. Reforms favoured the entrenched elites allied with the ruling regimes and allowed them to monopolize the benefits of economic progress. Political representation, including social dialogue, in the Arab region lagged significantly. Consequently, “poverty per se cannot adequately explain the explosion of the recent social unrest that has to do more with pervasive relative deprivation and calls for social justice”.<sup>97</sup>

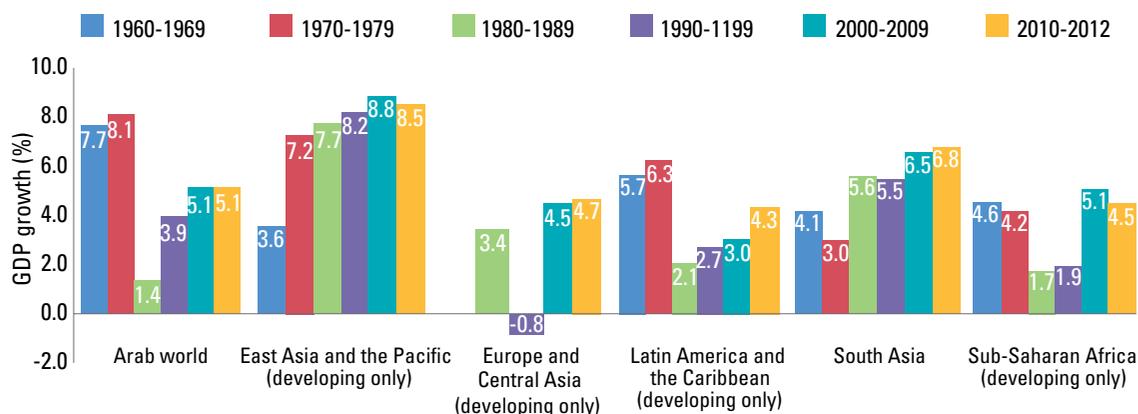
## II. Growth minus structural transformation

Macroeconomic policies have a strong and direct impact on the working conditions of the middle class. It has been argued that the global growth of the middle class in the 2000s was a result of job creation. The World Bank<sup>98</sup> ascribes the current spike in Latin American middle class numbers to record economic expansion and job creation in the last few years. Yet the number of jobs created is not the only

important factor, because the types of jobs created determine the impact of job creation on the middle class.

As figure 34 shows, in the 1970s, the Arab region witnessed an impressive economic growth of 8 per cent a year. In the following decades, growth was much lower, ranging from 1.4 per cent in the 1980s to 3.9 per cent in the 1990s, increasing to 5.1 per cent in the 2000s. Although economic growth has been relatively high, the region has been unable to effectively translate it into greater income. Income has not increased at the same pace as growth in the Arab region; income, measured as GDP per capita, has only increased by an average of 1.4 per cent over the last 30 years (figure 35). This is because growth in Arab countries is mainly driven by natural resources, such as oil and gas, hampering a structural transformation of the economy that could reduce poverty and inequality and create jobs. Instead, oil revenue has encouraged the import of manufactured goods at the expense of the productive capacities of local manufacturers and

**Figure 34.** Growth rates were impressive in earlier decades



Source: World Bank, 2014b.

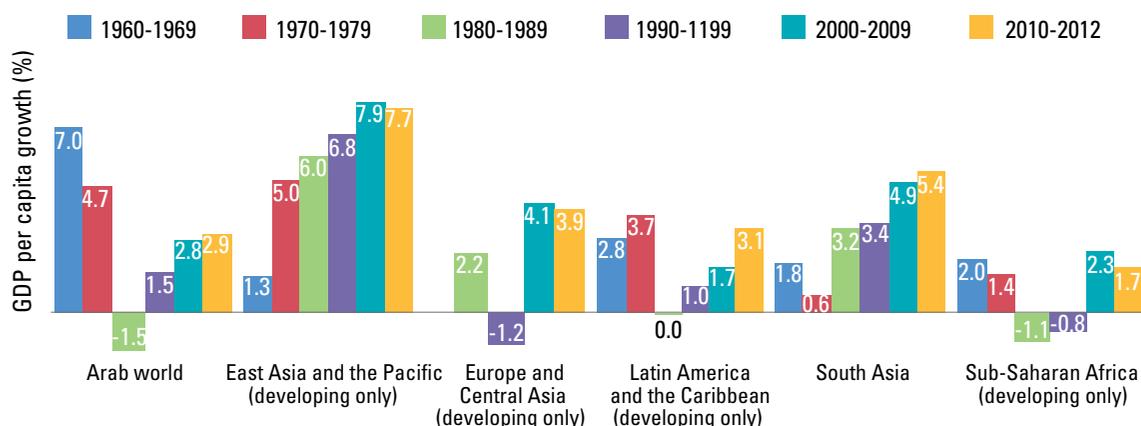
domestic industrial protection. At the same time, Arab populations continue to expand, which could explain low GDP per capita growth.

Arab growth processes are characterized by relatively high volatility, especially those of low income and oil-rich countries. Based on the analysis in Von Arnim and others,<sup>99</sup> in figure 36, the vertical axis marks the coefficient of variation (i.e. the ratio of the standard deviation to the value of the mean of the per capita GDP growth rates), while the horizontal axis depicts the average annual growth rate. This scatter plot should not be interpreted as representing a correlation or a functional relationship between the coefficient of variation and the average annual growth rate but, rather, as a means of categorizing countries so as to measure growth sustainability and volatility. When measuring volatility by the coefficient of variation and taking a value of 3 or less as a benchmark for very low volatility, only Egypt, Jordan, Libya, Morocco, Oman and Tunisia

were characterized by low volatility and sustained growth over the entire period 1970-2012: Egypt, with an average annual real GDP per capita growth rate of about 3.2 per cent and a coefficient of variation of 0.86; Jordan with 2.5 per cent and 2.6; Libya with 2.7 per cent and 1.8; Morocco with 2.4 per cent and 1.7; Oman with 2.6 per cent and 2.6; and Tunisia with 3.0 per cent and 1.1.

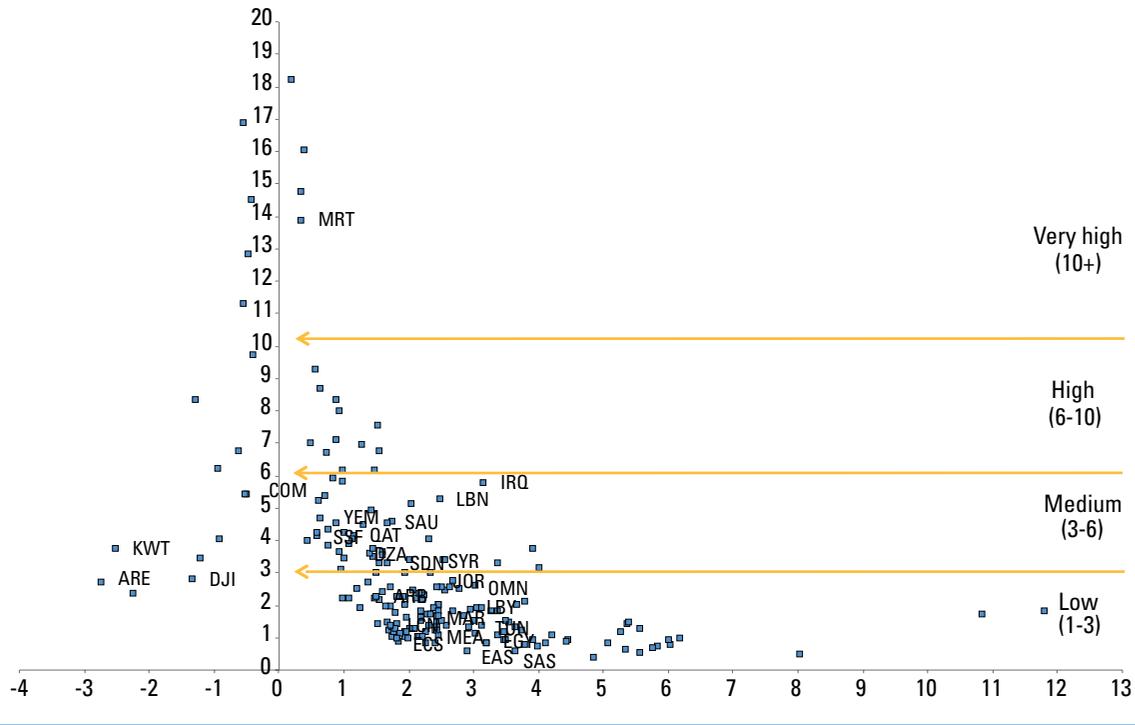
Of these six countries, only Jordan, Oman and Tunisia implemented noticeable structural transformations. From 1970 to 2012, the manufacturing sector in Jordan grew from 10 per cent of GDP to 18 per cent, in Oman from 0.4 per cent to almost 10 per cent, and in Tunisia from 9 per cent to almost 17 per cent. Egypt suffered from an incomplete manufacturing transformation; although the share of the manufacturing subsector was about 22 per cent of GDP in 1970, which could have classified it as an industrialized country, it declined to about 16 per cent of GDP in 2012 (figure 37).

**Figure 35.** Growth has not translated into greater income



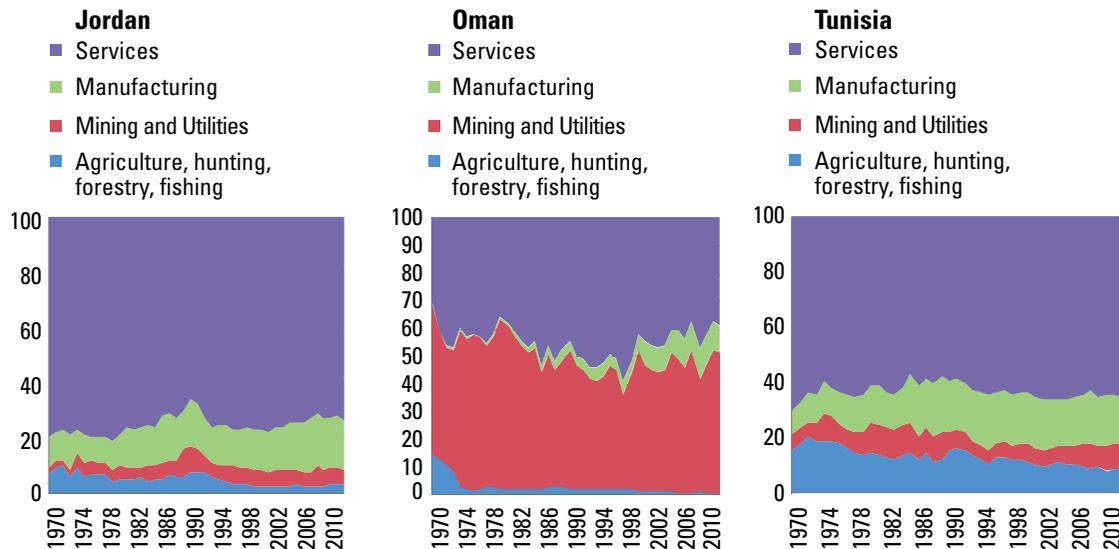
Source: World Bank, 2014b.

**Figure 36.** Volatility (coefficient of variation) and average annual real per capita GDP growth, 1970-2012 (percentage)



Source: ESCWA calculations based on data from the World Bank (2014b).

**Figure 37.** Economic transformation in Jordan, Oman and Tunisia, 1970-2012 (percentage)



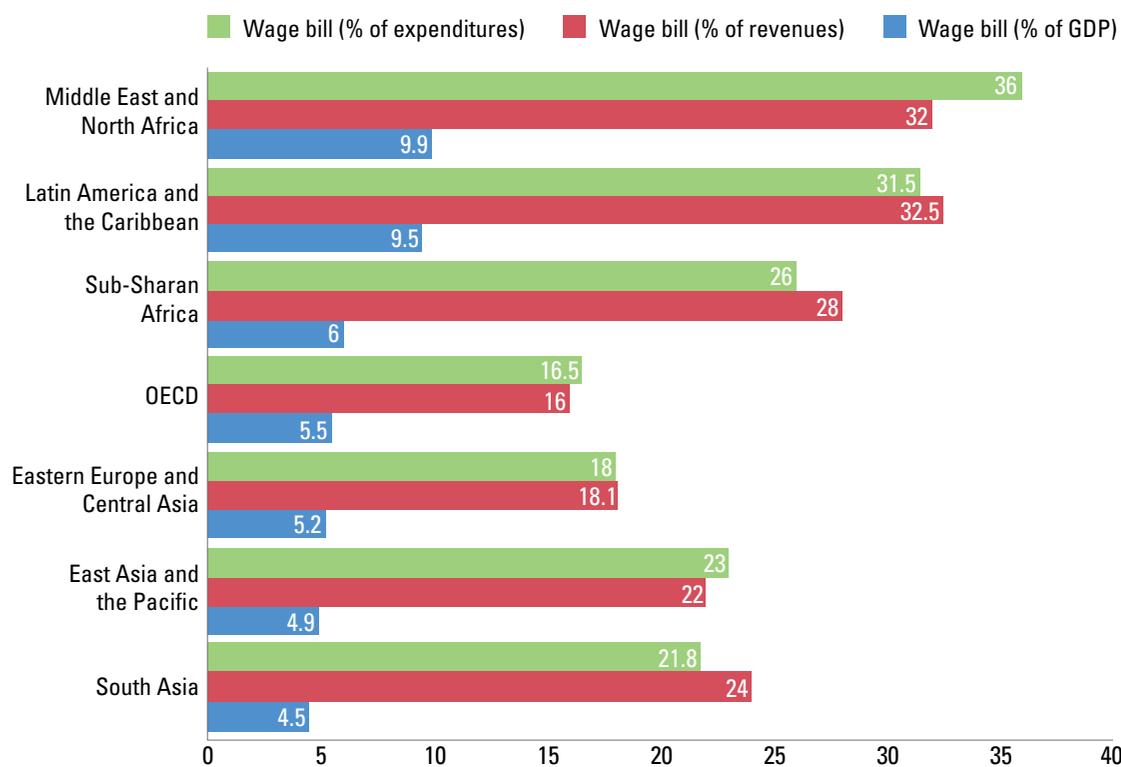
Source: United Nations Statistics Division (UNSD). Available from <http://unstats.un.org/unsd/snaama/Introduction.asp>.

As argued by Von Arnim and others, these results reflect a regional structural transformation pattern that contrasts sharply with that of other developing regions. The following outline the Arab structural economic problem: stagnating agricultural and manufacturing shares of GDP (albeit with a slight increase in the latter because of a rise in manufacturing sector contribution, particularly petrochemical industries in Gulf Cooperation Council (GCC) countries; a rapidly expanding service sector (although concentrated mainly in low value-added activities); and a still dominant oil sector. Furthermore, owing to the lack of structural

transformation, productivity gains have been the slowest in the world.

It is worth noting, however, that during the decade or so preceding the uprisings, the Arab region achieved fairly rapid rates of economic growth and relatively fast employment creation.<sup>100</sup> The economic growth witnessed in the 2000s had not been seen since the 1970s, but the impact on people's quality of life was less evident: "employment generation was not accompanied by the creation of decent jobs, that is, jobs that met the expectations of the increasingly educated job seekers and the aspirations of the middle

**Figure 38.** Wage bill percentage for central Governments remains high compared to other regions



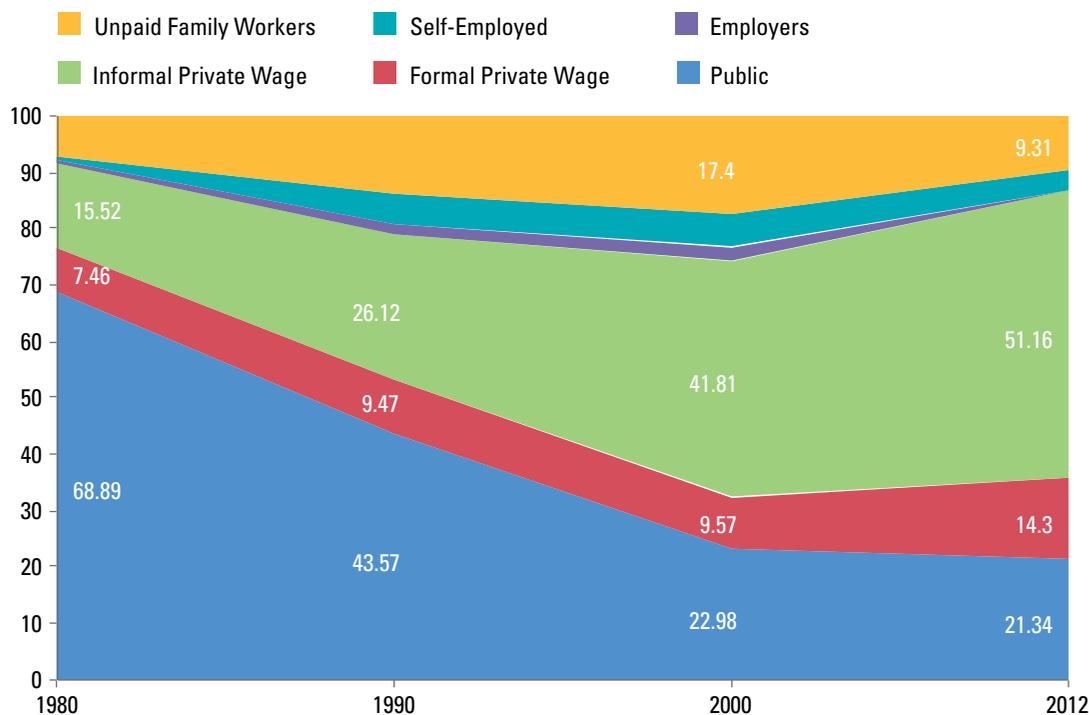
Source: World Bank, 2012a.

classes”<sup>101</sup> Therefore, although the region’s employment growth was the highest in the world at 3.3 per cent a year on average between 1998 and 2009, compared to an annual growth of 1 per cent in East Asia and developed countries and just over 2 per cent in Latin America and South Asia, the jobs that were created were largely in the informal low value-added sectors.<sup>102</sup>

This outcome is consistent with the nature of economic policy in rentier States that have a strong preference for public employment, often used as a redistributive mechanism. Until recently, educated young people were guaranteed public sector jobs. As a result of decades of public sector-led employment policies, public sector

employment still accounts for the majority of total formal sector employment (60 per cent), representing 29 per cent of the total employment in the region.<sup>103</sup> Large numbers of public sector employees mean that the wage bill for Arab countries is the highest in the world, at 36 per cent of government expenditure and 10 per cent of GDP (figure 38). Formal private sector employment is very small, representing 13 per cent of total employment (or around 40 per cent of total formal employment). When the promise of public sector jobs was revoked, the formal private sector was unable to keep up with the demand for employment from new entrants. Therefore, many graduates in the 2000s, left with no other choice, joined the informal sector.

**Figure 39:** Egypt: employment by sector for those with secondary and higher education (percentage)



Source: Assad, 2014.

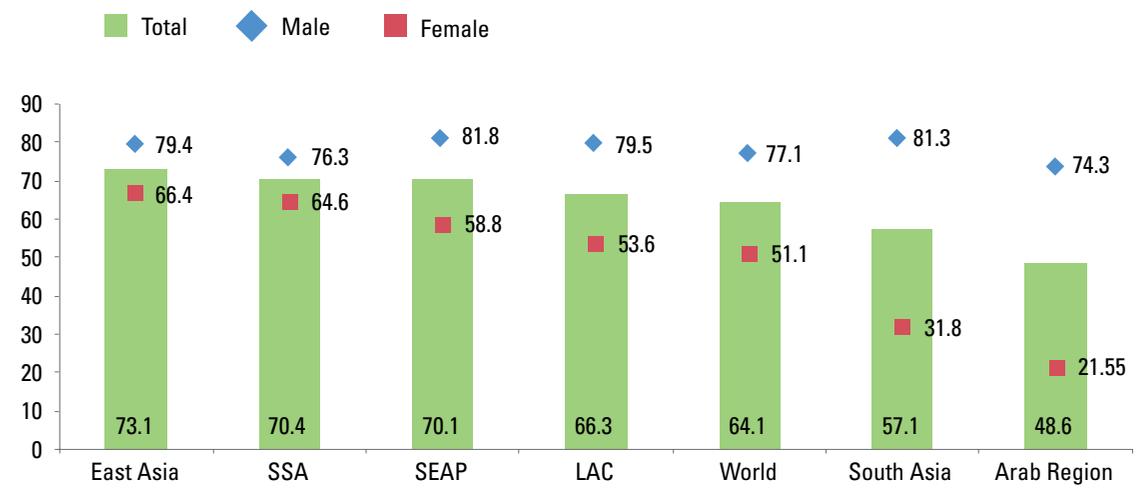
Informal employment in the Arab region stands at around 58 per cent of total employment.

To illustrate this point, the present report examined the situation in Egypt. In 1964, the authorities implemented a policy to hire all university graduates within two years of completing their studies, and all secondary graduates within three years of finishing school.<sup>104</sup> This waiting time increased by one year for each category in the 1980s. The armed forces also provided substantial job opportunities for young people; armed forces personnel increased from 1 per cent of the labour force in the 1960s to 4 per cent in the 1970s. In addition, all those who were discharged from the armed forces had the right to a public sector job from 1973 onwards. In 1980, around 69 per cent of those with secondary and higher education qualifications were employed in public sector jobs; a share that decreased to 21 per cent in 2012 (figure 39). At the same time, the share of informal private sector jobs increased from 16 per cent to 51 per cent.

Given that economic policy impacts the nature of employment, affecting the poor and middle class alike, the region's key labour market indicators, such as unemployment rates and labour force participation rates, reflect problems with the economic structure. In general, the majority of investment in Arab economies is directed towards the capital-intensive oil sector, low value-added trade services and construction and real estate sectors, which generate demand for low skilled employment. The result is a mismatch between labour supply and labour demand, where there is an over-supply of skilled labour. This hypothesis is also consistent with the following five employment and labour market stylized facts that are common to most Arab countries.

Firstly, the labour force participation rate (LFPR) of the Arab region is the lowest in the world at 48 per cent, compared to a global average of 64 per cent (figure 40). Although male LFPR in the Arab region is

**Figure 40.** The Arab region has the world's lowest labour force participation rate, 2012 (percentage)

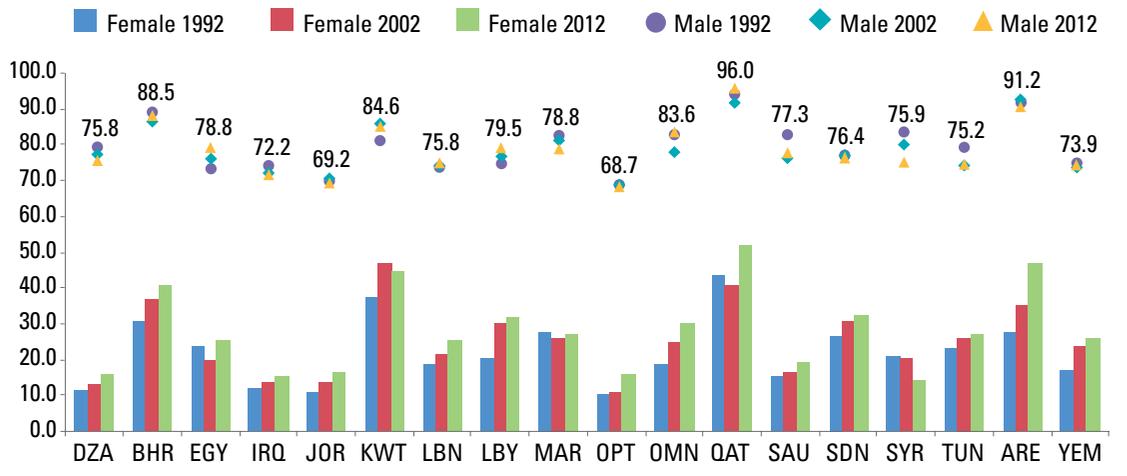


Source: ILO, 2014.

similar to the world average (74 per cent and 77 per cent, respectively), the region's overall labour force participation rate is influenced by a low female LFPR of only 21 per cent (compared to a global average of 51 per cent). The low female LFPR in the Arab region can be attributed to a number of causes, including non-existent

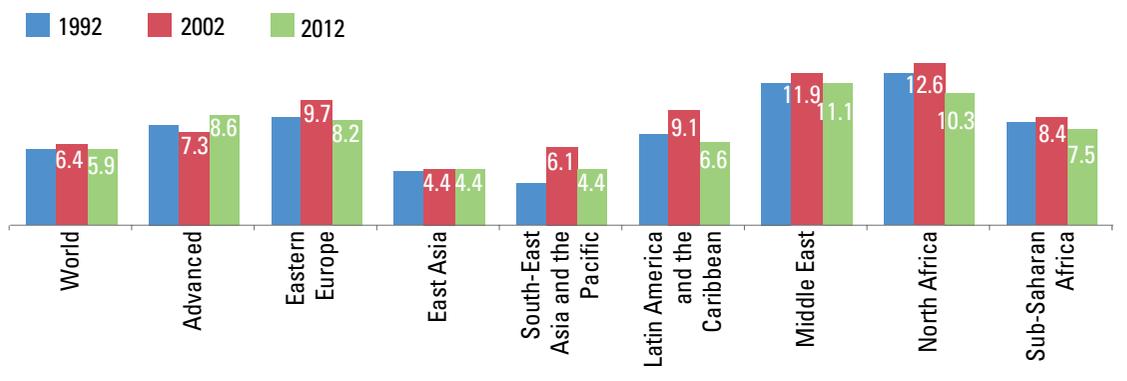
or expensive day care options, a lack of public transportation and cultural and religious traditions. Consequently, most married mothers stay at home. Women who enter the labour market mostly opt for public sector jobs, predominantly in education and health care; the rest join the informal sector.<sup>105</sup> However, from 1992 to

**Figure 41.** In the Arab region, women's labour force participation rate has increased, but lags far behind that of men, 1992-2012 (percentage)



Source: ILO, 2014.

**Figure 42.** The Arab region has the highest unemployment rate (percentage)



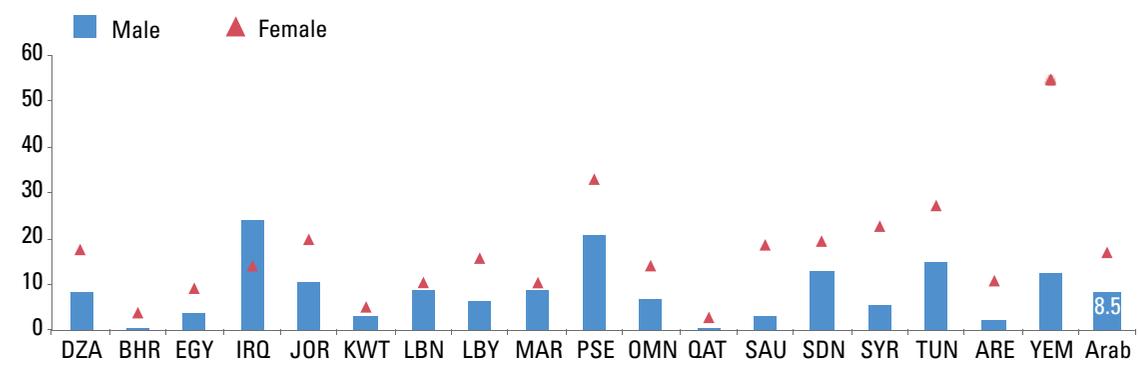
Source: ILO, 2014.

2012, there were increases in female LFPRs in most Arab countries (the prominent exception being the Syrian Arab Republic). It should be noted that the exceptionally high LFPRs in GCC countries are attributed to the inclusion of expatriates in the data (figure 41).

Secondly, a high unemployment rate has always been the norm in the Arab region, reflecting increasing population growth

and female LFPRs and, more importantly, weak labour demand from the formal private sector (figure 42). As expected, when adult unemployment is high, youth unemployment is much higher. While the world average stood at 12.8 per cent in 2012, the Arab youth unemployment rate was double that at 26 per cent (figure 44). High youth employment rates reflect high birth rates, a youth bulge and excessively rigid labour markets in some countries.

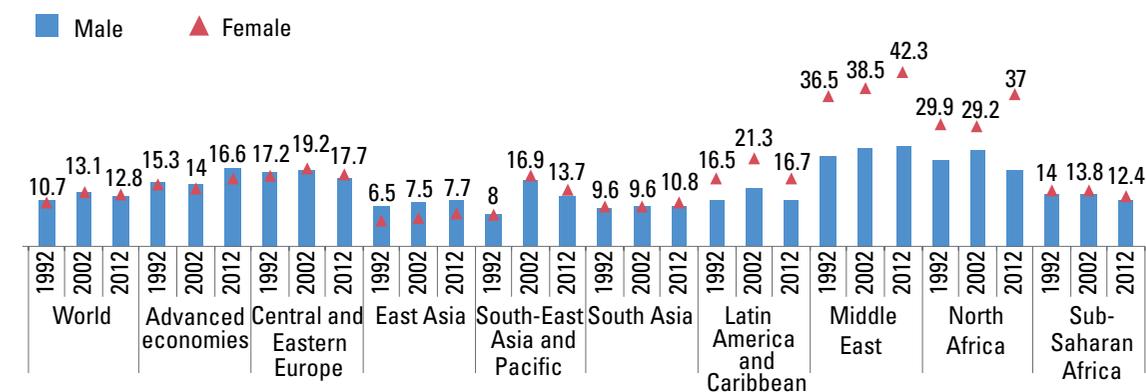
**Figure 43.** Women in all Arab countries are more likely to be unemployed (percentage)



Source: ILO, 2014.

Note: Data are from latest available household expenditure surveys.

**Figure 44.** The Arab region has the highest youth unemployment rate (percentage)



Source: ILO, 2014.

Thirdly, in many Arab countries, the better educated youth are more likely to be unemployed than their less skilled counterparts.<sup>106</sup> In recent years, over 30 per cent of qualified young people were unemployed in the Arab region, representing over 40 per cent of the total unemployment rate.<sup>107</sup> In Tunisia, 33.6 per cent of the overall population with university degrees was unemployed; a figure that was driven up by high unemployment among women at 43.8 per cent. This gender component to youth unemployment warrants further analysis. From 1992 to 2012, the female youth unemployment rate increased from 36.5 per cent to 42.3 per cent in the Middle East and from 30 per cent to 37 per cent in North Africa (figure 44). The female youth unemployment rate is considerably higher than the Arab youth unemployment rate, although in many Arab countries women represent the majority of skilled university graduates (figure 43).

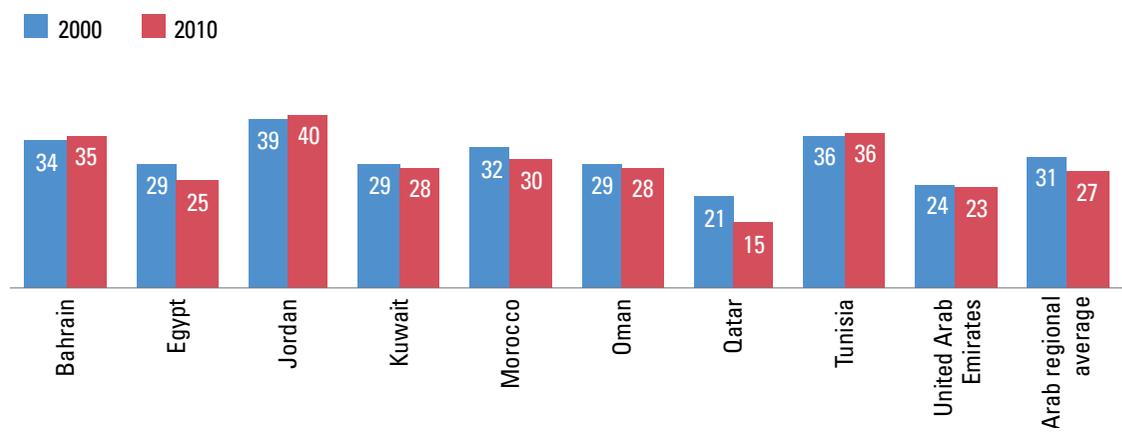
Unemployment in the Arab region is persistent in both low and high income

households.<sup>108</sup> This correlates with the high unemployment rates of more educated workers who predominantly come from better off families, lending further support to the idea that Arab economies fail to generate decent jobs for the population as a whole.

Fourthly, wages are low and real wage is declining or constant in most Arab countries.<sup>109</sup> Wages as a percentage of GDP (derived from national accounts) in the Arab region have been declining, from 31 per cent in 2000 to 27 per cent in 2009 (figure 45). Egypt witnessed the most dramatic decline, where the wage share dropped from 29 per cent to 25 per cent of GDP between 2000 and 2009. Economic growth has thus benefitted employers and capital holders instead of workers, given that real wages have not increased significantly since the 1970s (figure 46).<sup>110</sup> In fact, the Arab region is the only region where real wages have declined, dropping by 2.7 per cent between 2006 and 2011.<sup>111</sup>

Fifthly, as a result of the above four stylized facts, returns on education are low

**Figure 45.** Wage share has fallen as a percentage of GDP



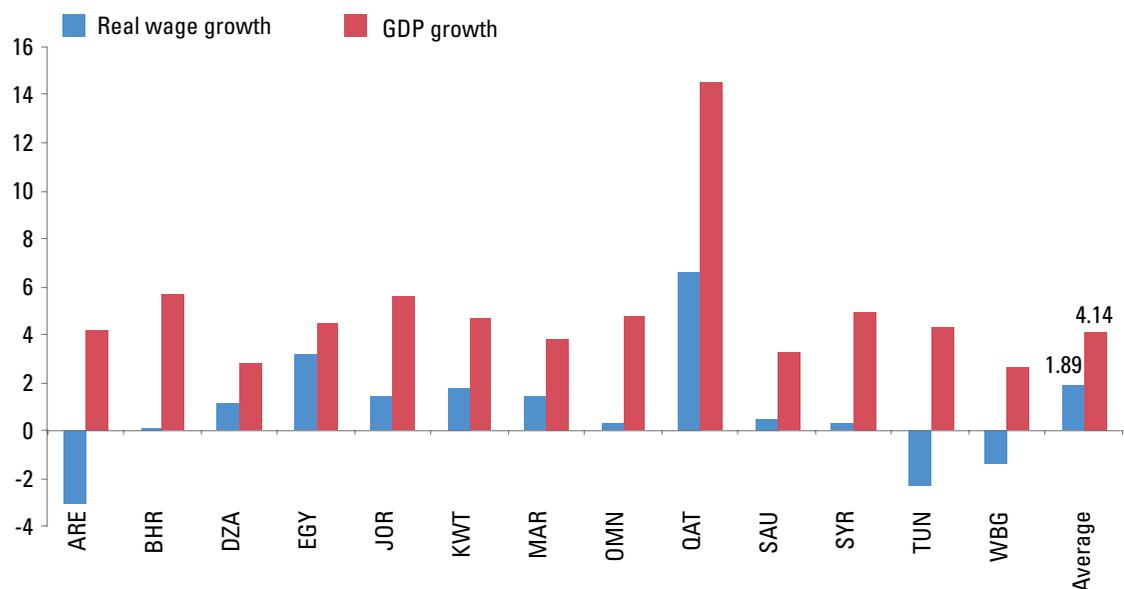
Source: ILO, 2012a.

Note: Regional average is population weighted.

(measured as the proportional increase of an individual's labour market earnings for an additional year of schooling). Individuals spend an average of 9.6 years at school in the Arab region, compared to 9.8 in Latin

America and the Caribbean, and 10.5 in East Asia and the Pacific (figure 47). Data shows that an additional year of schooling only increases an individual's earnings in the Middle East and North Africa region by

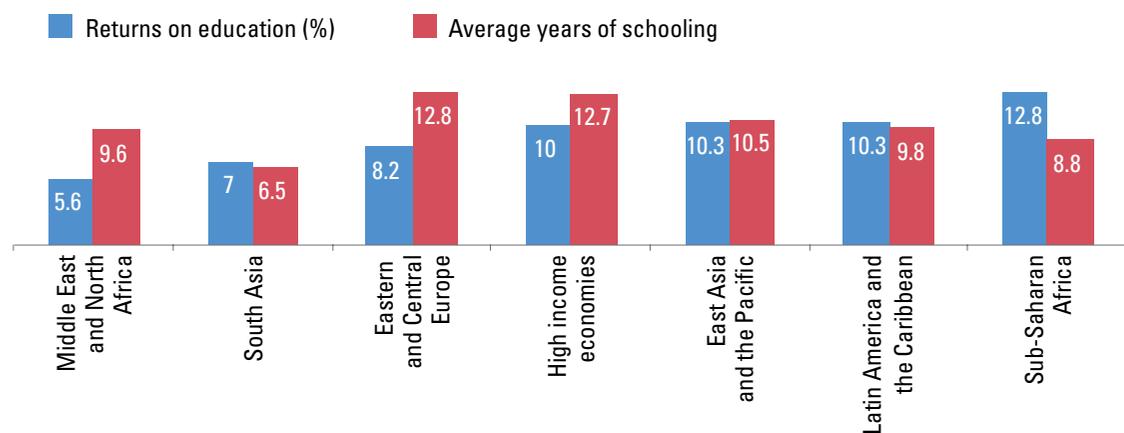
**Figure 46.** While economies have grown, wages have not, 1990s-2000s (percentage)



**Source:** ESCWA calculations based on ILO (2012a) and the World Bank (2014b).

**Note:** Regional average is population weighted.

**Figure 47.** The Arab region has the world's lowest return on education



**Source:** Montenegro and Patrinos, 2013.

5.6 per cent, making it the lowest return on education in the world. Nonetheless, the number of university students keeps growing in the region. This shows that Arab youth opt for higher education to acquire new skills but also to delay their entry into the labour market. In the earlier periods (1960-1970), a university graduate was guaranteed a public sector job, whereas today many are unemployed.

In summary, the lack of structural transformation of Arab economies is an expected outcome of decades of rentier patterns of economic growth. Consequently, insufficient decent jobs have been created owing to poor demand, especially from the formal private sector. Inevitably, this caused an increase in informal sector jobs generally associated with low pay, low quality and low productivity. Formal sector workers in the region represent only 19 per cent of the working age population (compared to 27 per cent in Latin American and 40 per cent in Eastern Europe); the informal sector is an enormous part of the region's economy and comprises the majority of working heads of middle class families.<sup>112</sup> Heads of households employed in the informal sector face more obstacles than those employed formally. Firstly, they do not have access to social protection insurance, such as health care and pensions. Secondly, their wages are lower than those of formal sector employees and their working conditions are far worse. Without contracts, they have no job security and are hired and fired at the sole discretion of their employers.

### III. Ineffective subsidies and inferior public services

#### A. Unfair subsidy distribution

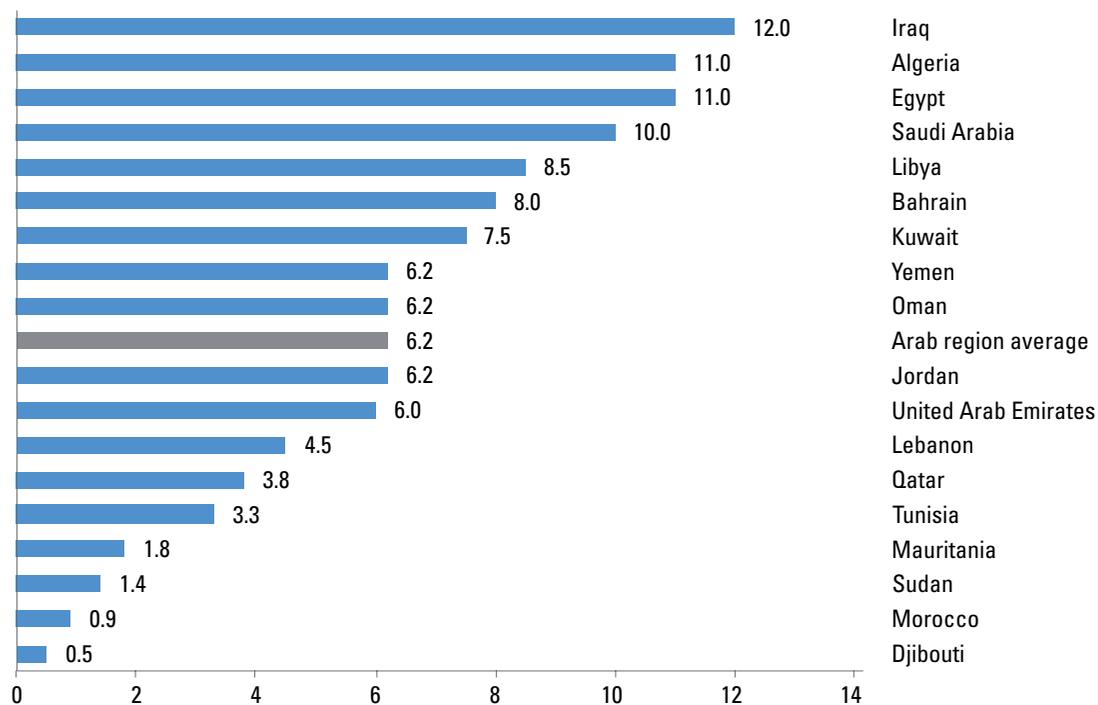
The Arab region spends, on average, over 6.2 per cent of GDP on subsidies (figure 48); other developing regions spend only

1.3 per cent.<sup>113</sup> In Egypt, subsidies represent 11 per cent of GDP or 30 per cent of total government expenditure; and in Iraq subsidies represent 12 per cent of GDP. However, the Arab region only spends an average of 0.7 per cent of GDP on social assistance programmes.<sup>114</sup>

The subsidization rate for energy in most Arab countries is particularly high (50-85 per cent of the cost or an average of 6 per cent of GDP) compared to other social expenditures (for example, on average only 2.7 per cent of GDP is directed at health care). Moreover, a recent study by the International Monetary Fund (IMF) showed that the benefits of energy subsidies are mostly reaped by the richest in society and the middle class (figure 49). In most Arab countries, the richest quintile (quintile 5) benefits the most from gasoline and diesel subsidies. In Egypt, the richest quintile captures 86 per cent of the gasoline subsidies as well as 71 per cent of the diesel subsidy. As shown in figure 49, energy subsidies are largely captured by the middle class. Food subsidies are captured by both the poor and the middle class (table 1).

A recent study by the World Bank<sup>115</sup> shed light on the problem of mal-distribution of social assistance expenditure in selected Arab countries. Only 26 per cent of the region's poor benefitted from social assistance programmes in 2002-2010, which is the lowest rate among developing regions (figure 50). For example, in Jordan (2010), the poorest quintile captured 43 per cent of the benefits from social assistance programmes and the middle class captured 51 per cent. Similarly, the Egyptian middle class captured 58 per cent of social assistance, 59 per cent in Yemen, 62 per cent in Morocco and 55 per cent in Iraq. These percentages confirm that the largest share of benefits was enjoyed by the middle class.

**Figure 48.** Significant amounts of national income are spent on unproductive subsidies (per cent of GDP)



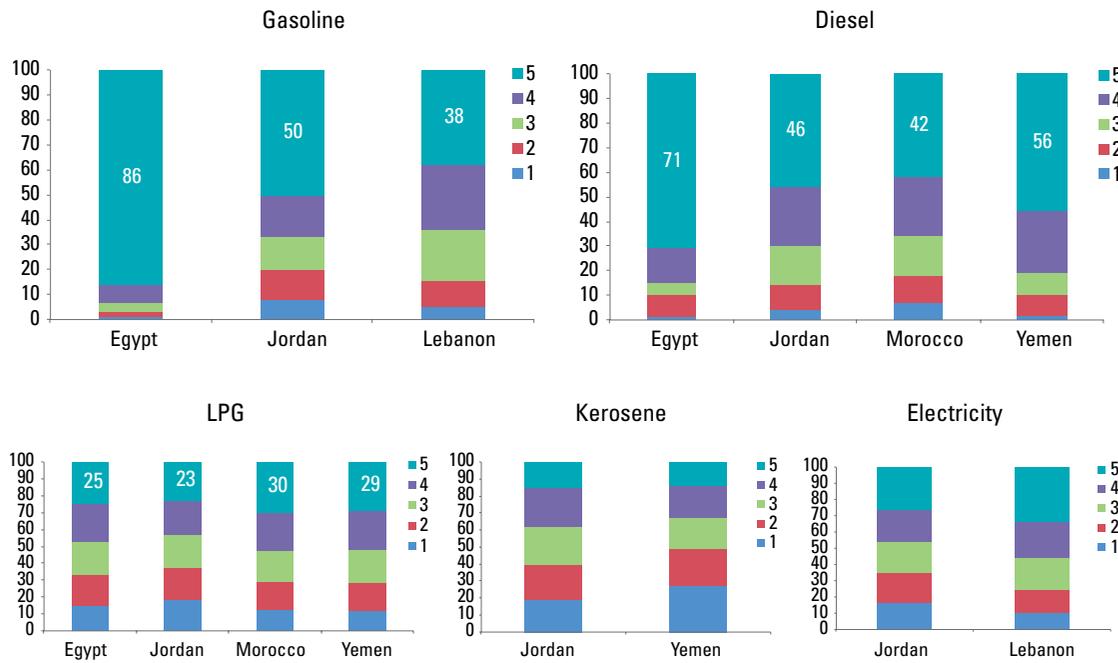
Source: IMF, 2013.

**Table 1.** Food subsidies help the poor and the wealthy (percentage)

Quintile	Bread			Sugar		Wheat	
	Egypt	Jordan	Lebanon	Egypt	Morocco	Egypt	Morocco
1	15	25	25	17	13	37	11
2	16	22	23	19	17	26	16
3	18	20	20	21	19	17	19
4	21	18	18	22	22	12	23
5	30	15	14	21	29	8	31

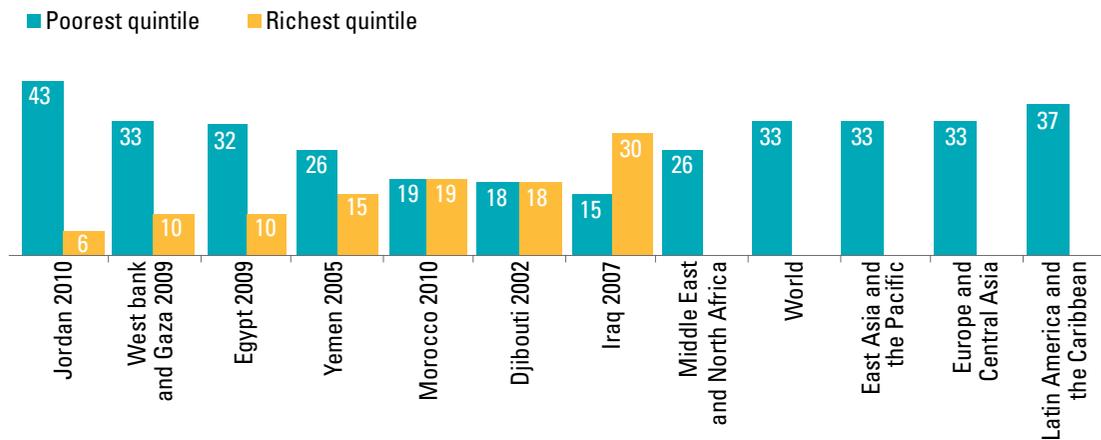
Source: IMF, 2014.

**Figure 49.** The poor benefit least from energy subsidies (percentage by quintile)



Source: IMF, 2014.

**Figure 50.** The poor in Arab countries benefit the least from social assistance among developing regions, 2002-2010 (benefit incidence, percentage)



Source: World Bank, 2013.

## **B. Poor quality of public health and education and weak social protection coverage**

Historically, the Arab region has not spent significantly more on social protection than other developing regions (figure 51). However, its expenditure on education is distinctly higher (figure 52). Education is a means of developing human capital and promoting economic growth and productivity. Arab regimes saw other advantages; they considered it to be an effective nation-building method that could be used to forge a common heritage, create cultural bonds and indoctrinate political ideas.<sup>116</sup> While higher education was used as a means of economic development in East Asia, education in the Arab region was provided to buy the support of citizens through job creation in the public sector.<sup>117</sup>

As noted earlier, the new leaders of Arab countries invested heavily in education; spending 4.4 per cent of GDP per year, on average, between 1965 and 1974 (compared to 2.6 per cent in Asia and 3 per cent in Latin America and the Caribbean (LAC), both of which had already undertaken an education revolution decades earlier and were at a more advanced stage in the demographic transition, and thus had a smaller share of young people and children).<sup>118</sup> Given the effect of social policy on education, the majority of Arab countries<sup>119</sup> made impressive strides: enrolment rates at the secondary level increased threefold between 1970 and the early 2000s; the average years of schooling rose rapidly from 1.3 years in 1960 to 9.6 years in the 2000s; and illiteracy rates among the adult population fell from 50 per cent in 1980 to 23 per cent in the 2000s.<sup>120</sup>

As a result, eight of the top 20 countries that increased their average years of schooling between 1980 and 2010 were in the Arab region (figure 53). Even after the uprisings, Arab countries have continued

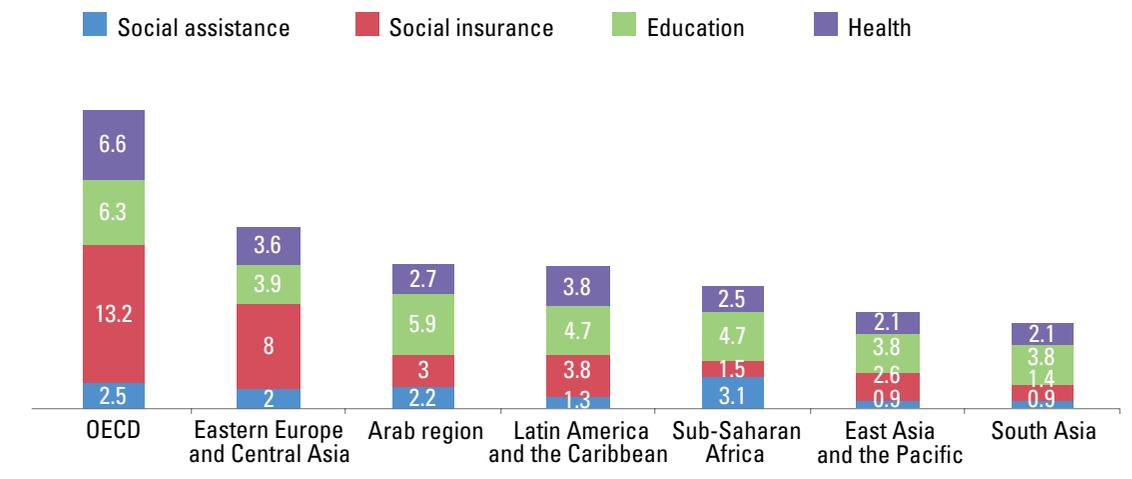
to invest in education, spending over 5 per cent of their GDP; equal to 20 per cent of their total government budgets.<sup>121</sup> Despite these impressive results and high shares of public expenditure allocation to education, the quality of education provided in many Arab countries has been deteriorating. According to a report by the Brookings Institute,<sup>122</sup> Arab children fall below the minimum competency thresholds in international literacy and numeracy assessments. Based on available data from 13 Arab countries, 56 per cent of primary students and 48 per cent of secondary students do not meet basic learning levels. Moreover, rural children do not perform as well as their urban counterparts, and overlapping disparities based on income, gender and geographic location create stark divisions. The deteriorating quality of public education provided by many Arab countries has therefore left most middle class households with little option but to seek private education.<sup>123</sup>

Similarly, the low and increasingly deteriorating quality of public health services, combined with rising corruption,<sup>124</sup> are a major concern for Arab middle class families.<sup>125</sup> Although the Arab region spends 2.7 per cent of GDP on health care, an amount close to the world average for developing countries, out-of-pocket spending on health is much higher. The Arab region pays almost half (47 per cent) of total health expenditures out of pocket (figure 54), reaching 58 per cent in Egypt and 78 per cent in Yemen. The Arab region therefore has the second highest out-of-pocket expenditure rate in the world (it stands at 60 per cent in South Asia), as a result of deteriorating health systems, which do not appear to be a government priority.<sup>126</sup> As a result, middle class citizens who can afford it are turning to private health care.<sup>127</sup> Figure 55, which shows out-of-pocket health expenditure as a share of

total private health expenditure, confirms the rising burden of health expenditure faced by almost all oil-poor countries, namely Jordan, Egypt, Morocco, Tunisia and Yemen; the opposite trend is witnessed in the oil-rich countries and Lebanon.

The deteriorating quality of health and education services have thus placed greater pressure on middle class finances by increasing out-of-pocket expenditure rates. In Egypt, health expenditure represented 4.1 per cent of

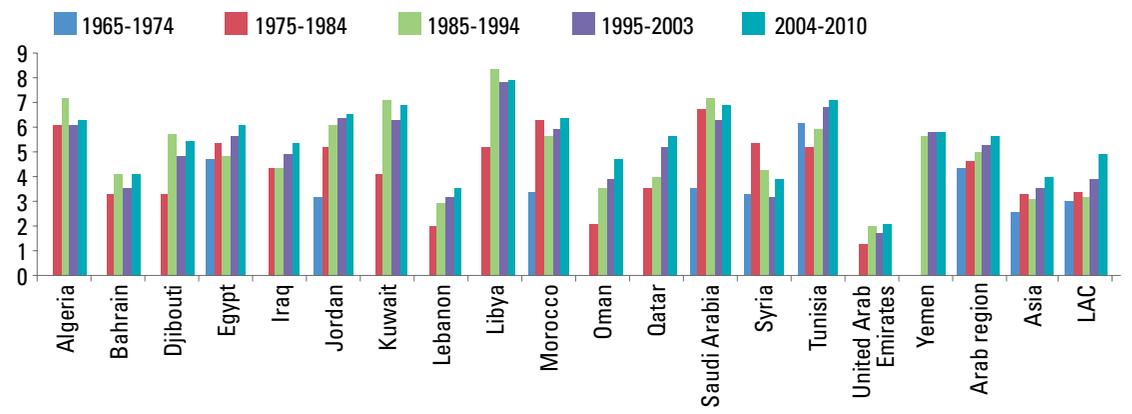
**Figure 51.** Social spending as a percentage of GDP



Source: Prasad, 2014.

Note: Data are from latest available household expenditure surveys.

**Figure 52.** Expenditure on education exceeds that in other developing regions, 1965-2010 (Percentage of GDP)

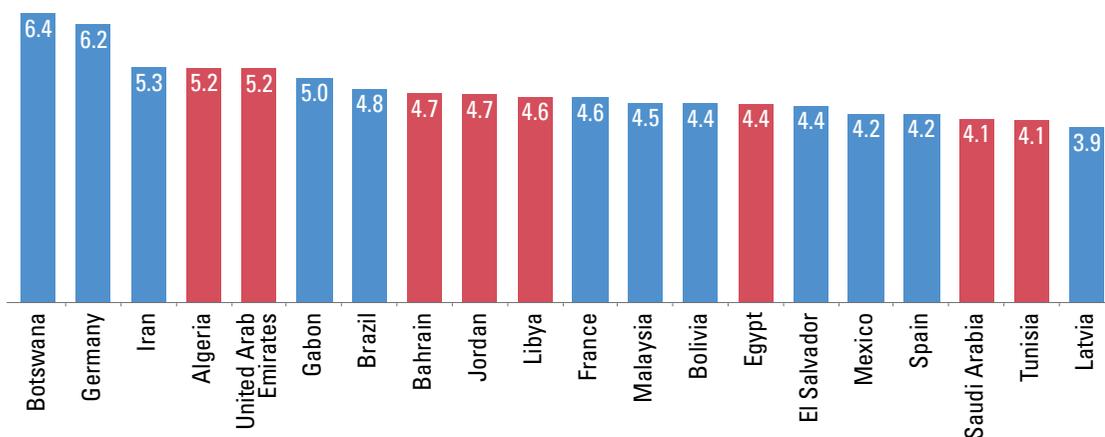


Source: ESCWA, 2013b.

total household consumption in 2005, which doubled to 8.2 per cent in 2011 (figure 56).<sup>128</sup> The data also revealed that health expenditure as a share of total consumption increased with income level: in 2011, the poor spent 5.6 per cent on

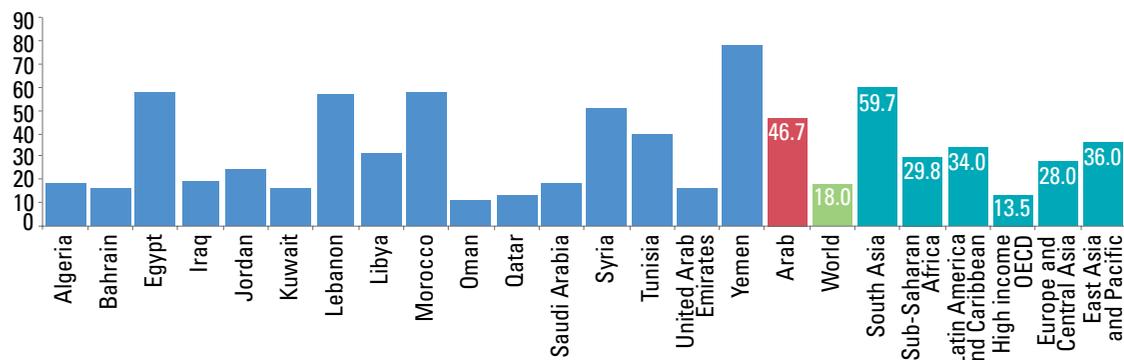
health, the middle class 8.6 per cent and the affluent 9.8 per cent. Those who can afford private health care therefore choose to pay out of pocket for services superior to those provided by the deteriorating public sector.

**Figure 53.** Eight Arab countries were among the top 20 achievers in education attainment, 1980-2010 (Average years of schooling)



Source: Campante and Chor, 2012.

**Figure 54.** The Arab region has the world's second highest out-of-pocket health expenditure, 2012 (Per cent of total health expenditure)

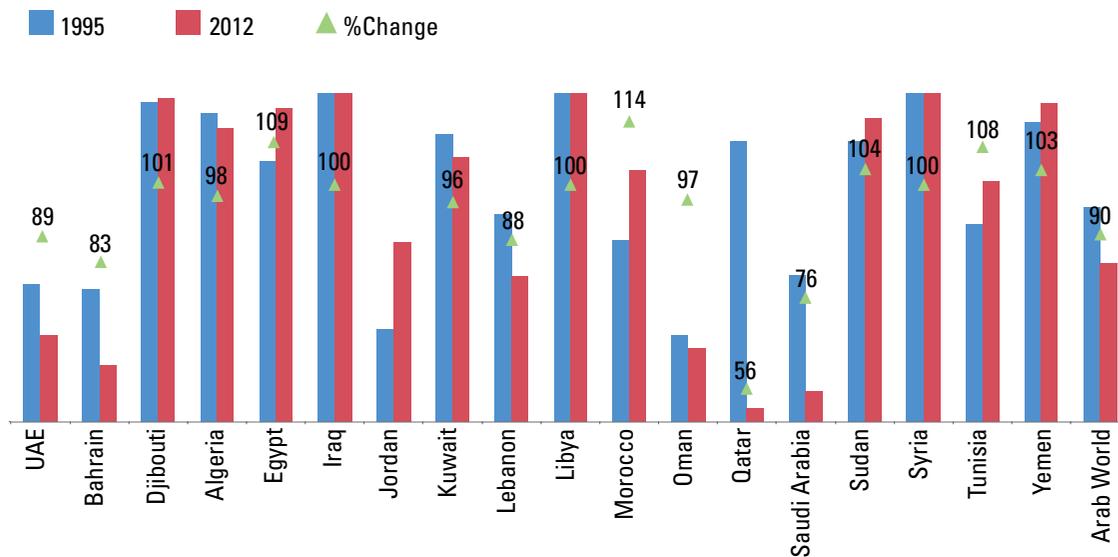


Source: World Bank, 2014b.

The same expenditure-income level relationship can be seen when studying out-of-pocket education expenditure. The Egyptian middle class spent 3.5 per cent in 2011 on education compared to 6.9 per cent

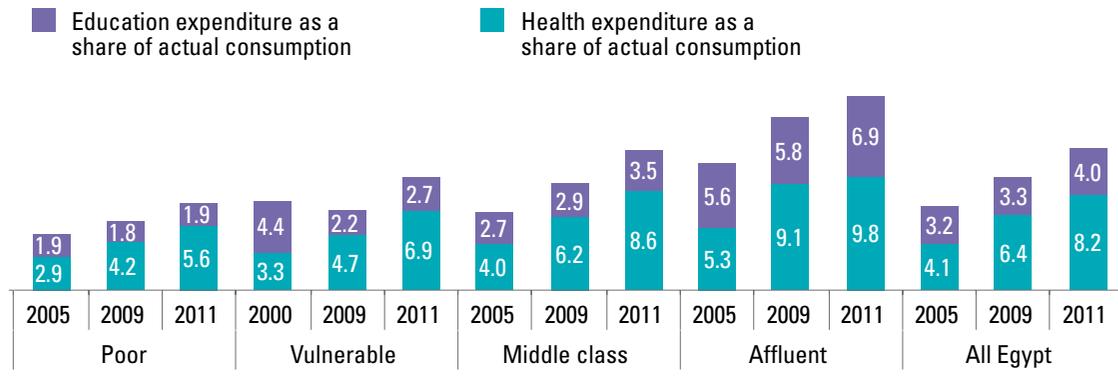
spent by the affluent and 1.9 per cent spent by the poor (figure 56). Therefore, as income increases, the out-of-pocket share spent on education increases. As with health care, the quality of public schools is deteriorating so

**Figure 55.** Out-of-pocket health expenditure, 1990-2012 (percentage of total private expenditure on health)



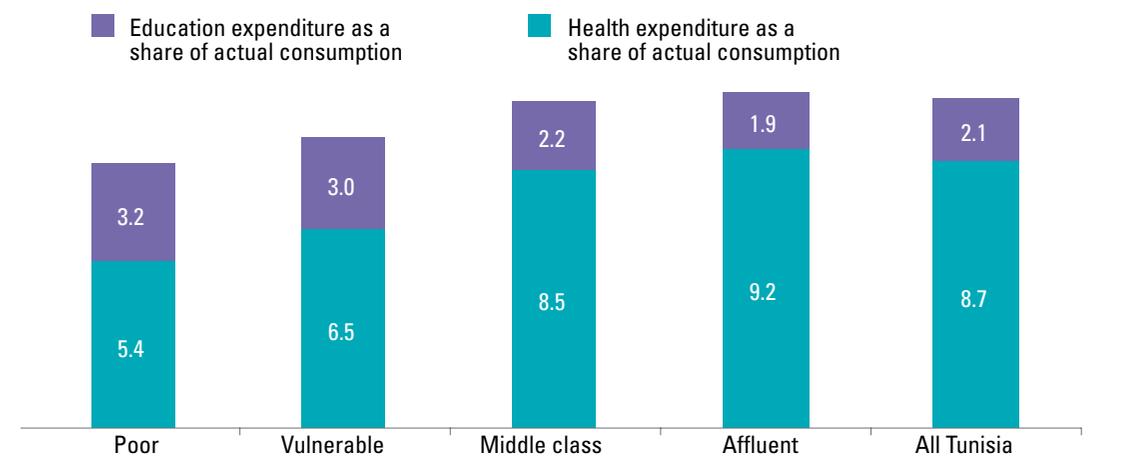
Source: World Bank, 2014b.

**Figure 56.** In Egypt, the health and education share of household expenditure is increasing



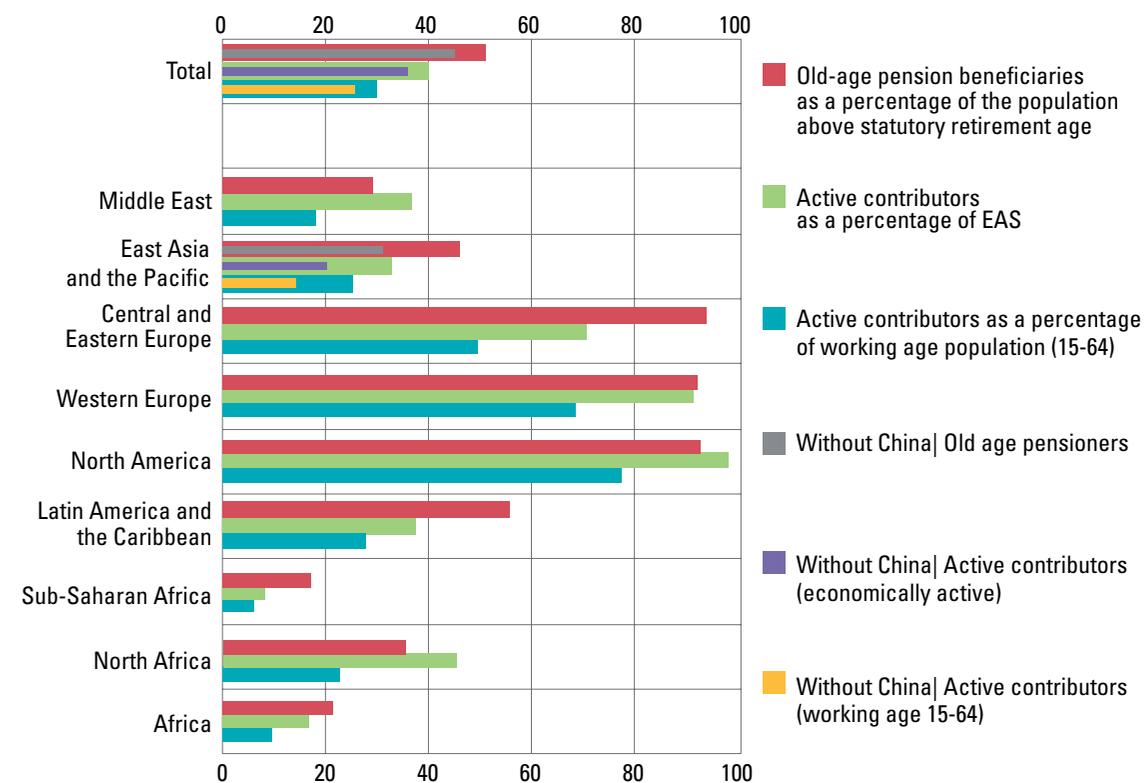
Source: Prasad, 2014.

**Figure 57.** Tunisia: health and education expenditure as part of total household consumption, 2010 (percentage)



Source: Prasad, 2014.

**Figure 58.** The Arab region lags behind in pension coverage (percentage)



Source: ILO, 2013.

Note: Regional aggregates are weighted by total population.

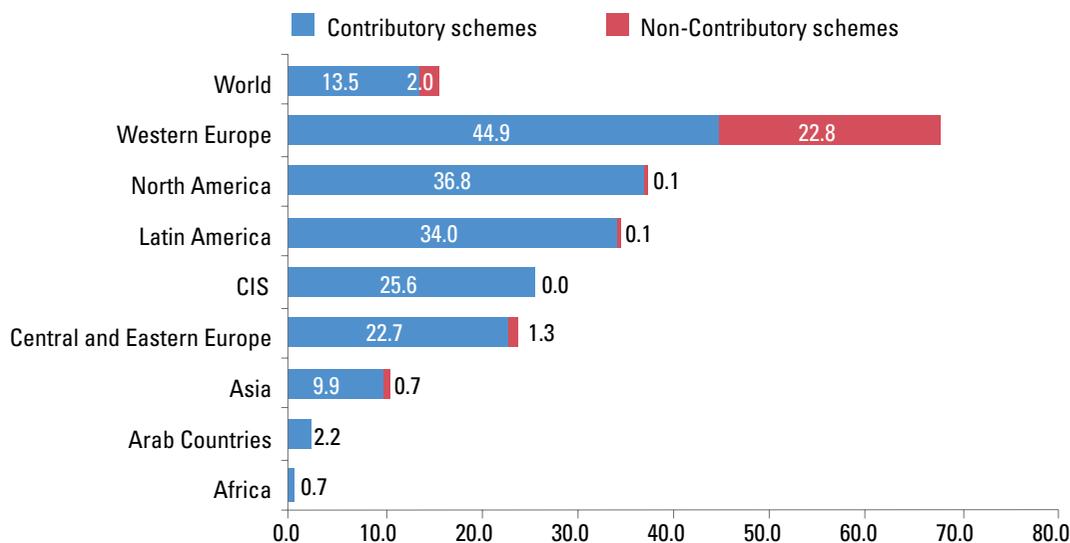
those who can afford to pay out of pocket are choosing private education.

Tunisia is another example (figure 57). The average household spent 8.7 per cent of its total consumption on health in 2010. Health expenditure in Tunisia, as in Egypt, increased with income level: the middle class spent 8.5 per cent, the poor spent 5.4 per cent and the affluent spent 9.2 per cent. However, in Tunisia, a different trend emerges with regard to education expenditure as a share of total household consumption (figure 57). The middle class spent 2.2 per cent on education, the poor spent 3.2 per cent but the rich spent only 1.9 per cent. Contrary to the pattern for education spending in Egypt, in Tunisia the level of education spending decreases as income increases. The cost of education is thus a greater financial burden on the poor than on the rich.

Exacerbating middle class concerns regarding rising costs of health and education is a weak and limited social protection system for the majority of formal sector workers.<sup>129</sup> For example, the Arab region lags behind other developing countries in pension coverage (figure 58). A total of 48 per cent of the retirement-age population in other developing countries receives pensions, compared to 38 per cent in North Africa and 32 per cent in the Middle East.<sup>130</sup> The Arab region also has among the lowest pension coverage from active contributors:<sup>131</sup> 24 per cent in North Africa and 19 per cent in the Middle East, compared to 31 per cent globally and 22 per cent in other developing countries (although that number drops to 12 per cent if China is excluded).

Those employed in the informal sector do not receive a pension. For example,

**Figure 59.** Only 2.2 per cent of unemployed persons in the Arab region receive unemployment benefits, 2011



**Source:** Tzannatos and others, 2011.

**Note:** Regional estimates are weighted by labour force, 2009.

Morocco has three different pension schemes: one for civil servants, one for State-owned enterprises and one for private sector workers. Yet, as a result of a large informal sector and a large self-employed population, only a third of the working age population is covered by a pension system.<sup>132</sup> In addition, there is little protection for the unemployed. Only a few countries, among them Algeria and Tunisia, have unemployment insurance schemes, and unemployment insurance coverage in the Arab region remains the second lowest in the world after sub-Saharan Africa (figure 59).

#### IV. Conclusion

The data and analyses in Part Three of the present report suggest that socioeconomic policies in the Arab region were implemented to create a class of loyal supporters. The bias towards the middle class in the allocation of various subsidies confirms this hypothesis. Although this led to middle class expansion in many Arab countries, the flipside is that regimes kept tight control of political power and the productive economic base was weakened. The elite wanted mass compliance of the masses, not their political participation. In return for unquestioning support, the middle class was rewarded with well-paid jobs and generous subsidies. To finance these policies, regimes relied on oil revenue, remittance flows and aid funds (in the case of non-oil exporting countries).

Consequently, and given the fundamental shifts in socioeconomic policy since the 1990s, it is easy to understand why the middle class revolted. Two main explanatory factors are set out in Part Three of this report. Firstly, the hiring freeze in the public sector and weak employment demand from the formal private sector left few options beyond low-paying low value-added jobs in the informal service

sector, with no social protection. As a result, middle class youth and women, in particular, were at a major disadvantage in the labour market. Secondly, the poor quality of public health and education added a significant financial burden on middle class families as they sought private alternatives to inadequate public services.

In a functioning democracy, the social, economic and political power of the middle class generally influences policymaking. However, a disenfranchised middle class would normally demand institutional reforms to rectify its deteriorating situation. Nevertheless, when self-interested elites and policymakers, engaging in blatant crony capitalism, leave little or no room for others to voice their opposition, weaknesses in governance systems are exacerbated. This, along with social and economic hardship, provides sufficient motive for a middle class revolt.

A close-up photograph of a person's hand holding a white ballot paper. The hand is positioned over a ballot box, with the paper being inserted. The person is wearing a silver ring with a blue gemstone on their ring finger and a blue braided bracelet on their wrist. The background is a dark, blurred blue. A semi-transparent blue box with white text is overlaid on the bottom right of the image.

Compared to other regions, Arab countries' governance indicators are poor and have deteriorated over time. Some of the most evident manifestations of poor governance are tightly controlled political and civic spaces and corruption.

## Part Four

# Explaining the authoritarian legacy

In the past, middle class members in non-Arab countries demanded greater political participation, reforms and social policies; they acted as agents of change in their societies. The Arab middle class, however, reaped the benefits of government policies in the post-independence era, when public education, public sector employment and State handouts were given to pre-empt threats to power.<sup>133</sup> As a result, it were passive and unlikely to criticize. The elites also co-opted the middle class, bringing them into the ruling coalition (or as tolerated opposition).<sup>134</sup> In other words, the regime depended on the middle class as much as the middle class depended on the regime. Diwan<sup>135</sup> argued that the authoritarian model of the Arab region represented an alliance of elites and sections of the middle class, offering economic benefits to its members, such as subsidies. However, it was not just a matter of accepting social assistance in exchange for passive support; the middle class supported State central planning and controlled political opposition. They believed their interests were best protected through State control of the economy.<sup>136</sup> They depended on the State for jobs, business and social services. Therefore, the Arab middle class, rather than criticize and call for political reform, counteracted its implementation, favouring economic liberalization instead, which backfired in the long-run.<sup>137</sup> The authoritarian bargain thus grew from this dynamic, in the form of a social contract “in which the right of citizens to participate in public affairs was

supplanted by promises of social welfare and security”<sup>138</sup>

Part Four of the present report focuses on governance issues to explain the reasons behind the Arab uprisings. Governance spans the public, private and informal sectors and has been widely acknowledged in the literature as one of the main determinants of why some countries succeed on their development paths and others do not. Governance issues also help explain cross-country income and growth differences.<sup>139</sup> Part Four examines these intricate links between the Arab middle class and their political systems and governance structures by analysing governance trends and studying the political beliefs and behaviours of the Arab middle class.

### I. Poor progress on governance

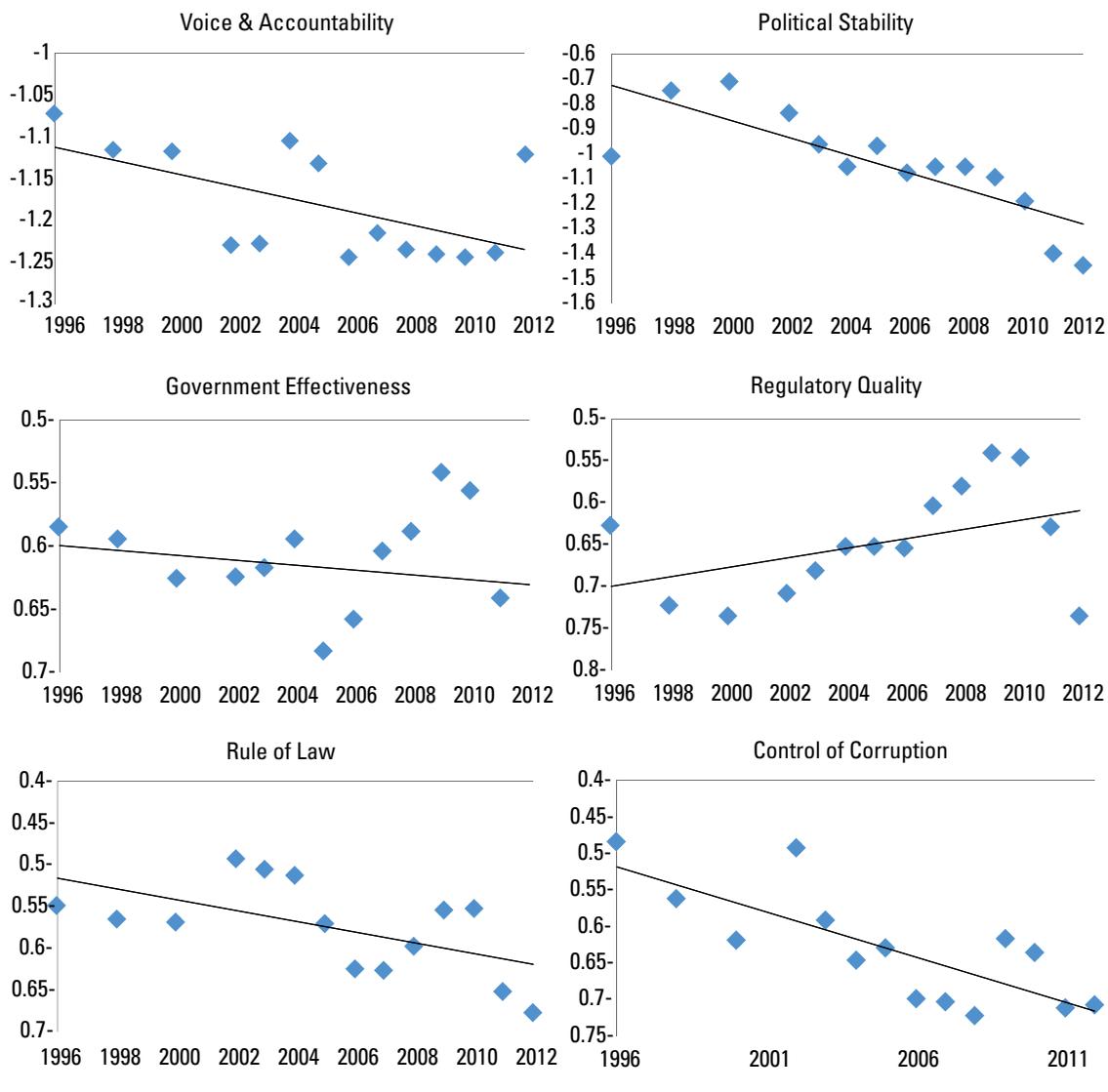
There are several indicators measuring institutional quality, in general, and governance, in particular. They are provided by the Arab Democracy Index, Freedom House, the World Bank, the Polity IV project, the Heritage Foundation and Transparency International, among others. However, these governance indicators are not universally accepted for a number of reasons, such as validity, accuracy and sensitivity to country specificities. An analysis of governance thus needs to consider different, multidimensional indicators so as to better capture the quality of governance.

The Worldwide Governance Indicators (WGI) consist of aggregate and individual

governance indicators for 215 economies over the period 1996-2012 for the following six dimensions of governance: voice and accountability; political stability and absence of violence; government effectiveness; regulatory quality; rule of law; and control of corruption.<sup>140</sup> The average values in all

six governance dimensions are plotted in figure 60 for Arab countries that, in general, do not perform well on governance when compared to other regions. What is more worrying, however, is that the linear trends in five of the six governance indicators are negative for the period 1996-2012. The most

**Figure 60.** Average governance trends in Arab countries



**Source:** Worldwide Governance Indicators (Kaufmann and others, 2014) and ESCWA calculations.

**Note:** The regional average is population weighted.

apparent, and by far most striking, trend is the freefall witnessed in “political stability and absence of violence”, which more than halved from its peak in 2000. The second most salient negative trend is the drop in “control of corruption”, followed by “voice and accountability” (with a noticeable pick up in the latter after 2011, implying an improved perception of governance in the region following the civil demonstrations), “rule of law” and lastly “government effectiveness” (which is quite volatile). The only positive governance trend in the region is in “regulatory quality”, although this indicator also experienced a large drop after 2010.

Arab countries can be split into the following three groups on the basis of their labour and resource characteristics: labour-scarce resource-rich countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates), labour-abundant resource-rich countries (Algeria, Iraq, Libya, the Sudan, the Syrian Arab Republic and Yemen) and labour-abundant resource-poor countries (Comoros, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Palestine, Somalia and Tunisia).

Within the subregional population-weighted averages, there are differences in both the levels and dynamics of governance indicators. Firstly, the best governance indicators, excluding the voice and accountability indicator, is found in labour-scarce resource-rich countries, namely the Gulf Cooperation Council (GCC) countries. They come first in terms of overall dynamics, showing improvements in government effectiveness, regulatory quality and corruption control. However, their voice and accountability indicators have recently deteriorated; GCC Governments do not tolerate political dissent and have oil rents per capita large enough to buy political stability by offering

the middle class public sector jobs and subsidized public services, and providing business elites with State subsidies and allowing them to import labour.

Secondly, the labour-abundant resource-rich combination is seemingly very detrimental to the quality of governance; the countries in this group do worst in absolute numbers in all indicators and show a negative trend in political stability and absence of violence, especially in recent years. The economies in those countries are not industrialized, but have medium oil rents per capita, enough for a chosen few. Their Governments have close ties to the national security and army apparatuses and responded to the Arab uprisings with force.

Thirdly, labour-abundant resource-poor countries fall between the other two groups in terms of quality of governance indicators. The exception is “voice and accountability” where, although they rank first, the negative trend of the indicator is so slight that it could be interpreted as stagnating. The political system in these countries is relatively competitive; autocrats survive largely because of the tacit or direct support of the West and a mix of give-and-take policies.

Undoubtedly, subregional aggregation hides country heterogeneities; in terms of progress, the Arab region has underachievers, but it also boasts overachievers. Kuwait, Tunisia and the United Arab Emirates are three of the top five improvers of legal institutional quality across the world, and Qatar and the United Arab Emirates are two of the top five improvers of political institutional quality.<sup>141</sup> Absolute levels of governance quality are still distant from those of some western countries. In general, governance quality fell over time in the Arab region, quite starkly in some countries.

As argued earlier, falling governance quality weakens the social contract and limits the avenues available for political expression. In the absence of a participatory process, individuals begin demonstrating, which is not always a sustainable option.

Examining the four Arab countries where civil uprisings resulted in political transition (Egypt, Libya, Tunisia and Yemen) and their relative (in relation to other countries) and absolute (within the country itself) quality of legal, political and economic institutions, table 2 sheds additional light on the region's quality of governance, which has been deteriorating since the 2000s. Although these countries had differing levels of institutional quality, they had a common trend in the quality of political institutions. The quality of the political system in all four countries had been deteriorating compared to other countries (relative) and within each country over time (absolute). Other Arab countries, where civil unrest did not result in political transition, shared this negative trend in political system quality. Therefore, this deterioration in political governance cannot be interpreted as a deciding factor leading to uprisings and political transition. It did, however, weaken the traditional social contract by making the trade-off between political rights and economic benefits less attractive. The increasing exclusion of the population

from the political process might therefore have tipped the balance, causing popular discontent.

The deteriorating quality of Arab political systems can be confirmed by the indicators from Cingranelli-Richards (CIRI) Human Rights Dataset.<sup>142</sup> The Political Empowerment Index shows that the Arab region experienced a drop in political openness between 1980 and 2010. The regional average fell from approximately 6 in 1980 to 2 in 2010 on a scale from 0 to 14, where 0 represents complete dictatorship. Similarly, the Physical Integrity Index, which ranges from maximum repression at 0 to 8, fell from 4.5 to 2.5 over the same period, indicating that the ruling elite increasingly used repression as a political tool even before the uprisings.<sup>143</sup>

Another way of gauging the quality of governance is to use the average values of several institutional proxy variables. Using more than thirty institutional quality variables to sort countries, five clusters with specific characteristics emerge. Cluster five comprises countries with the best quality institutions and cluster one consists of countries with the worst. Of the 12 Arab countries for which data is available, three are in cluster 1 and nine are in cluster 3. Cluster characteristics are determined

**Table 2.** Poor governance indicators prior to the Arab uprisings

	Relative institutional dynamics			Absolute institutional dynamics		
	Legal	Political	Economic	Legal	Political	Economic
<b>Tunisia</b>	Positive	Negative	Negative	Positive	Negative	Positive
<b>Egypt</b>	Positive	Negative	Negative	Positive	Negative	None
<b>Libya</b>	Negative*	Negative	No data	Negative	Negative	None
<b>Yemen</b>	Negative*	Negative	No data	Negative	Negative	Positive

**Source:** Abu-Ismaïl and others (2014) from Kuncic (2014).

\* Data to 1999

by comparing the average values of institutional quality and other variables between clusters over a 21 year period, from 1990 to 2010. The average values for these two decades indicate that several countries have improved significantly over that period while others have regressed.<sup>144</sup>

Cluster 1, which includes Algeria, Egypt and the Syrian Arab Republic, is the worst in terms of governance quality, consistently scoring one standard deviation below the world sample average in legal, political and economic institutional quality. The average GDP per capita of the 28 countries in cluster 1 is only \$933, life expectancy is less than 58 years and the literacy rate is below 67 per cent. These countries are underdeveloped, poor and politically unstable and often exhibit characteristics of failed States.

Most Arab countries, however, are in cluster 3, including Bahrain, Jordan, Kuwait, Morocco, Oman, Qatar, Saudi Arabia, Tunisia and the United Arab Emirates. Cluster 3 is peculiar; despite being the middle cluster in ordinal ranking, it does not score average values on institutional quality across the different indicators. Instead, it does very well in some institutional variables and development indicators and very poorly in others. Under legal institutional quality, cluster 3 scores well on the quality of courts and protection of property rights, but poorly on freedom of the press, civil liberties and interference of religion in politics. With regards to political institutional quality, it does very poorly on the autocracy versus democracy measure, checks and balances and democratic accountability but very well on the measure of corruption in the public sector. Lastly, it does reasonably well in terms of quality of economic institutions and governance, with the exception of economic oppression of the press in which the cluster scores very poorly.

It is interesting that cluster 3 exceeds cluster 4 in terms of average GDP per capita, but falls behind it by more than 10 percentage points in literacy rates. Therefore, “countries in cluster 3 seem to be reasonably well off, with the exception of providing certain civil liberties (which might depend also on gender and religion), democratic accountability and free media”<sup>145</sup> and, as seen time and again in the Arab region, “political space, whether that of political parties, professional associations and trade unions, civil society or the media, remains constrained and often tightly controlled, restricting people’s options to voice their concerns”<sup>146</sup>

The Arab Millennium Development Goals Report<sup>147</sup> also shows a strong and positive correlation between good governance, as captured by the voice and accountability indicator of the World Bank,<sup>148</sup> and prosperity, as captured by taking the log of GDP per capita, which is shown in figure 61 for the year 2012: “the Arab region lags behind other regions in most governance indicators. Most countries are in the bottom quadrants [...], especially on the lower right, which suggests a combination of national wealth and poor governance”<sup>149</sup> It is evident from figure 61 that Arab countries fall below the sample average in terms of governance quality; the positive sample trend linking higher incomes with higher governance quality also disappears when only the Arab countries are considered.

This combination has at least two corollaries: one confirms, again, that the Arab region lags behind other regions in institutional quality but not necessarily in income; the other, indicates that an implicit agreement must exist between governing elites and citizens – a social contract in the form of an authoritarian bargain – which makes possible this combination of relatively high incomes and few political rights.

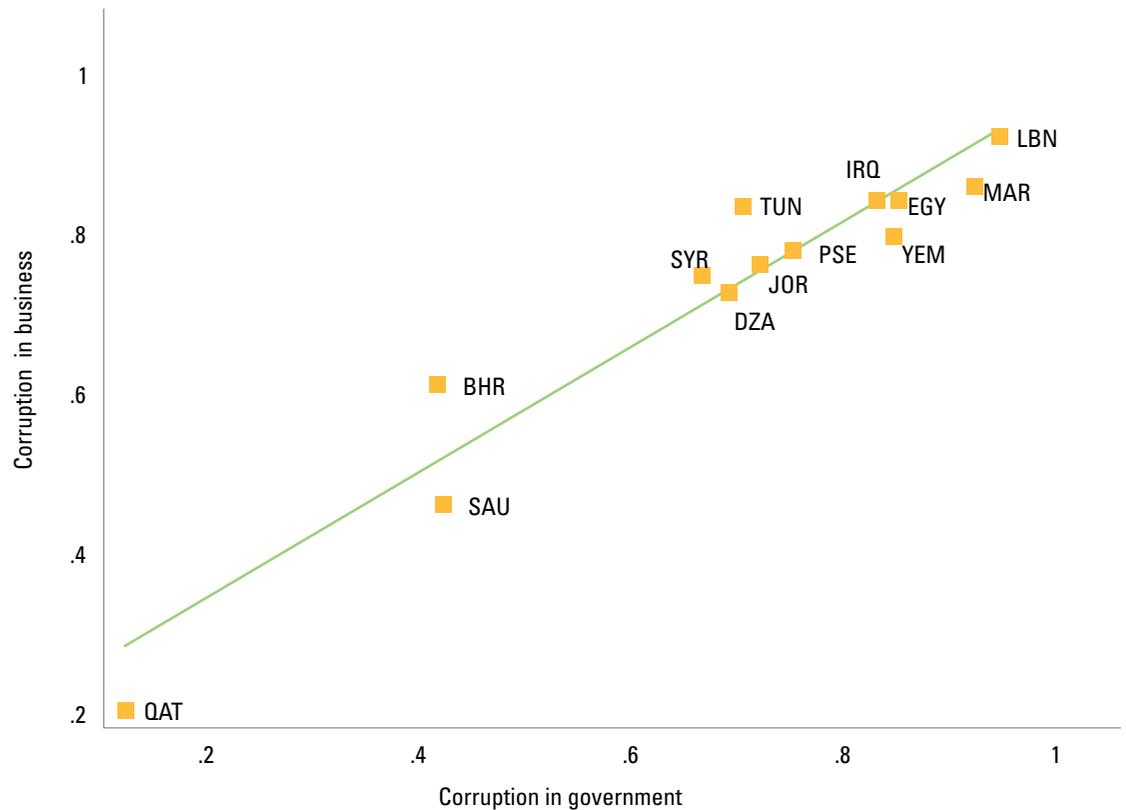


were co-opted by regimes. As such, the middle class benefited from the largesse of government handouts and other economic rents and therefore did not demand reform. This *modus operandi*, based on a rent-seeking political economy, has led many Arab States down a non-developmental path. The apparent political stability of Arab countries was in reality the result of the oppression and suppression of its citizens' human rights.<sup>153</sup> Patronage of State apparatuses by Arab Governments, described as "uncivil" States by Ismael and Ismael,<sup>154</sup> was often aided by external powers with vested interests in the region, using pretexts such as the Cold War or the War

on Terror to interfere. Some Arab citizens strongly criticized their Governments for behaving like foreign occupiers in their own countries, participating in "internal colonialism"; whereby the ruling elites act like settler communities.<sup>155</sup> This model led to a lack of State accountability and an increasing concentration of political and economic power in the hands of a few.

The result of this governance system has been disastrous in the long-term. There continues to be a general perception of corruption in most Arab countries. The Corruption Perceptions Index 2013,<sup>156</sup> a widely accepted corruption measure, still

**Figure 62.** Corruption was widespread in both the public and private sectors



Source: Diwan and Nabli, 2013.

places six Arab countries (Iraq, Libya, Somalia, the Sudan, the Syrian Arab Republic and Yemen) in the bottom 10 countries of the 175 countries surveyed. Similarly, the Arab Opinion Index,<sup>157</sup> examining the positions of people in 12 Arab countries, found that 83 per cent of respondents believed corruption was widespread in their countries. It also found that most people attributed the Arab uprisings to corruption, dictatorship and the lack of justice and equality. The public sector was perceived as corrupt and the private sector was seen to be complicit in corruption (figure 62).

These perceptions reflect the prevalence of practices such as cronyism, granting inner circle groups access to monopoly rights, privileged business deals and financial market manipulation, especially in Algeria, Egypt, Libya, the Syrian Arab Republic, Tunisia and Yemen.<sup>158</sup> Cammett and Diwan argue that crony capitalism weakened the private sector in the Arab region, thus negatively affecting countries' economic performance, making it one of the many factors that led to the Arab uprisings. Nevertheless, the most relevant impact of cronyism was that it tightened the authoritarian coalition, negatively affecting the middle class. This was the tipping point that led the middle class to join forces with the protestors. Given that it is the largest social group, its defection was vital to any regime-changing efforts.

## II. Middle class attitudes on political participation

Subnational analysis and data is essential to determining whether the Arab middle class has particular preferences and political attitudes. One source is the World Values Survey (WVS), which explores peoples' attitudes, values and beliefs across countries and over time,<sup>159</sup> mainly evaluating governance issues through

informal institutions, such as attitudes, trust and norms.

WVS wave 6 data that, upon completion, will cover 13 Arab countries (11 of which are included in the dataset in table 3), facilitate the study of Arab middle class attitudes and their comparison to those of other socioeconomic groups. Moreover, middle class attitude dynamics can be traced in the five countries with more than one data point, namely Algeria, Egypt, Iraq, Jordan and Morocco.

The following Survey question in particular helped identify those who perceived themselves as members of the middle class: "People sometimes describe themselves as belonging to the working class, the middle class, or the upper or lower class. Would you describe yourself as belonging to the middle class; upper class; upper middle class; lower middle class; working class; or lower class?" Middle class size measured by self-perception in the Survey is similar to that measured by the method proposed in this report. What emerges is that the middle class is, by far, the largest class in all Arab countries, except in Morocco and Yemen, where the working class is slightly larger (table 1). Representing the largest social group, the middle class in the Arab region has the capacity to be the driver of change, given that its attitudes, beliefs and actions play a big role in society.

The added value of the Survey data is that the attitudes and beliefs of each class can be examined separately and compared. For example, it clarifies whether middle class political participation differs from that of other classes. Several questions in the Survey deal with political processes; examples include the importance of politics in life, membership in a political party, the importance of order and price stability

**Table 3.** Coverage of Arab countries in the World Values Surveys

	Wave 4	Wave 5	Wave 6
Country	1999 - 2004	2005 - 2007	2010 - 2014
Algeria	yes		yes
Egypt	yes	yes	yes
Iraq	yes	yes	yes
Jordan	yes	yes	yes
Morocco	yes	yes	yes
Saudi Arabia	yes		
Bahrain			yes*
Kuwait			yes**
Lebanon			yes
Libya			yes
Palestine			yes
Qatar			yes
Tunisia			yes
Yemen			yes

Source: WVS, 2008; and WVS, 2014.

\* Not available at the time of writing.

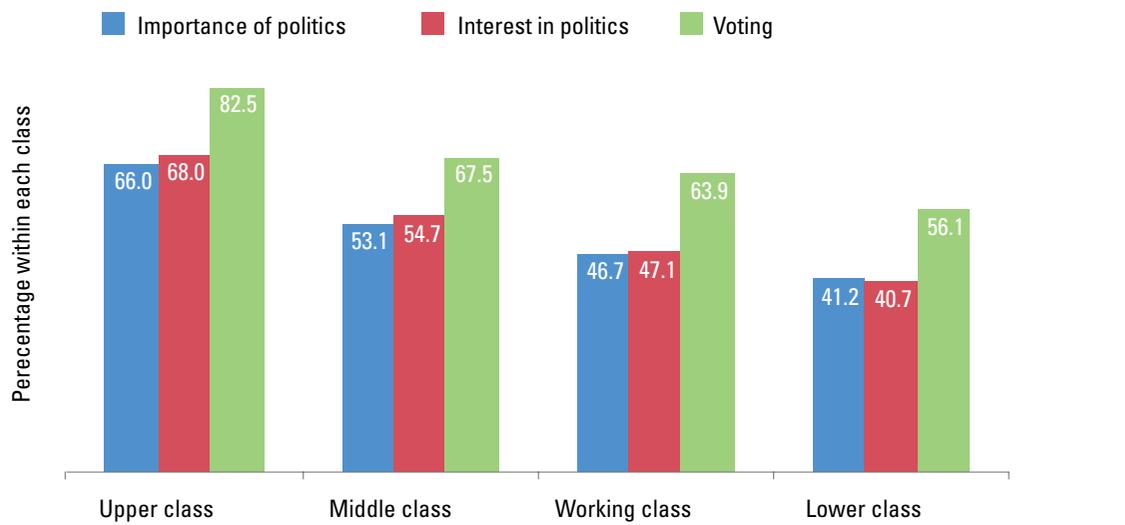
\*\* Not included in the dataset.

versus freedom of speech and options of political participation, interest in politics, likelihood of joining or having already taken part in a political or civil initiative, confidence in State structures, views on political systems, importance of being governed democratically, voting in elections, opinion on election fairness, etc. This report examines selected questions from wave 6, which has the broadest country coverage, by disaggregating views and attitudes by social class. It also studies selected questions repeated in waves 4, 5 and 6 to determine how middle class attitudes evolved over time, from 1999 to 2014.

#### A. Political engagement of the middle class

Figure 63 presents the share of participants, by social class, who responded that politics was important in life, said they have an

interest in politics, or that they usually or always voted in national elections. All three sets of responses are similar in that the share of people that place value on politics decreased with each social class examined: the upper class had the highest percentage of people valuing politics and who had an interest in politics and voting, while the lower class had the lowest shares in all three categories. Middle class responses to all three questions showed that over half of the middle class valued politics. In terms of relative shares, the middle class was the second highest class that valued politics. In terms of population size, the middle class had the largest number of people who said politics was important in life, had an interest in politics and voted in national elections. Since the middle class is the largest population group, its political participation is very significant.

**Figure 63.** Importance of politics, interest in politics and voting in national elections

**Source:** WVS (2014) and ESCWA calculations.

**Note:** Country shares by class are population-weighted to arrive at the regional mean. In countries and classes with fewer than 10 respondents, the shares were not calculated on account of the unrepresentativeness of such a small sample and the likelihood of biasing the regional average.

The graph represents individuals' responses to three separate questions from the WVS, therefore the percentages within a class do not add up to 100 per cent.

**Figure 64.** Interest in politics over time

**Source:** WVS (2014) and ESCWA calculations.

**Note:** Country shares are population-weighted to arrive at the regional mean in every wave, and the three points are then connected with a line.

A disaggregated and dynamic view is set out in figure 64, where this trend can be observed country by country, with an overall similarity. For example, interest in politics has declined over time in Iraq, Jordan and Morocco; the exceptions are Egypt, where interest in politics has markedly increased over time, and Algeria, where there has been a slight increase.

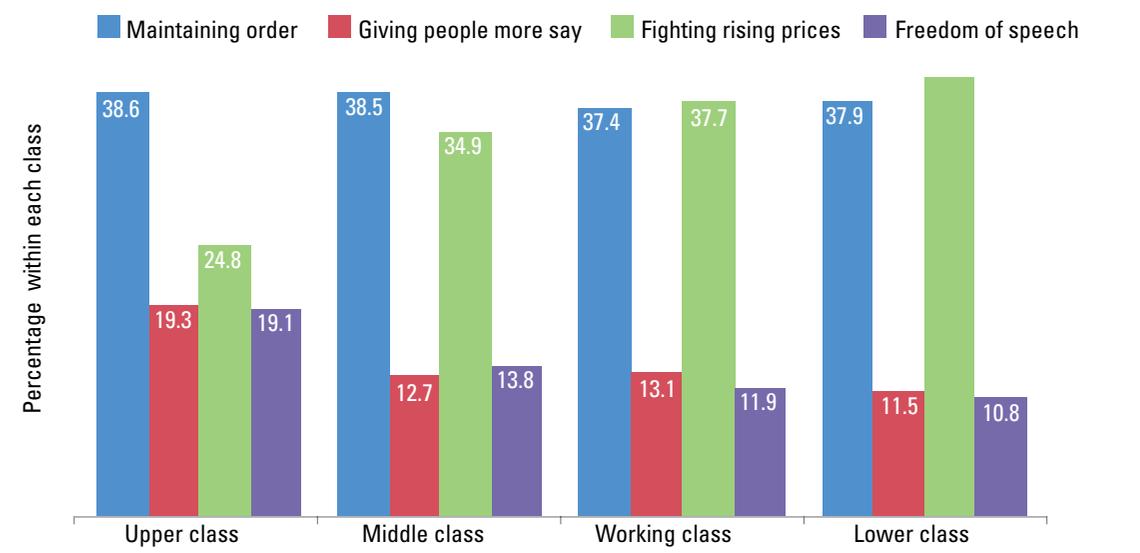
## B. Stability versus freedom

In the sixth wave, people were asked what they deemed to be the most important and second most important concept from the following list: maintaining order in the nation; giving people more say in important government decisions; fighting rising prices; and protecting freedom of speech. Figure 65 shows that all social classes highly valued maintaining order; almost 40

per cent of respondents within each social class prioritized this category or classified it as a close second. After maintaining order, inflation concerns were central to all classes. Lastly, protecting freedom of speech and giving people more say were chosen by no more than 14 per cent and 13 per cent of the middle class, respectively.

As discussed earlier, economic hardship is widespread in most Arab countries, reflected in people's desire for Governments to control inflation. Freedom of speech and giving people more say in government decisions were not considered as important as security and inflation. On average, only around 10 per cent of the lower class and 20 per cent of the upper class saw freedom of speech as important. Since the Arab region is conflict-prone, people prefer leaders who can provide security and economic stability;

**Figure 65.** Maintaining order and curbing inflation are top priorities



**Source:** WVS (2014) and ESCWA calculations.

**Note:** Country shares by class are population-weighted to arrive at the regional mean. In countries and classes with fewer than 10 respondents, the shares were not calculated on account of the unrepresentativeness of such a small sample and the likelihood of biasing the regional average.

The graph represents the responses of individuals to two questions of the 2014 WVS, which have been equally weighted so the answers add up to 100 per cent within each class.

political participation and freedom of speech concerns lag behind or perhaps only become relevant when Governments fail to cater for the first two concerns.

The countries with higher shares of the middle class placing importance on freedom of speech and giving people more say in governance are Lebanon (21 per cent), Libya (18 per cent) and Algeria (17 per cent); at the bottom of the list are Tunisia (7 per cent), Yemen (8 per cent) and Egypt (10 per cent). Inversely, the countries where the middle class places the most value on maintaining order and fighting rising prices, are Tunisia (44 per cent), Yemen (42 per cent) and Egypt (40 per cent); the countries where they place the least importance are Lebanon (31 per cent), Libya (32 per cent) and Algeria (33 per cent). This indicates which aspect of the social contract was

more scrutinized by the middle class: the economic or the political. In general, particularly in Egypt, Tunisia and Yemen, the deteriorating economic side of the social contract might have contributed more to civic discontent, but in Libya, political factors might have been more relevant.

Looking at people’s views on the importance of these concepts is revealing, especially in terms of the share of the middle class that ranked one or both of the democracy related concepts – freedom of speech and giving people more say – as more important in comparison to maintaining order and fighting inflation. This is a much more robust way of looking at the data, given that it appropriately captures the dynamics over time. This type of counting in disaggregated form and throughout all three WVS waves is set out

**Figure 66.** Maintaining order and fighting inflation override democratic values



**Source:** WVS (2014) and ESCWA calculations.

**Note:** Country shares are population-weighted to arrive at the regional mean in every wave, and the three points are then connected with a line.

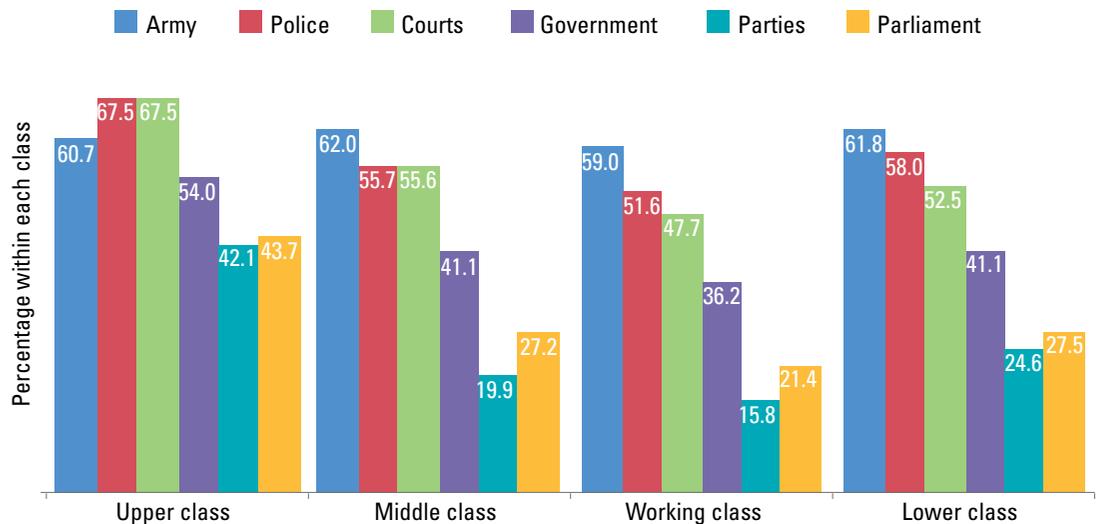
in figure 66. Firstly, it shows that only a very small share of the middle class responded to such general questions, between 11.5 per cent in wave 4 to 8.5 per cent in wave 6, following the uprisings. Accordingly, looking at the shift from before to after the civil uprisings, the share of people preferring either freedom of speech or giving people more say to maintaining order or fighting inflation dropped sharply in Egypt, Iraq, Jordan and Morocco, increasing only in Algeria. This is further confirmed by looking at the added shares of people choosing maintaining order or fighting inflation as important, which increased in the weighted sum from 63 per cent to 65 per cent between wave 4 and wave 5, peaking at over 72 per cent in wave 6. Egypt and Iraq made the largest jump in the last period (increasing by 20 per cent

and 25 per cent, respectively), followed by Morocco and Jordan, while again in Algeria this share of people slightly decreased. The increasing preference for order and economic stability, combined with a decreasing preference for democratic ideas, is clearly visible in this type of analysis between wave 4 and wave 6 - before and after the civil uprisings.

**C. Confidence in political and State structures**

Figure 67 sets out the share of people who responded that they had either a “great deal” or “quite a lot” of confidence in State structures. Differences in confidence levels across social classes were not very pronounced in the sixth wave, but there were only three State structures scoring consistently around 50 per cent across all classes; the most trusted was the army,

**Figure 67.** Confidence in State structures



**Source:** WVS (2014) and ESCWA calculations.

**Note:** Country shares by class are population-weighted to arrive at the regional mean. In countries and classes with fewer than 10 respondents, the shares were not calculated on account of the unrepresentativeness of such a small sample and the likelihood of biasing the regional average.

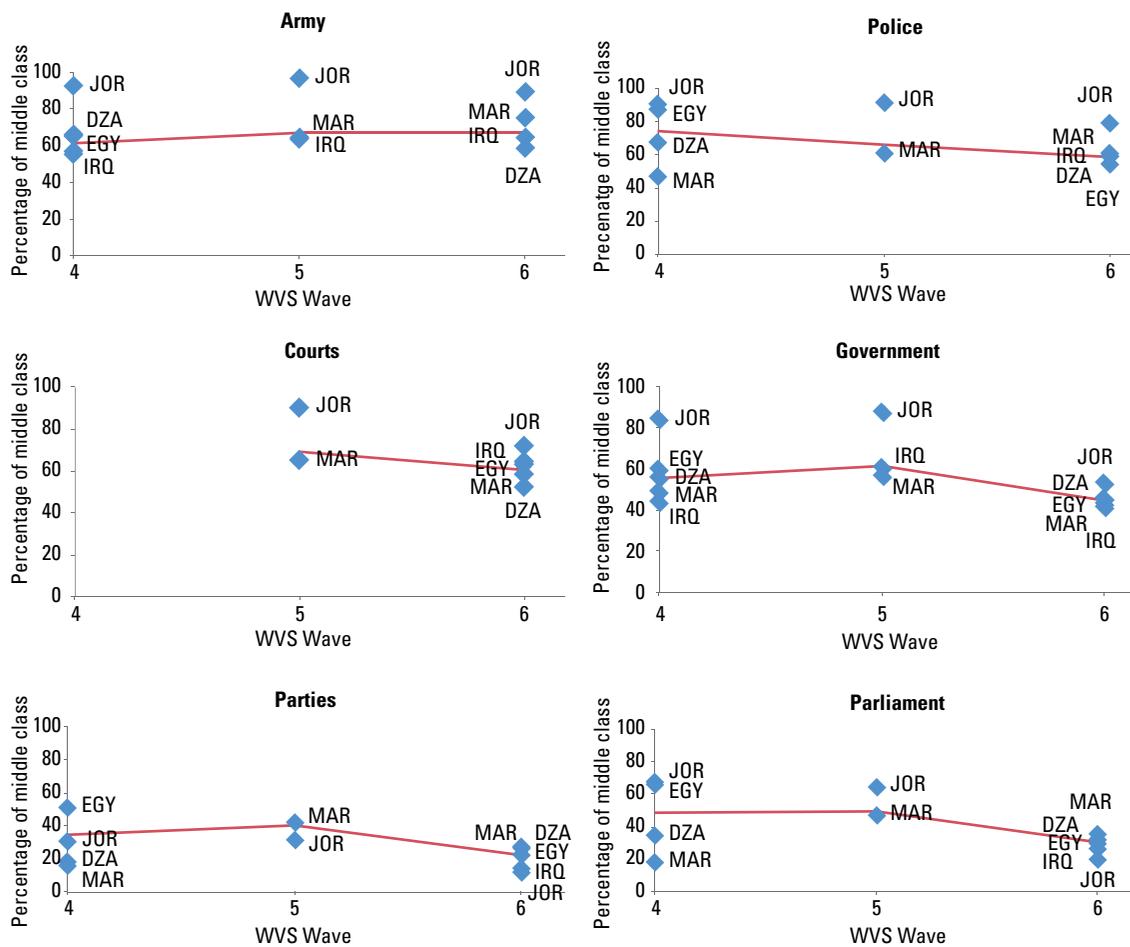
The graph represents the responses of individuals to six separate questions on the WVS, therefore the percentages within a class do not add up to 100 per cent.

followed by the police, then the courts. On a much lower level is confidence in Government, parliament and political parties, which are at the bottom of the list, especially the latter two. The working class had the lowest confidence in these three State structures, tightly followed by middle class disappointment in party politics and parliament.

It is worth noting that questions about confidence in the army were not asked in

Egypt, and questions about confidence in political parties were not posed in Qatar. The country with the highest vote of confidence from the Arab population was Qatar, where 80-90 per cent of respondents said that they had confidence in each State structure. At the other extreme was Yemen; levels of confidence in all State structures were well below the 37 per cent vote of confidence given to the army, which scored the highest. In addition to Qatar (96 per cent), the army and police

**Figure 68.** Confidence in nearly all State structures has declined over time



**Source:** WVS (2014) and ESCWA calculations.

**Note:** Country shares are population-weighted to arrive at the regional mean in every wave, and the three points are then connected with a line.

enjoyed an extremely high overall level of trust by citizens in Jordan (88 per cent) and Morocco (70 per cent); the lowest levels of overall trust were observed in Yemen (37 per cent) and Lebanon (43 per cent). Political parties and Government were the least trusted in the region; the countries with the least confidence in them were Tunisia (11 per cent), Libya (16 per cent) and Yemen (20 per cent); and the countries with the highest (although still low) confidence in them were Palestine (29 per cent) and Morocco (37 per cent).

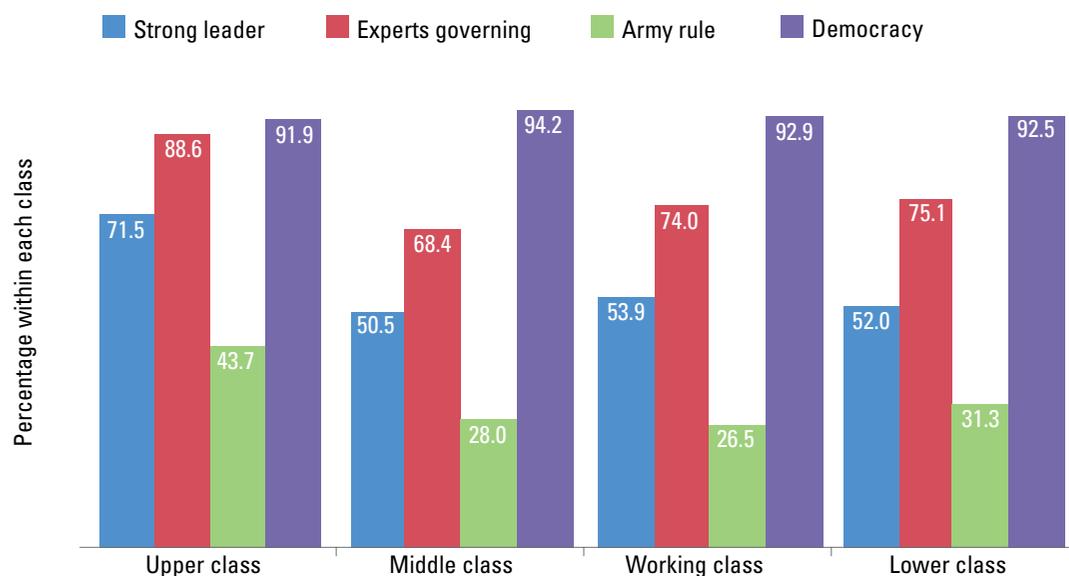
Confidence in all political and State structures, except the army, declined over the second half of the 1990s, as shown in figure 68. Over waves 4, 5 and 6 of the Survey, confidence in the army stayed stable, even marginally increasing to over

60 per cent of the middle class holding a favourable opinion. However, confidence in the police decreased in most countries from 80 per cent to 60 per cent among the middle class. Likewise, middle class confidence in Government, political parties and parliament declined.

#### D. How to govern a country

Over 90 per cent of those surveyed in each class believed that democracy was the best way to govern a country, as shown in figure 69. Around 70 per cent agreed that having experts, not Government, make decisions was a good way of governing, while less than 50 per cent of each social class believed that having a military government was good. A strong leader, unbound by elections and parliament, had around 50

**Figure 69.** Best way of governing a country



**Source:** WVS (2014) and ESCWA calculations.

**Note:** Country shares by class are population-weighted to arrive at the regional mean. In countries and classes with fewer than 10 respondents, the shares were not calculated on account of unrepresentativeness of such a small sample and the likelihood of biasing the regional average.

The graph represents the responses of individuals to four separate questions from the Survey, therefore the percentages within a class do not add up to 100 per cent.

per cent of the population's support in all but the upper class. Comparing across classes, the sixth wave data showed that the middle class believed the least in the capacity of a strong leader to govern the country well and, along with the working class, believed the least in the governing capacity of the army. Distaste for the army and a strong leader was reflected in their low scores that were much lower than democracy, which was by far the highest ranking system of governance across all classes and all countries.

Qataris were not asked any of these four questions. Egyptian respondents overwhelmingly supported all three systems of governance (over 80 per cent for each); but neither they nor Moroccans were asked the question about army rule. The middle classes most in favour of democracy and experts governing were in Tunisia (85 per cent) and Morocco (84 per cent); and those least in favour were in Algeria and Jordan (both 68 per cent). However, support for more autocratic rule, where either the army or a strong leader were thought to be favourable, was mostly found in Lebanon (54 per cent) and Libya (48 per cent), but not in Algeria (25 per cent) or Iraq (28 per cent).

**Figure 70.** Support for a strong leader



**Source:** WVS (2014) and ESCWA calculations.

**Note:** Country shares are population-weighted to arrive at the regional mean in every wave, and the three points are then connected with a line.

In terms of general trends, figure 70 showed that middle class preference for a strong leader increased between the fifth and sixth waves, while that for experts governing, army rule and democracy remained stable over time. The large increase in the preference for a strong ruler was especially affected by the large increase in support in Egypt.

### E. High democratic aspirations that do not reflect reality

Two of the questions in the sixth wave asked respondents to rank, on a scale of 1 to 10, the importance of living in a democratically governed country; and how democratic did they believe their country to be. Number 10 represented the most important for the first question and most democratic for the second. The histogram of fractional distributions of both questions is shown in figure 71.

Close to 50 per cent of respondents gave democratic governance the highest importance (10) and very few respondents ranked it less than 5. Opinions on the current state of democratic governance were much more evenly distributed, with two slight peaks at the worst value (1) and one at 5. The difference between the first and the second distribution implies a mismatch between the importance and the actual state of democratic governance in the Arab region. For instance, there is a large gap between those who ranked democratic governance to be the most important (the opinion of 45 per cent of people) and those that judged the current state of democratic governance to be the most democratic (the opinion of only 6 per cent of people). This gap, in aggregate terms, of practically forty percentage points relays a mismatch between aspirations and reality.

Even on an individual level, most people perceived a mismatch between aspirations

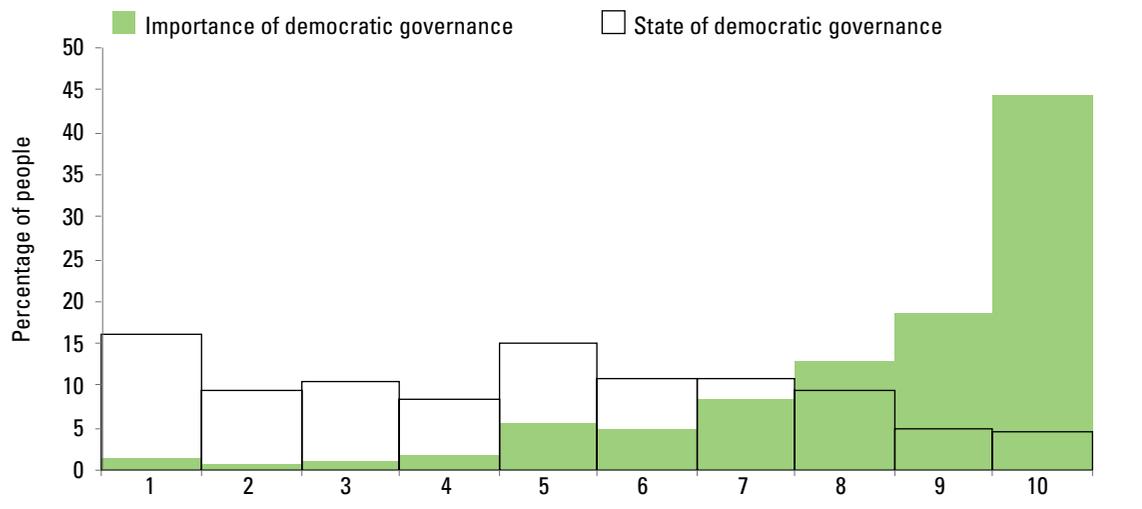
for democracy and the reality in their countries; only 17 per cent did not perceive this mismatch. Of these 17 per cent, less than 10 per cent thought the state of democratic governance was better than what it should be. Looking at the extremes, the share of people with the highest possible mismatch (people placing the highest value on the importance of democratic governance and judging the actual state of democratic governance to be the least democratic) is quite large: 10 per cent for the upper class, 8 per cent for the middle class, 12 per cent for the working class and 21 per cent for the lower class.

Calculating the positive individual mismatch points between the importance of democratic governance and the current state of democratic governance, aggregating the value to a country total, dividing by the maximum number of dissatisfaction points per country (N\*9, to control for sample size),<sup>160</sup> yields a democratic dissatisfaction score (DDS). DDS provides a ranking of countries

whereby both the number of dissatisfied people and the intensity of their dissatisfaction are reflected, capturing two crucial dimensions: scope and depth. It can also be normalized into an index, where 100 represents the least dissatisfied country. Table 4 sets out the ranking from least dissatisfied to most dissatisfied countries, along with the three variables used to calculate the score (individual mismatch points, number of respondents and maximum points), DDS and a normalized democratic dissatisfaction score index. Algeria, Jordan and Lebanon were the least dissatisfied countries, while Egypt, Libya, Morocco and Tunisia were the most dissatisfied; Libya had a DDS score almost double that of Jordan.

The findings from the different waves of the Survey are corroborated by country-level surveys for the case of Egypt, for example (box 5). What emerges is that, although most people prefer democratic forms of government, this opinion is faltering as a result of the turbulent political transitions

**Figure 71.** Importance of democratic governance versus state of democratic governance



**Source:** WVS (2014) and ESCWA calculations.

**Note:** Country shares by class are population weighted to arrive at the regional mean.

**Table 4.** Democratic dissatisfaction score

Rank	Country	Points	N	Maximum points (N*9)	DDS (100*points / maximum points)	DDS Index (100* DDS_i/DDS_Jordan)
1	Jordan	2211	712	6408	34.50	100
2	Lebanon	2981	791	7119	41.87	121
3	Algeria	2696	706	6354	42.43	123
4	Iraq	4194	939	8451	49.63	144
5	Yemen	3138	672	6048	51.88	150
6	Palestine	3436	714	6426	53.47	155
7	Egypt	6412	1174	10566	60.69	176
8	Morocco	4365	795	7155	61.01	177
9	Tunisia	5105	901	8109	62.95	182
10	Libya	8512	1421	12789	66.56	193

**Source:** WVS (2014) and ESCWA calculations.

**Note:** The question on the state of democratic governance was not asked in Qatar.

### Box 5. A rocky transition in Egypt

This report analyses democratic perception in Egypt using the Pew Research Centre's survey. For example, in Egypt, 60 per cent of people thought that democracy was the best form of government. This opinion increased to a peak of 71 per cent in 2011 but has been declining since, dropping to 59 per cent in 2014. In other words, unsuccessful political transition left people very dissatisfied. Egyptian dissatisfaction over the situation in their country increased to phenomenal levels, reaching 72 per cent in 2014 (it was at 69 per cent just before the Arab uprisings in 2010 and declined to 34 per cent in 2011 after the overthrow of the Mubarak regime). In 2007, roughly 50 per cent of people preferred a democratic form of government. This figure increased to 64 per cent in 2011 after the Arab uprisings and has since declined to 52 per cent. In contrast, 47 per cent of people preferred a strong leader in 2007, an opinion which dropped to its lowest level of 33 per cent in 2012, rising again to 43 per cent in 2014.

In general, the perception of the country's economic conditions has further deteriorated from 46 per cent who thought the economic situation was unfavourable in 2007, to 80 per cent just before the uprisings in 2010, then down to 76 per cent in 2014. However, when asked whether strong democracy or stable government was more important, 54 per cent of people in 2011 preferred strong democracy (compared to 32 per cent preferring stable government), dropping to 44 per cent in 2014, while preference for a stable government increased to 54 per cent in the same year.

In 2011, around 88 per cent of people said that the military was a good influence on the country, dropping to 56 per cent in 2014. Confidence in the courts also declined from 67 per cent in 2011 to 41 per cent in 2014. However, 63 per cent of those surveyed in 2014 thought that the Government did not respect personal freedoms, up from 44 per cent in 2013.

**Source:** Pew Research Centre, 2014.

taking place in the Arab region. This supports this report's findings on people's preference for stability and inflation control over freedom of speech and political participation, as well as an increasing preference for a strong leader.

### III. Conclusion

Arab countries' governance indicators are poor in relation to other regions and have deteriorated over time. However, country variations must be considered because there have been some improvements in some countries. Moreover, compared to their income levels, Arab countries are doing poorly in terms of governance. Some of the most common manifestations of poor governance are constrained and tightly controlled political and civic spaces, and corruption. Deteriorating political system quality is a characteristic that all the so called Arab Spring countries share, namely Egypt, Libya, Tunisia and Yemen.

These results are consistent with this report's earlier conclusions on the nature of the traditional social contract. The middle class was brought into the ruling coalition through public handouts, subsidies and public sector employment or, in some countries, it formed the tightly controlled tolerated opposition. As such, it did not or could not demand political reform or better governance.

Part Four of the present report reviewed the World Values Survey results on the political attitudes and political participation of the Arab middle class. With regard to participation, the majority of the middle class is interested in politics and this interest is increasing over time. They (as well as other classes) overwhelmingly rank democracy as the best form of government. There is, however, a significant mismatch between high aspirations for democratic governance and the actual state of

democratic governance in Arab countries. This is especially evident in Egypt, Libya, Morocco and Tunisia. Surprisingly, however, confidence in repressive State structures, such as the army, police and courts, is higher than that in democratic structures, such as parliament, political parties and Government. Nevertheless the middle class's confidence in all political and State structures, except in the army, has declined since the second half of the 1990s; another sign of the growing dissatisfaction that led to the uprisings.

Although the importance of democracy is frequently professed, when ranking concepts by order of importance, people still value stability and low inflation twice as much as participating in important decision-making processes and protecting freedom of speech. Moreover, preferences for a strong leader are increasing. This could be derived from the difficult political transitions in the region that have taken time and have come at an economic cost. The nominally expressed support for democracy but the preference for stability and economics over democratic values could indicate a continued preference for the old authoritarian bargain – limited political rights in return for stability and economic benefits. Alternatively, stability could be seen as a necessary prerequisite for a successful democracy.



The Arab region is in desperate need of a governance revolution to undo the old authoritarian bargain; development policies must no longer be used primarily as political tools. Democratic change can only be achieved by using fiscal space to implement inclusive development plans and by establishing a safe social space where the middle class can establish a collective identity.

## Part Five

# A socially conscious developmental State

The present report was prepared amid conditions of economic uncertainty and political instability in the Arab region, which have significantly affected many national economies since 2011. The economic cost of the unrest in the Syrian Arab Republic alone was estimated to have reached \$140 billion by the end of 2013; adding losses incurred in Egypt, Libya and Yemen, the regional GDP cost could exceed double that amount.<sup>161</sup> In this context, discussing the notion of a developmental State might appear a luxury. However, this State is needed now more than ever to offer security, create decent jobs and provide quality social services so as to reassure households. Otherwise, many more Arab countries face the risk of becoming politically unstable and economically dysfunctional.

As the title suggests, Part Five of this report defines a socially conscious developmental State. As stated in the previous parts of the present report, this requires a move away from the “rentier State” or “police State”. The nature of the post-revolutionary developmental State and the priority policy shifts it needs to promote have already been the subject of several studies, notably the 2011 Arab Development Challenges Report<sup>162</sup> that was entirely devoted to this issue; the ILO and UNDP report<sup>163</sup> on rethinking growth that addressed it from an employment centred perspective; and the ESCWA reports entitled *Arab Integration: A 21st Century Development Imperative* and *Promises of Spring*.<sup>164</sup> The emerging

consensus is that a developmental State presupposes a governance system based on mutual accountability through social dialogue and political participation. It can also be defined in terms of an inclusive development model that it advocates, implying, among other things, respect for the values of equality, equity, rights and participation;<sup>165</sup> and social and economic justice.<sup>166</sup>

Part Five of this report discusses what such development policy measures should look like, highlighting the long-term possibilities for today’s middle class (politically stable countries) and ways to assist the vulnerable and the poor to become the middle class of tomorrow. Needless to say, in politically charged conflict zones, the priority is conflict resolution and peacebuilding. Hence, Part Five covers Arab countries where general conditions allow for the design and implementation of long-term development plans and where the middle class is a sizable socioeconomic force.

With these considerations in mind, Part Five begins by defining the general features of this developmental State. It then discusses measures to improve the position of today’s middle class; decent employment creation would largely meet most of these concerns by yielding higher and more equally distributed labour incomes. Secondly, it argues that measures to expand the middle class are also necessary; expanding the capabilities of the vulnerable and the poor by embracing social protection floors as

the most comprehensive policy solution for ensuring that everyone has approximately the same opportunities in life. Thirdly, fiscal policy issues are discussed to suggest means for financing schemes through measures such as reforming energy subsidies, taxation systems and army expenditures. Lastly, as noted above, improving governance is an overarching objective with positive spillovers in all suggested policies.

## I. What is a developmental State?

As a result of the 2008 global financial crisis, the subsequent threats to development progress and the effects of the Arab uprisings, this report suggests a stronger State role in the development process, which entails actively promoting socially inclusive and economically just structural transformation in the Arab region. Nevertheless, there is still no consensus on the role of the State, which remains a major topic of disagreement in development debates. During the 1980s and 1990s, there was a shift towards market-oriented neoliberal policies emerging from the Washington Consensus, which forced many Arab countries to roll out the State. However, recent breakthroughs in development, especially in emerging countries, including Brazil, China, India, Malaysia, Mauritius and the Republic of Korea, have shown that there is a need to revisit the State's role in development thinking. These countries resorted to unorthodox policies to advance growth and development, reflected in their development and economic indicators.

The Least Developed Countries Report 2009<sup>167</sup> proposes “building a new developmental State” where knowledge is central to the development process and structural transformation takes place through diversification, by involving domestic capital in the

development process, adopting a regional developmentalist approach and ensuring that the new developmental State is not authoritarian. As mentioned above and based on recent advances in development, there is a need to revisit the central role of the State in actively instigating, promoting and sustaining development progress. In this sense, development implies structural transformation towards fairer, more equitable and sustainable societies, thus going beyond State “regalian functions” such as maintaining law and order and setting regulatory frameworks. There is a call, even by free market-oriented organizations (such as the World Bank, international financial institutions and the Organization for Economic Cooperation and Development (OECD), among others), to extend the State's role in actively promoting industrial policies and technology transfer, on the basis of countries comparative advantage.

Based on successful developmental State experiences, it has been acknowledged that long-term development necessitates identifying enablers for transformation and change that are not only restricted to individual achievements (such as health and education), but also include institutions, leadership, visions, standards, norms, values, rules, trust and cohesion, among other intangible factors. It is important to understand how these elements have affected society, and how they interact with different sets of policies and reform initiatives.

Keeping the history of developmental States in mind (box 6), Part Five of this report suggests that Arab countries should embrace the idea of creating a developmental State by learning from other countries' experiences, particularly the Asian development transitions in Indonesia and Malaysia, given the cultural similarities

## Box 6. The developmental State has a long history

The history of development and developmental States is well covered in the literature. Reinert<sup>a/</sup> argued that the prototype of a developmental State was developed by the Tudor Kings (1485-1603) to imitate the economic structures of the wealthy Italian city-states of Venice and Florence. He also claimed that Adam Smith (1723-1790) was an advocate of the developmental State, in the sense that his concept of the “invisible hand” should work towards industrialization under a developmental State. Alexander Hamilton (1755-1804), the first United States Secretary of the Treasury, also supported a developmental State to industrialize the United States of America, using the same arguments put forward in Europe. Gerschenkron<sup>b/</sup> (1962) argued that late industrializers should also pursue industrialization through a developmental State. Recently, a wide literature has emerged on developmental State theory, especially from the political science and development studies disciplines,<sup>c/</sup> but Frederick List was one of the first architects of developmental State theory.<sup>d/</sup>

Johnson<sup>e/</sup> was the first to use the term to describe the Japanese planning agency (MITI) in the post-World War II period of economic miracle as an interventionist State that was neither socialist nor free market, but a plan-rational capitalist State conjoining private ownership with State guidance. The Government acted as a “surrogate for a missing capital market” and for inducing transformative investment decisions.<sup>f/</sup>

Developmental States are characterized by a combination of “capacities, visions, norms and/or ideologies”<sup>g/</sup> leading to structural transformation and industrialization. The developmental State depends on private capital and ownership and is able, through its bureaucracy, to stimulate, shape and cooperate with the private sector to identify projects where the private sector’s profit-seeking motives coincide with national development goals. As such, a developmental State is defined as a “seamless web of political, bureaucratic and moneyed influences that structures economic life”, mainly in the East Asian context.<sup>h/</sup> Leftwich defined developmental States as those “whose politics have concentrated sufficient power, autonomy and capacity at the centre to shape, pursue and encourage the achievement of explicit developmental objectives”<sup>i/</sup> Political factors, such as nationalism, regional competition, external threats, ideology or the wish to “catch up”, have shaped developmental States. According to Mkandawire,<sup>j/</sup> developmental States have two components: ideological (developmentalist) and structural (autonomous capacity determined by various institutional, technical, administrative and political factors to implement policies).

Fritz and Menocal<sup>k/</sup> claim that a developmental State exists “when the State possesses the vision, leadership and capacity to bring about a positive transformation of society within a condensed period of time”. East Asian countries tried to generate growth through industrialization and to participate in the modern economy through the expansion of public services (education, health care and agricultural extension). Generally, this transformation took place by shifting from subsistence farming to more commercial, export-oriented agriculture, textile processing and tourism, or a combination of all these.

The most common factor in developmental States is “committed leadership that is embedded in the right context of demands”<sup>l/</sup> In other words, leaders are committed to development goals rather than personal enrichment or short-term political gains. However, a stable political condition must prevail for human and administrative capacities to be enhanced and sustained.

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**Notes:** a/ Reinert, 2007.

b/ Gerschenkron, 1962.

c/ Leftwich, 1995; Evans, 1995; Reinert, 2007; Woo-Cumings, 1999; and Mkandawire, 2001.

d/ List, 1841.

e/ Johnson, 1982.

f/ Evans, 1995, p. 48.

g/ Fritz and Menocal, 2007, p. 534.

h/ Woo-Cumings, 1999, p. 1.

i/ Leftwich, 1995, p. 401.

j/ Mkandawire, 2001, p. 190.

k/ Fritz and Menocal, 2007, p. 533.

l/ *Ibid.*, p. 534.

and, most importantly, the abundance of oil and natural resources. This subject, however, requires further investigation beyond the scope of this report. The present report suggests four main pillars to define the Arab developmental State. Implemented together, these policies would not only empower the middle class but also serve as an upward social mobility mechanism for the poor.

Firstly, the Arab developmental State should adopt macroeconomic policies that prevent the middle class from slipping into poverty. This implies a shift in macroeconomic and sectoral policies to generate decent jobs that can better capitalize on an increasingly educated middle class. The first function of the Arab developmental State therefore is to steer the economy towards a more sustainable and productive growth path. In the regional Arab context, this is also predicated on successful regional economic integration.

Secondly, the State must be conscious of the need to support the poor and vulnerable. This can be done by implementing the social protection floor promoted by the International Labour Organization (ILO), which would not only contribute to peace and stability by fostering a sense of economic justice, but would also play a major role in expanding the middle class base.

Thirdly, the State would need to ensure enough fiscal space to finance structural transformation and social transfers by making tough decisions on fiscal policy, including better subsidy targeting, reduced military expenditure and improved tax collection.

Fourthly, the Arab developmental State would need to dramatically improve its governance framework in areas related to

the rule of law, voice and accountability, institutional strength, management and reduction of corruption and increased transparency. More importantly, the following are prerequisites for State success: a determined developmental elite supported by strong development planning State functions; relative geopolitical autonomy; a powerful, competent and insulated economic bureaucracy; and efficient management of non-State private economic interests.

## II. Strengthening economies to generate millions of decent jobs for today's middle class

Despite relatively high unemployment rates, employment growth in the Arab region was rather impressive over the period 2000-2010 compared to other regions, with an employment elasticity of 0.7 compared to around 0.5 for other regions and only 0.3 for Asia. This shows that growth has not been jobless as presented in the press; however, the main issue is the quality of the jobs created (mainly unsecure with deteriorating working conditions).<sup>168</sup>

The Arab uprisings had broad economic repercussions. Together with the Latin American region, it was estimated that Arab countries would have the lowest economic growth rates up to 2015.<sup>169</sup> Arab countries' fiscal position has also deteriorated considerably. Increasing population pressures are most likely to exacerbate already dire economic indicators, especially because of the increasing number of women and young people joining the labour force.

To tackle unemployment, the Arab region needs to create around 60 million jobs by 2030<sup>170</sup> (some estimates place this number at 100 million)<sup>171</sup> and increase the labour force participation of qualified women

to 35 per cent (currently at a mere 17 per cent). It is estimated that investment would have to rise to around 50 per cent of the regional GDP to create the required number of jobs.<sup>172</sup> However, increasing investment rates to this level would be extremely difficult in the current socioeconomic and political climate. The main loser is the youth population, which is less employable. International experiences show that young people are not easily employed despite economic recovery and it may take 11 years on average for youth unemployment to reach pre-crisis levels.

For the middle class, simply getting a job does not guarantee social and economic justice since job quality is also important, given that good jobs imply access to social security benefits, good working conditions, decent wages and respect for labour laws and other international labour standards. An ILO/UNDP report<sup>173</sup> provides some policy suggestions as to how to create decent jobs in the Arab region, including the following: coordinated economic policies that increase labour demand; improvements in social dialogue; expansion of social protection; and specific sectoral policies such as managing migration, active labour market policies, quality education and skills development. These policies can only succeed within the context of regional integration, industrialization and governance reforms. However, other organizations, including international financial institutions, argue that, to create enough jobs in the region, labour markets should be made more flexible and address supply-side constraints. Moreover, they assume that, since public sector jobs are unproductive, economic growth is hindered as a result of human capital misallocation. However, both sides agree that increased public investment improves the business climate, thus creating more jobs.

It is well documented that the structure and level of labour demand has been an obstacle to the creation of decent jobs in the region. Data shows that 66 per cent of investment (both domestic and foreign) went towards the mining and real estate sector over the period 2003-2010, which do not create much employment.<sup>174</sup> However, the 20 per cent of investment that went towards manufacturing activities generated more than half of foreign direct investment-related jobs. Therefore, investment should go towards sectors that create jobs. This can only happen if there is a clear proactive development strategy to promote structural transformation towards high value activities that are job-centred. In other words, the best route for creating decent and well-paid jobs is to increase productivity and effectively allocate resources to labour-intensive sectors.<sup>175</sup>

Apart from offering a development approach towards decent employment, macroeconomic policies are central to job creation. For example, monetary policies play an important role in promoting job-centred development. Monetary policies in the region depend largely on situations in other countries owing to pegged currencies. This means that interest rates in other countries, such as in the United States of America, affect development in the Arab region; a lacuna that policymakers have been unable to address to date. Exchange rates also influence development and job creation policies since they affect resource allocation to specific sectors, therefore impacting labour demand. This report argues that the Arab region should have a much more balanced and expansionary monetary policy and should actively manage exchange rates through central banks to create an environment conducive to employment creation, which cannot solely depend on traditional sectors; macroeconomic policies should therefore favour increased diversification.

Another policy tool available to policymakers in the region is fiscal policy. A balanced expansionary fiscal policy is needed to control inflation and promote growth so as to create decent jobs. To do this, policymakers should encourage public investment. Appropriate coordination between fiscal and monetary policy is needed in case of capital flight, especially given the volatility of the Arab region.

Many reports have discussed at length the problems associated with low value-added activities and low wage equilibrium in Arab economies. A moderate fiscal approach that produces many quality jobs is therefore needed. Structural transformation in the region should be carved judiciously with the help of the public and private sectors within the sphere of a developmental State.

#### A. Better quality public investment

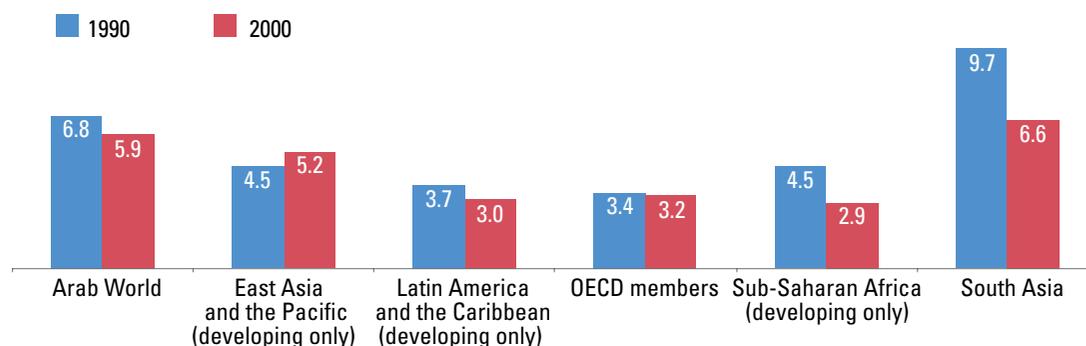
Public investment, which is capital expenditures in government budgets, refers to building physical infrastructure, such as roads, ports, schools and hospitals. In many cases, public investment is associated with generating positive spillovers in the economy through the

provision of infrastructure, education, health and scientific research; and it tends to be productivity and growth enhancing. The micro-effects of public investment are associated with poverty reduction and income distribution in an economy.

However, there are empirical questions about the efficiency of public investment and its relationship with “crowd in” private investment. Data from Arab countries shows that public investment in the Arab region in the 1990s and 2000s was higher than in most other developing regions (figure 72).<sup>176</sup> Since the 1970s, the investment rate in the region has increased,<sup>177</sup> but this has not always been associated with increases in economic growth. Historically, the Arab region has witnessed fluctuations in economic growth, although public investment has increased and remained high.

With regard to the association between public investment and “crowd in” private investment, the evidence from the Arab region is rather discouraging. For the region as a whole, the ratio of private to public investment is close to 2 over the period 1974-2000, meaning that private

**Figure 72.** Public gross fixed capital formation by region (percentage)



Source: ESCWA, 2013d.

investment was twice as large as public investment. The ratio remained well below the levels of OECD economies (with ratios close to 6) or of the rapidly growing East Asian economies (with ratios close to 5).<sup>178</sup>

Despite large public sector investments in the Arab region as a whole, significant disparities remain in the quality and quantity of infrastructure across different countries and subregions. Gulf Cooperation Council (GCC) countries have invested oil revenue into creating improved infrastructure. In contrast, developing countries suffer from serious infrastructure deficiencies, which are a developmental challenge and an obstacle to regional integration. Public spending on investments has been particularly weak in oil-importing countries, which have more limited fiscal space than oil-exporting countries.

Therefore, not the overall level of investment but its quality and efficiency,<sup>179</sup> including careful choice of the optimal investment level and allocation across sectors, are essential for boosting economic growth that benefits large sections of society. This means reorienting the focus of public investment from grand projects to small scale projects, especially in rural areas. Moreover, credit policies should be designed to promote private enterprises with high employment elasticity. Greater efforts must be made towards ensuring a financial infrastructure conducive to market development, especially by improving access to finance for small and medium enterprises.<sup>180</sup>

Furthermore, policy support is needed to improve entrepreneurial skills and innovation. In particular, public investment support for research and development is essential to reducing the private costs of

innovation. In the early stages of research, direct government support can back high-risk fundamental research with a long-term perspective, whilst the private sector tends to focus on near-competitive technologies and shorter-term demonstration projects. Supporting research institutes, academic institutions and specific technology research programmes and offering grants to private sector research and development efforts can boost innovation. The initial impetus, however, would most likely have to come through public investment. For instance, the lesson from China and Viet Nam is that successful transitions generating private sector confidence require a purposeful Government with an active fiscal policy that targets public investment.<sup>181</sup> Furthermore, establishment of a public-private-partnership can help boost private participation in infrastructure development.<sup>182</sup> In addition, cooperation in regional projects can lower the individual burden of countries and spread the infrastructure development load across regional stakeholders.

## **B. Trade and industrial policy to deepen and sustain growth**

Middle class purchasing power can be improved through structural transformation, resulting in better quality jobs. The economic structure in the Arab region strongly emphasizes resource-extraction industries and lacks manufacturing activities. Even though the region has one of the highest trade to GDP shares, as a result of trade and capital flow liberalization, the share of manufactured goods in trade is dismal. The sources of such growth are therefore not sustainable, unlike the East Asian growth model, for instance, where accelerated sustained growth was a result of manufacturing-led development. Their experience is relevant for outlining potential policy improvements for the Arab region,

incorporating the key factors contributing to East Asian growth.

In the 1990s and 2000s, East Asian economies had rapid and sustained economic growth, exceeding the Arab region (as well as Latin America and South Asia) by as much as three times, and managed to maintain an equitable income distribution. This can be attributed to policies such as progressive taxation and high taxes on luxury consumption, especially in services and imports; policies supporting reasonable real wages; and investment promotion policies in specific sectors of the economy.<sup>183</sup> The development model of the East Asian economies transitioned from import-substituting industrialization to export-led growth, as a result of increased manufacturing, resulting in high productivity levels and rapid economic growth.<sup>184</sup> The East Asia experience stands in stark contrast to dominant economic policies in the Arab region over that period.

Several factors played a major role in the East Asian development model, not least macroeconomic management and broad-based education policies, but also export promotion strategies and industrial policies. The guiding principle was that free trade on its own does not guarantee growth and development, and that an active policy role is necessary to achieve growth, by using rules and incentives to guide private investments in the highest value-added sectors, where the “innovative end of ‘the product cycle’” is located.<sup>185</sup> In addition, States were selective with regard to foreign direct investments depending, among other things, on whether foreign direct investment was targeting sectors that were considered strategic. In Singapore, the Government incentivized this process by providing subsidies to the private sector.<sup>186</sup> Such policies prevented the region from

becoming simply a production platform for foreign multinationals and enhanced productive capabilities in strategic sectors, which was further supported by government-owned enterprises that provided investment for infant industries in cases where private sector investment was insufficient to make such industries globally competitive.<sup>187</sup>

Industrial policy is inherently linked to trade policy in a liberalized global economy, which was integrated and codified through international trade negotiations and agreements. Ideally, policies, such as the ones in place in the East Asian development model, should be applied in the Arab region, but would be very difficult to implement given the current context of global trading rules,<sup>188</sup> which disproportionately benefit industrialized developed countries. As a result of these global trading rules and challenges, there is limited policy space for developing countries to implement trade and industrial policies aimed at proactively increasing jobs for the middle class.

Given these trading rules and sophisticated global production interdependencies, Arab countries face the challenges of increased production fragmentation and rapid technological change, thus increasing pressure to innovate and remain competitive within global value chains.<sup>189</sup> Moreover, the current global financial crisis and fiscal austerity in developed countries is detrimentally affecting demand for products and services from developing countries.

The potential for structural transformation aided by trade is large, since Arab economies combined represent only 5.8 per cent of world merchandise exports and only 3.1 per cent of world service exports.<sup>190</sup> Given that most Arab countries are still

developing, there is scope for innovative and effective industrial and trade policies other than tariffs, quotas and subsidies, including the following:

- a. Lengthening the specified transition period for implementing trade rules, already authorized under TRIPS (the Agreement on Trade-Related Aspects of Intellectual Property Rights), applicable to least developed countries; postponing the elimination of export subsidies; and encouraging developing countries to take advantage of specific waivers allowed under TRIPS;
- b. Pursuing a mix of technical assistance, information provision and coordination policies, as export performance requirements are not prohibited under TRIMs (trade-related investment measures), as long as they apply to both foreign and domestic producers, even by utilizing State-owned enterprises, such as in Singapore and Taiwan;<sup>191</sup>
- c. Promoting trade in services, as developing countries stand to gain more from increased trade in services, which has also been growing faster than trade in goods;<sup>192</sup>
- d. Strengthening regional economic integration through trade agreements to improve the Arab position at international trade negotiations.

It should be noted that differences exist within countries in terms of development orientation and that the policy space available for industrial and trade policies supporting structural transformation is not only limited, but also contested. However, the bottom line is whether enough political will can be mustered to pursue and benefit from these policies. The guidance and informational role that the State can play is indispensable for adopting trade and structural transformation.<sup>193</sup>

### **C. Regional economic integration could result in massive gains**

Early attempts at economic integration in the Arab region, such as the 1957 Economic Unity Agreement and the 1980 Charter for National Economic Action, fell short of their economic integration goal. One of the latest attempts, the Greater Arab Free Trade Area Agreement (GATFA), approved by Arab States in 1997, did better, going a long way to fully liberalizing trade in goods by exempting those of Arab origin from custom duties and other fees. Although efforts on trade liberalization for services have not yet succeeded and a number of non-tariff barriers to trade in goods still exist, Arab countries have expressed a willingness to pursue a customs union and common market, set out in the Riyadh Declaration of the Third Arab Economic and Social Development Summit held in 2013.<sup>194</sup>

As a result of bilateral economic integration agreements between Arab countries and non-Arab countries and regional groupings, the customs union and a common market have not yet been implemented. The Arab region is one of the least integrated regions in the world in terms of trade and investment. In 2010, exports between Arab countries did not exceed 5.2 per cent of total regional exports. In contrast, intra-European Union trade represented around 65 per cent of all European Union trade, the North American Free Trade Agreement (NAFTA) was 49 per cent and the Association of Southeast Asian Nations (ASEAN) was almost 25 per cent of the total. The same applies to investments; Arab intra-regional investments are low, representing only 11.2 per cent of total investment of Arab sovereign funds outside the region, which total over \$1,600 billion. In cumulative terms, the stock of inward foreign direct investment for the period 1995-2011 stood at less than \$180 billion or at 31 per cent of total inward foreign direct investment.<sup>195</sup>

Arab economic integration therefore has the potential to be strengthened and hastened by establishing a free trade area through the following:

- a. Lifting non-tariff trade barriers to GAFTA;
- b. Introducing trade in services into GAFTA;
- c. Reducing technical barriers to intra-Arab trade.

These measures alone would reap static and dynamic benefits. Static gains from both intra and inter-industry level trade result from exchange, specialization and economies of scale; while dynamic gains result increased cost efficiency, investment stimulus and technological advances (owing to spillovers). Research on the so-called "border puzzle" (reduced trade because of border frictions) shows that fully integrating can increase trade considerably, by as much as 30 per cent for industrialized countries,<sup>196</sup> thus increasing the pace of structural transformation, competitiveness, employment and growth.

The next stage of economic integration in the Arab region is a common market or an economic union (common market with a customs union) resulting in the free movement of labour, capital, goods and services. The advantage of such flows goes well beyond the advantages provided by cheaper labour and more access to capital, as there are positive spillover effects in the form of technological and knowledge spillovers, which can be either vertical (down or up the supply chain) or horizontal (intra-industry), resulting in higher productivity.<sup>197</sup> This in turn supports the depth and speed of structural transformation.

In all cases of increased transformation, distributional issues should not be neglected given that, although stronger

economic integration in the Arab region would undoubtedly result in a net gain for the region as a whole, regions or specific groups within countries could face adverse consequences. It is therefore important to note that regional bodies should undertake the following:

- a. Develop Arab investment projects;
- b. Reduce disparities in development.

Arab development funds, including bilateral ones such as the Kuwait Fund for Arab Economic Development, the Abu Dhabi Fund for Development and the Saudi Fund for Development, or multilateral ones, such as the Arab Fund for Economic and Social Development, the Arab Gulf Programme for Development, the Arab Monetary Fund, the Arab Bank for Economic Development in Africa, the Islamic Development Bank and the OPEC Fund for International Development, should strengthen their support for cross-Arab investment projects, especially regarding infrastructure. They could also consolidate economic integration by reducing disparities in development through a structural and cohesion fund, modelled on existing experiences, such as those of the European Union.

In 2011, the monetary backing of Arab development funds by Arab countries was low at \$79 billion, in comparison to the Asian Development Bank at around \$165 billion or the Inter-American Development Bank at approximately \$105 billion. This falls short of the investment needs of pan-Arab projects and of reducing the huge economic disparities between Arab countries, which have increased since the 1990s. In 2011, for instance, the highest per capita GDP in Qatar was 116 times higher than the lowest one in Comoros.<sup>198</sup> Arab development funds should thus replenish their capital stocks and play a more important investment-supporting and developmental regional role.

Lastly, following the achievement of greater economic integration of trade and services, a common market and a customs union, the need to coordinate macroeconomic sectoral, fiscal and monetary policies would bring additional challenges and benefits, which would have to be tackled by existing regional bodies. However, the preliminary first steps outlined in the previous paragraphs alone would result in massive gains for the region, given that “total Arab GDP would grow by the equivalent of a further 3.1 per cent by 2020”<sup>199</sup>

### III. Social protection to enlarge tomorrow’s middle class

The concept of social protection is deeply embedded in the fundamental principles of social and economic justice. It is regarded as an essential element in achieving key human rights.<sup>200</sup> Realizing core social, economic and political rights also promotes social and economic justice – a key demand of the popular uprisings in some Arab countries. Therefore, social protection is also enshrined in the values of social justice and provides an institutional framework for promoting fair development.<sup>201</sup> Social protection should not be considered a deadweight burden on fiscal policy, but rather a necessary component of development. It also stimulates growth, especially when embedded in a win-win strategy of pro-poor inclusive growth. Investing in people and social protection measures can also have a multiplier effect on income generation and the health and education of a population, and can lead to a cycle of social and economic development.<sup>202</sup>

As discussed in Part Three of this report, social protection in Arab countries has been operating under two broad categories. The first is the contributory social insurance system based on formal employment (30-40 per cent of

the workforce) and the second is social assistance, which mainly includes cash transfers and subsidies for energy and food. On the side-lines, civil society organizations, such as *zakat* funds, provide relief for the poor. Social protection in the Arab region is therefore not universal, comprehensive or rights-based. A quarter of the Arab population is covered by social insurance and social assistance within the formal economy while the remaining three quarters do not receive any such services.<sup>203</sup>

ILO developed the social protection floor initiative in 2011,<sup>204</sup> based on a 2009 United Nations Chief Executives Board for Coordination paper.<sup>205</sup> ILO offered the following explanation of the concept: “social protection floors are nationally defined sets of basic social security guarantees that should ensure, as a minimum that, over the life cycle, all in need have access to essential health care and to basic income security which together secure effective access to goods and services defined as necessary at the national level.”<sup>206</sup>

The ILO recommendation calling for national social protection floors<sup>207</sup> defines the concept in two broad categories: basic income security, social transfers (in cash or in kind), pensions, assistance to persons with disabilities, child benefits, income support benefits and/or employment guarantees and services for the unemployed and working poor; and universal access to essential affordable social services in the areas of health, water and sanitation, education, food security and housing, among others, defined according to national priorities. In this sense, a social protection floor is a comprehensive approach towards realizing most of the Millennium Development Goals, through the principles of inclusiveness and universality. The basic

social protection floor, excluding universal access to areas such as education, is focused on the following four pillars:<sup>208</sup>

- a. Essential health care;
- b. Basic child benefits;
- c. Basic income security for persons of active age (unemployment benefits);
- d. Basic income security for persons of old age (pensions).

Social protection floors are being discussed in the Arab region and emphasized as one of the priorities for which fiscal space should be created.<sup>209</sup> In 2001, estimations of a basic social floor package for selected Arab countries (Algeria, Egypt, Lebanon, Morocco, Saudi Arabia, the Syrian Arab Republic, Tunisia and Yemen) were 1.4-2.5 per cent of GDP for child benefits, 0.2-0.7 per cent of GDP for unemployment benefits and 0.9-2 per cent of GDP for pensions and disability; health care was left out. The total costs of such a social floor protection package would therefore have ranged from 3.1 per cent of GDP in Saudi Arabia to 4 per cent of GDP in Tunisia in 2011.<sup>210</sup> Adding what the predicted costs of essential health care would be judging by previous developing countries costing exercises estimating essential health care to amount to 1.5-5.5 per cent of annual GDP,<sup>211</sup> the total package for Arab countries would cost 4.6-9.5 per cent of GDP.

Taking into account that average government social expenditure in Arab countries is already 8 per cent of GDP, the average Arab country would therefore only need to increase its social expenditures by just over 1.5 per cent of GDP to finance the most basic social protection floor programme on its own (education and other non-basic services are not included). Nevertheless, spending must be directed at areas that are integral to basic social protection. Moreover, countries have varied financing needs depending on their level of development.

Table 5 presents the current amount of spending on social protection by each country, and then calculates the minimum and maximum financing gap to finance an estimated social protection floor, with the assumption that all social expenditures go towards that goal. As expected, there are large variations in financing gaps across Arab countries. Several countries already spend enough on social protection to cover a social protection floor, while others are off the mark by as much as 7 per cent of GDP. The percentage increase needed in addition to what a country is already spending on social protection to finance a social protection floor is shown in the last column, which ranges again from 0 per cent for countries with high shares of social spending to a needed increase of more than 100 per cent for countries such as Lebanon, Qatar, the Syrian Arab Republic and the United Arab Emirates.

To respond to popular demands, Arab countries should try to implement a comprehensive social protection floor to promote social and economic justice and economic development. Besides the costs of financing such a package, some criticisms and caveats must be kept in mind. Increasing social expenditures and adding elements to a social protection floor might also serve the interests of ruling elites as a way to buy people off. Such trade-offs are common in rentier economies, which do not generate their own revenue but usually rely on rents from natural resources or aid, which are redistributed in part to the public in exchange for political power, especially in countries where governance systems have few democratic checks and balances.<sup>212</sup> As demonstrated in Part Four of the present report, this is especially a feature of the Arab region. Moreover, in Arab countries experiencing popular unrest, social expenditures have already increased in

line with rentier economy characterization, especially in GCC countries, possibly to stop the spread of civil dissatisfaction (but spending was not necessarily targeted at elements central to a social protection floor), leaving smaller fiscal space to be utilized in the future.<sup>213</sup>

Lastly, an important point when setting up a social protection floor is ensuring that its public financing does not necessarily entail public execution and management of its systems, as they can be privately set up and managed on a concessional basis. However, there is no one size fits all

**Table 5.** There are wide variations in financing gaps for a social protection floor

Country	Public exp. (per cent GDP)	Current exp (per cent public expenditure)	Social exp. (per cent current expenditures)	Social exp. (per cent GDP)	Min gap (per cent GDP)	Maximum gap (per cent GDP)	Percentage increase needed
All Arab countries	32.6	77.4	39.9	10.00	0.17	1.25	32.14
Jordan	30.4	83.16	47.5	12.01	0.00	0.00	0.00
United Arab Emirates	30.1	72.71	18	3.94	0.66	5.56	141.17
Bahrain	30.5	70.88	40.3	8.71	0.00	0.79	9.04
Tunisia	30.4	78.42	47.9	11.42	0.00	0.00	0.00
Algeria*	37.7	59.47	39.9	8.95	0.00	0.55	6.19
Djibouti	38.4	64.69	22.8	5.66	0.00	3.84	67.75
Saudi Arabia	38.9	69.59	37.6	10.18	0.00	0.00	0.00
Sudan*	18.4	87.43	39.9	6.42	0.00	3.08	48.00
Syria	25.8	57.00	17.7	2.60	2.00	6.90	264.97
Somalia							
Iraq	44.7	81.20	23.8	8.64	0.00	0.86	9.97
Oman	30.3	57.19	41.8	7.24	0.00	2.26	31.15
Qatar	26.7	67.09	16.5	2.96	1.64	6.54	221.43
Comoros*	23.3	68.69	39.9	6.39	0.00	3.11	48.75
Kuwait	31.5	88.35	24.9	6.93	0.00	2.57	37.10
Lebanon	28.8	95.65	12.1	3.33	1.27	6.17	185.00
Libya*	58.5	42.46	39.9	9.91	0.00	0.00	0.00
Egypt	30.3	86.79	52.3	13.75	0.00	0.00	0.00
Morocco	32.8	83.00	37.4	10.18	0.00	0.00	0.00
Mauritania	28.4	75.85	34	7.32	0.00	2.18	29.71
Yemen	35.1	82.52	59.3	17.18	0.00	0.00	0.00

**Source:** Arab Monetary Fund, 2011.

**Notes:** Estimates for 2010. Average share is population weighted.

\* Represents social expenditure share (per cent of current expenditures) is missing and was substituted by the average share of all Arab countries.

recommendation and the choice between private or public management will depend on the institutional environment of a country and other factors. Generally, the empirical evidence supports the claim that private ownership and management outperform public administration.<sup>214</sup>

#### IV. Finding room in the budget for better development

Financing measures aimed at improving economic justice through policies that support economic transformation and social protection floors can be summarized within the fiscal space diamond, which differentiates between the following four sources of finance for Governments:<sup>215</sup>

- a. Official development assistance;
- b. Domestic revenue mobilization;
- c. Deficit financing;
- d. Reprioritization and efficiency of expenditures.

Given that official development assistance depends on donors and deficit financing depends on private domestic and private and public foreign willingness to lend, the only two finance channels under direct government control are domestic revenue mobilization, and reprioritization and efficiency of expenditures. The bulk of the first is mainly taxes, while an important part of the second entails subsidy and security sector reform. This report thus concentrates on reforming taxes, subsidies and military expenditure, all under direct government control, as a potential way of financing measures for increasing economic justice.

##### **A. Reforming subsidies to benefit those in need**

As discussed in Part Three of this report, subsidies represent a large portion of government budgets in the Arab region and

thus provide a considerable opportunity for creating fiscal space through reprioritization. The resources devoted to energy subsidies in particular would, in many cases, come close to financing social protection floors. Moreover, repealing energy subsidies would be a move towards economic justice, since the well-off disproportionately benefit from them.<sup>216</sup> Fuel subsidies also distort consumption and production in the market, leading to increased negative externalities.

Table 6 shows that, if the region as a whole wanted to introduce a basic social protection floor, the finances currently being spent on fuel subsidies would be more than sufficient to cover the costs. Moreover, even at the country level, eliminating fuel subsidies would cover the financing for social protection floors in all countries, except Djibouti, Lebanon, Mauritania and the Sudan. If part of existing social expenditure is diverted to or included in the social protection floor initiative, all Arab countries would have sufficient financial coverage for the introduction of social protection floors.

Subsidy reform should be approached cautiously given that its costs and benefits are not equally distributed amongst population groups. Economies would need time to adjust, and there could be political consequences and civil unrest following subsidy reforms. There is an especially large difference between short-term negative effects of subsidy elimination and long-term positive effects. In the short-term, the social and economic costs of reform include direct effects, such as higher energy prices and inflation, and indirect effects, such as increasing the prices of other goods that use energy products as intermediate goods thus leading to further inflation. These, in turn, reduce the international competitiveness

of domestic firms (by increasing export prices) and lower demand, employment and GDP growth.<sup>217</sup> For example, a computable general equilibrium model of the Egyptian economy<sup>218</sup> shows that subsidy elimination would negatively affect GDP and consumption. Such negative effects might be amplified if structural and institutional issues are not addressed prior to the implementation of subsidy reforms, including a large informal sector, institutional weaknesses and the overall political and security situation.<sup>219</sup>

To tackle the potential negative consequences of subsidy reform, economic, social and governance factors must be taken into account. Moving away from generalized subsidies, in particular energy subsidies, towards targeted social expenditures would support poor and vulnerable households and would free up resources for implementing policies that support social protection floors and economic transformation, which in turn would result in employment creation and growth. However, good governance

**Table 6.** Eliminating fuel subsidies could finance social protection floors

Countries	Social exp. (per cent GDP)	Maximum gap (per cent GDP)	Fuel subsidies (per cent GDP)	Sufficient coverage with fuel subsidies
All Arab countries	9.63	1.61	7.65	yes
Jordan	12.01	0.00	6.20	yes
United Arab Emirates	3.94	5.56	6.00	yes
Bahrain	8.71	0.79	8.00	yes
Tunisia	11.42	0.00	3.30	yes
Algeria*	7.22	2.28	11.00	yes
Djibouti	5.66	3.84	0.50	no
Saudi Arabia	10.18	0.00	10.00	yes
Sudan*	5.18	4.32	1.40	no
Syria	2.60	6.90		
Somalia				
Iraq	8.64	0.86	12.00	yes
Oman	7.24	2.26	6.20	yes
Qatar	2.96	6.54	3.80	yes
Comoros*	5.15	4.35		
Kuwait	6.93	2.57	7.50	yes
Lebanon	3.33	6.17	4.50	no
Libya*	8.00	1.50	8.50	yes
Egypt	13.75	0.00	11.00	yes
Morocco	10.18	0.00	0.90	yes
Mauritania	7.32	2.18	1.80	no
Yemen	17.18	0.00	6.20	yes

**Source:** First two columns from table 5 of this report, third column from Prasad (2014).

**Notes:** Average share is population weighted.

is a precondition for successful subsidy reform.<sup>220</sup> As noted by an International Monetary Fund (IMF) study, “the public often has little confidence that the Government will use savings from subsidy reform wisely, and therefore resists their removal.”<sup>221</sup> Therefore, successful reform involves addressing structural and institutional characteristics that include the following:

- a. Economic diversification plans, especially comprehensive strategies for energy sector reform;
- b. Institutional arrangements with checks and balances for utilizing freed resources from subsidy reform;
- c. A comprehensive communications strategy and accountability mechanisms;
- d. Efficient State-owned enterprises to reduce producer subsidies;
- e. Depoliticized price setting.

With several Arab countries still in economic disarray or experiencing political and social instability, the timing of such reforms is more salient than ever, as increasing instability with poorly timed reforms might put public finances and Arab economies on a worse path than before.

That noted, subsidies in the Arab region are not sustainable and long-term benefits of their reform outweigh short-term costs. In the long-run, the positive effects of subsidy reform would include better subsidy targeting, freeing up fiscal space for economic justice policy options and other positive spillover economic effects, as mentioned above.<sup>222</sup>

## B. Tax reform

Broadly speaking, taxation systems are considered the most basic instrument to generate government revenue and

achieve economic and social justice from a redistributive perspective. Typically, Governments levy a mix of taxes, including personal and corporate income taxes, property taxes and wealth transfer taxes, and impose higher or lower taxes on certain goods. There are therefore many nuances when it comes to tax fairness, as fairness depends on the purpose behind the tax, the goods on which it is imposed and the income bracket on which the tax burden falls.

In the same vein as pro-poor policies, pro-poor taxation has fewer direct detrimental effects on the poor. For example, in a progressive tax system, after-tax income is more equally distributed than pre-tax income. This occurs when the share of income paid in taxes increases with income. In other words, progressive taxation has fewer direct detrimental effects on the middle class, the vulnerable and poor. Pro-poor taxation also prefers corporate and wealth taxes to income taxes, as the middle class, vulnerable and poor do not normally have stakes in companies and rarely have capital gains or real-estate holdings, which can also be taxed.

Governments need revenue for administration, infrastructure and social services, such as health and education. The major source of revenue for most Governments is taxes (62 per cent of government revenue worldwide is derived from taxes). For the Arab region, taxes form only 37 per cent of government revenue, mainly consisting of revenue derived from natural resources in GCC countries.

Tax revenue as a percentage of GDP is around 15 per cent worldwide (10-15 per cent for low income countries, 20 per cent for middle income countries and 30 per cent in advanced countries).<sup>223</sup> For Arab countries, it varies from as little as 1 per cent of GDP in Kuwait to 23 per cent in

Morocco. In Algeria, Libya, the Sudan, the Syrian Arab Republic and Yemen, the share is at or below 10 per cent of GDP.<sup>224</sup> Tax revenue, as a share of total revenue and of GDP, in the Arab region is lower than that in other developing regions. The low levels and fluctuations of tax revenue over the years indicate that many Arab countries have the potential capacity to mobilize additional revenue through tax reforms, in particular through improving enforcement and increasing tax bases while taking into account equity concerns.<sup>225</sup>

It should be emphasized that tax revenue as a percentage of GDP in developing countries has not changed much since the 1970s. Low dependence on taxes in many Arab countries is also a reason often cited as contributing to poor accountability and poor governance.<sup>226</sup> Kaldor<sup>227</sup> argued that for a country to become developed it needed to generate tax revenue of around 25-30 per cent of GDP. In addition, for countries to achieve the Millennium Development Goals, they should increase tax revenue by 4 per cent of GDP.<sup>228</sup> Increasing tax revenue is important for development, but tax composition must also be taken into account, as well as the distributive nature of taxes and the utilization of tax revenues. For instance, in Morocco, which utilizes a progressive income tax rate system, tax revenues have increased by an average of 8 per cent per year over the decade 2000-2009. From 2004 to 2008, tax revenues increased by 15 per cent per annum. In 2010, taxes accounted for 24 per cent of GDP in Morocco, and have contributed to poverty reduction, inequality reduction and public investment in infrastructure, among other social benefits.<sup>229</sup>

Taxes comprise personal income taxes, profit and capital taxes, taxes on goods

and services (mainly value-added taxes) and taxes on property and international trade. At the global level, income, profits and capital taxes represent around 48 per cent of total tax revenue, while taxes on goods and services total another 40 per cent. Taxes on property form around 7 per cent and taxes on international trade are insignificant, which is not the case in the Arab region for GCC countries.

Developing countries, including Arab countries, depend more on indirect taxes for their revenue than direct taxes on income and profit for four main reasons.<sup>230</sup> Firstly, owing to low income levels, the tax base is relatively small and therefore indirect taxes are one of the easiest ways to get government revenue. Secondly, tax collection in developing countries is often inefficient. Thirdly, there is a high rate of tax evasion. Fourthly, developing countries have a large informal sector that does not pay taxes. For example, Egyptian income tax represents some 10 per cent of total tax, followed by 36 per cent derived from corporate tax and 40 per cent from indirect taxes, such as goods and services taxes. In Tunisia, income taxes (personal and corporate) form 41 per cent of total tax revenue; and 45 per cent of total tax revenue is derived from indirect taxes such as value-added taxes. Income taxes attract great attention since they are the most visible form of tax. However, for developing countries, income taxes affect a narrow base and therefore represent a small proportion of total taxes. Therefore, the distributional impact of an income tax is small (figure 73).

The picture is different in natural resource rich countries. For example, in Saudi Arabia, income tax represents around 37 per cent of total tax while 62 per cent is derived from custom tax.

In general, customs in the form of export taxes are the least efficient way of collecting taxation, as they generate deadweight losses on the demand (consumer) and supply (producer) sides within a country. However, in the case of natural resources, where producers have monopolistic market power, an export tax can lead to a net gain for a country, not taking into account distributional issues. In other words, if a country is a price setter on the world market, an optimal export tax improves its trade terms and transfers some foreign consumer surplus to it, resulting in a net gain for that country.

Three policy implications follow from these facts. Firstly, the tax effort in the Arab region should be increased, which would not only create more fiscal space for economic justice measures, but would also have positive spillover effects on good governance. Secondly, the mix of taxes should affect the poor and vulnerable less than proportionately, as they are the target groups for expanding the middle class. Thirdly, trade taxes should be avoided as a rule, with the possible exception of GCC countries because of their market power in natural resources.

**Figure 73.** Composition of tax revenue (as a share of total tax revenue) in Arab countries (percentage)



Source: ESCWA, 2014d.

Globally, there is a positive relationship between development and taxes as a share of GDP. Although there are few defined targets on what the tax effort should be (the West African Economic and Monetary Union has a target of 17 per cent),<sup>231</sup> in comparison to other more developed countries, the tax effort in several Arab countries could be increased. In the specific case of Jordan, increasing the tax effort by two percentage points would already be beneficial. "Time-series analysis shows that in Jordan there is a strong causal relationship between tax revenue and other economic variables. As a direct result of the higher tax revenue, the estimate shows that GDP per capita will increase by approximately 5 per cent, employment will grow by 3 to 9 per cent, and household consumption will increase 10 to 15 per cent from current levels."<sup>232</sup>

A tax system has to be simple and transparent as complexities and exceptions lead to tax evasion and tax avoidance. An intelligent mix of direct and indirect taxes has to be pursued, avoiding trade taxes and excises when possible. Tax administration should be simplified, as this is often cited as more of a burden than the tax rates themselves.<sup>233</sup> A progressive tax system should put disproportionately less tax burden on the poor and vulnerable; however, it must be judicious in establishing tax rates. Low income tax rates promote and advance the accumulation of capital. As such, a tax system should be wary of discouraging entrepreneurship, especially small and new firms.<sup>234</sup> Too little tax revenue is not sufficient to implement public policies and very high tax rates can harm business, create work disincentives and distort efficient resource allocation.

### C. Military expenditure reform

In 2013, global military expenditures, defined as a flow that includes global

government spending on military forces and activities, stood at \$1,747 billion. Countries spend 0-11.3 per cent of GDP on military expenditures; the average is 1.9 per cent of GDP, with a relatively large standard deviation of 1.6 per cent of GDP.<sup>235</sup> In the long-term, the Arab region could benefit from military expenditure reform, reprioritizing a share of those expenditures towards economic diversification and social protection policies to boost economic growth and improve living standards.

Table 7 below shows the top 10 countries in terms of absolute military expenditure, relative expenditure as a share of GDP and in terms of largest increase in military expenditure since 2004. The United States of America is by far the biggest spender in absolute terms, spending on average around \$700 billion per year on the military over the past five years, followed by China, spending around 150 billion. China, the Russian Federation and the United States of America together represent more than 50 per cent of global military expenditure. In the Arab region, only Saudi Arabia joins the top 10 spenders in dollars, with an average annual expenditure of around \$50 billion.

However, when eliminating the effect of country size and looking at military expenditures as a share of GDP in table 7, Arab countries rank prominently. Oman tops the list of all countries in the world with a staggering yearly average of 10.84 per cent of GDP, followed by Saudi Arabia at 8.52 per cent of GDP. Within the top 10, there are four more Arab countries, resulting in a total of six out of ten top spenders coming from the Arab region.

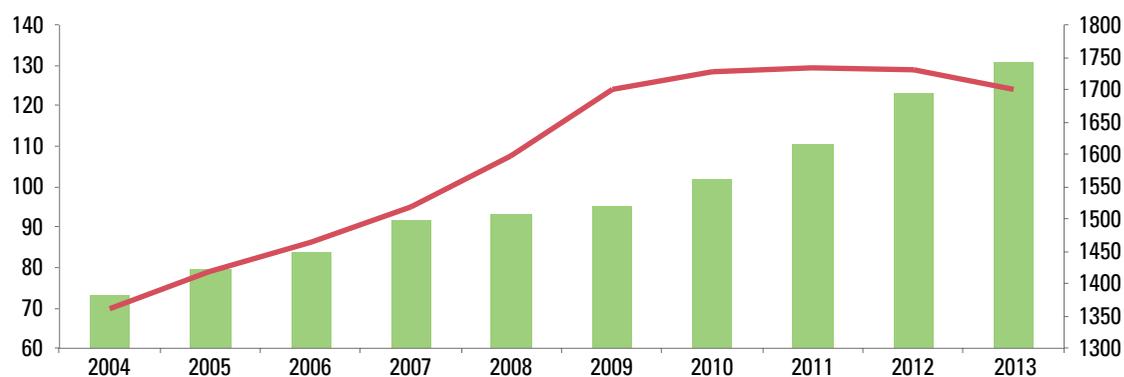
Table 7 also shows the largest 10-year increases in absolute military expenditures, where Iraq is third with an increase of 284.46 per cent and Algeria is eighth with a 176.21 per cent increase.

**Table 7.** Arab States are among the top military spenders

Abs. rank	Country	Millions of \$	Rel. rank	Country	Share of GDP	Change rank	Country	Percentage change since 2004
1	United States of America	684489.20	1	Oman	10.84	1	Afghanistan	556.65
2	China	148648.40	2	Saudi Arabia	8.52	2	Azerbaijan	493.45
3	Russia	73281.60	3	South Sudan	6.50	3	Iraq	284.46
4	France	65263.60	4	Israel	6.14	4	Kazakhstan	247.93
5	United Kingdom	60294.20	5	United Arab Emirates	5.18	5	Ghana	243.00
6	Japan	59638.40	6	Jordan	4.64	6	Georgia	229.85
7	Saudi Arabia	52019.20	7	United States of America	4.50	7	Liberia	189.13
8	India	49261.20	8	Algeria	4.20	8	Algeria	176.21
9	Germany	49080.40	9	Lebanon	4.20	9	Angola	175.12
10	Italy	37025.20	10	Afghanistan	4.08	10	Ecuador	174.71

Source: SIPRI, 2014.

Notes: "Millions of \$" (expressed in constant 2011 USD) and "share of GDP" are the five-year averages from 2009 to 2013.

**Figure 74.** Arab region military expenditure, in billions of USD

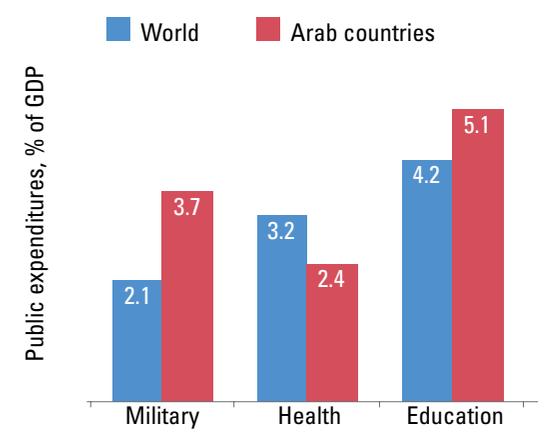
Source: SIPRI (2014) and ESCWA calculations.

Note: The left axis represents Arab military expenditure and the right axis represents world military expenditure, in billions of constant 2011 United States dollars.

In comparison to the rest of the world, military expenditure in the Arab region has been consistently increasing over the past 10 years. As figure 74 shows, it has increased by 80 per cent, with large increases after 2011 when the world's military expenditure started declining. On account of this, the Arab region's share of military expenditure in terms of total world expenditure increased from 5.3 per cent in 2004 to 7.7 per cent in 2013. Only Central America and the Caribbean and Eastern Europe increased their expenditures by more, 94 per cent and 112 per cent, respectively over the same period. The Arab region's increase in military spending was higher than Western and Central Europe (-6.5 per cent), North America (12 per cent), South America (58 per cent), sub-Saharan Africa (55 per cent), Central and South Asia (49 per cent), East Asia (74 per cent), Oceania (19 per cent) and South East Asia (47 per cent).<sup>236</sup> This places the Arab region third from 11 regions to increase spending.

It follows that the Arab region's increasing military expenditures are the highest in the world, expressed as a share of GDP, implying that military expenditure reform would bring the Arab region closer to the world average and potentially release funds for economic development. Figure 75 compares the public expenditure of the world and the Arab region in terms of healthcare, education and the military. The world as a whole spends the most on education, in relative terms, followed by health care and, lastly, the military. The Arab region spends a significant amount on education, relatively, although with poorer results (see Part Three of the present report), but more on the military than on health; and more on the military than the world average spending on health. These numbers indicate the long-term benefits of military expenditure reform and the potential funds that could be released for development, either to assist the poor and vulnerable or to enhance job market opportunities for the existing middle class.

**Figure 75.** Arab countries spend more on the military than on health care



**Source:** SIPRI, 2014; World Bank, 2014b; and ESCWA calculations.

**Note:** Five-year averages (2009 to 2013) are used, and the world and Arab aggregation is population weighted.

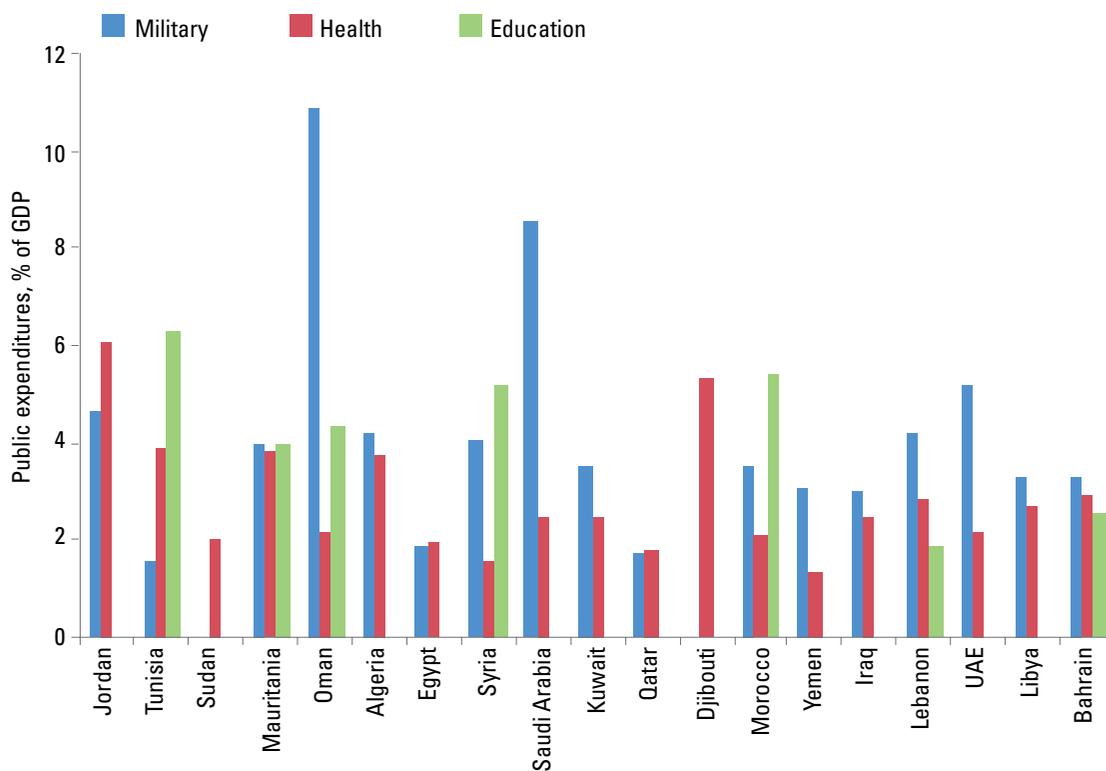
Figure 76 shows the country-level fiscal potential of military expenditure reform, using public health and education expenditures as a benchmark. If the reference is that Governments should spend the most on education, followed by health and then the military, there are only a few Arab countries where this is the case. Tunisia, where average military expenditure is only 1.6 per cent of GDP, spends more than double that on health and more than triple that on education. However, Oman, Saudi Arabia and the United Arab Emirates spend on the military more than double the amount they spend on either health or education. Moreover, over half of Arab countries spend more on the military than on health or education. Egyptian official numbers imply a very low spending percentage on the military (only 1.9 per cent of GDP); however, these numbers

do not take into account the large United States military aid in kind (non-monetary), which amounts to about 80 per cent of total Egyptian military procurement (in addition to the official number) and economic activities of the armed forces (which are estimated to generate 5-15 per cent of Egyptian GDP).<sup>237</sup>

Although Western developed economies have reduced their military expenditures over the last few years, the Arab region has increased them. It can be argued that the peace dividend, the money diverted from military expenditures to more productive uses, could lead to a considerable increase in economic growth, resulting in more government revenue in

the long-term. "Had Arab States adjusted their military budgets to European levels in 1990 – and maintained them – their economies would have grown by between 2-3 per cent a year, and generated output levels over 50 per cent higher than at present."<sup>238</sup> The additional fiscal space created through such reforms would cover a considerable gap to finance measures supporting economic justice, namely creating a better environment for the development of high value-added sectors; providing the middle class with more job opportunities; and supporting the enlargement of the middle class through poverty reduction measures and social protection floor initiatives.

**Figure 76.** Public expenditures on the military, health and education



**Source:** SIPRI, 2014; World Bank, 2014b; and ESCWA calculations.

**Note:** Five-year averages (2009-2013) are used.

## V. Good governance underpins effective reform

The Arab middle class, frustrated by economic hardships and self-interested elites and without opportunities to affect political processes and voice dissatisfaction, took part in the uprisings.<sup>239</sup> Governments had failed to uphold their end of the traditional social contract, both economically and politically, and the middle class refused to uphold theirs any longer. The new Arab development model should therefore be based on good governance principles that help address the prevalent “dignity deficit” in the region. The process of growth and structural transformation is not linear or smooth. It is uneven, with losers and winners, and, more often than not, with unintended outcomes. For too long the Arab region has been complacent and has nurtured its reputation as the region where democracy cannot take hold. However, there is no solid empirical evidence that shows the region as exceptional in that regard or that its people have an inherent affinity to authoritarian regimes.

It is the desire to move away from traditional modalities of authoritarian rule that encouraged people to take to the streets. Testing the waters of democracy, people took personal risks to demand a more participatory relationship with their Governments.

The middle class in particular is crucial in this process, not only because of its size, but also because of its aspirations. When the middle class begins exploring, to further its economic interests and opportunities, it finds itself needing, “a way of articulating [its] demands publicly, [...] demanding a place at the decision-making table.”<sup>240</sup> Moreover, the middle class has been defined as “the backbone of both the market economy and of democracy in most

advanced societies”<sup>241</sup> and is associated with social cohesion and political stability.<sup>242</sup>

Heydarian<sup>243</sup> argues that economic globalization in Arab countries transformed the “social State” into a “regulatory State”, which tailored the rules of the game<sup>244</sup> – moulded legislation and regulation for the benefit of the chosen few, essentially excluding the middle class from the process. The elite, with unchecked power, passed reforms that guaranteed their own interests. A newly liberalized private sector did not evolve from considerations of performance and productivity; it grew from loyalty to the ruling regime in power.<sup>245</sup> The ruling elites designed privatization schemes in a way whereby public assets were transferred to regime supporters and ruling parties, forming coalitions “which were no more than coalitions of self-interest.”<sup>246</sup> Little was done to pre-empt the concerns of the middle class, which had become accustomed to decades of government largesse. As such, the Arab region’s structural deficiencies (as reviewed in Part Three of this report in indicators such as high unemployment, a youth bulge, income inequality, etc.) were a direct outcome of the emergence of predatory capitalism and unaccountable political institutionalism, strengthened by economic globalization.

Unfortunately, these obvious grievances were not enough to sustain a successful transition when the need and will for it appeared. There is an increasing gap between aspirations and realities following the uprisings, as shown in Part Four of this report, and democratic aspirations might no longer be enough to keep countries transitioning towards a human rights-based free society.

While the Arab uprisings blurred the lines between formal and informal political spheres, the Arab region is currently

undergoing a difficult transition process that might not result in democratic governance. The political influence of the middle class might assist or counteract this democratic process by supporting the ruling elite. If ruling regimes are expected to be facilitators, partners and collaborators that encourage dialogue, build teams, foster partnerships and utilize participatory decision-making strategies, then significant change must be implemented to improve current systems of economic, developmental and political governance. With changing social contracts and government-public relations in Arab countries, the region's aspirations and ambitions could translate into material and non-material investments geared towards increasing policy influence and civil society engagement. In turn, increasing the opportunities, capabilities and freedoms of the middle class would hopefully cause a development trickle-down effect that not only benefits the middle class but could also benefit the poor and vulnerable.

Given the critical role of the middle class in democratic movements, the post-2010 period saw changes among its ranks and changes to its economic welfare that do not bode well for the future of transformative change in the region. Tragically, the region is also hostage to protracted sectarian conflicts and external interventions. As a consequence of this instability and violence, it is currently home to the world's largest number of internally displaced persons.

This perennial instability and conflict has entailed the diversion of substantial resources towards military expenditure at the expense of growth-promoting activities and the social sector. The economic analysis of pro-middle class development policies should therefore not preclude the impact of wars and conflicts. In this regard, it is pertinent to note that the menu of policy

alternatives that Governments in the region can adopt is bound by prevailing constraints. This is particularly valid given that a variety of non-State actors are now playing a powerful role in many Arab countries (Iraq, Libya, Somalia, the Sudan, the Syrian Arab Republic and Yemen). Proposing a "middle-class-friendly" reform agenda in this context may seem unrealistic.

However, as argued in this report, these countries slipped into conflict because the policy mix they adopted was anti-developmental and therefore anti-middle class. The traditional social contract has already shown its inability to deliver in the long-run, in the absence of continued injections of substantial amounts of external resources in the form of political or economic rents. This caused some elements of the middle class, notably young people, to break ranks with the elite and join protest movements. At least a portion of the Arab middle class has therefore taken on its expected role as an agent of change. It is finally calling for the rule of law and a merit-based socioeconomic system, where entry into business activities or the public sector is based on efficiency and qualifications rather than political connections.

However, middle class aspirations for quick economic benefits from post-revolutionary political orders were not met because of uncertainty-induced capital flight, which further reduced the already limited levels of private sector job creation. In addition, the use of limited public sector jobs to pay off regime supporters went counter to demands for a merit-based public sector recruitment process. Moreover, the limits placed on personal freedoms by new rulers aggravated restrictions imposed by a breakdown of traditional systems of law and order. This led to noticeable elements of the middle class deserting the uprisings and

reverting to the comfort of the old order. However, the erosion of the middle class in the strife-stricken Syrian Arab Republic and Yemen further strengthened the reactionary tendencies of the established middle class core that had traditionally been allied with the ruling autocratic elite.

A revitalized and vibrant economy that promotes efficiency and competition is the only way to offer the evolving middle class and the increasing number of educated young people acceptable economic opportunities. Reincarnations of the old order are unlikely to have the resources needed to continue with the “authoritarian bargain” by absorbing the youth population into public sector jobs. Hence, the middle class is likely to have an important role in the fight for social justice, which ignited the Arab uprisings in the first place.

The following four key governance related measures can sustain an enlarged alliance for a socially conscious developmental State:

- a. Peaceful demonstrations;
- b. Rule of law based on protection of property rights and working courts;
- c. A merit-based public sector that delivers quality basic services, including an appropriate level of social protection, as opposed to a public service that is used to dispense political patronage;
- d. A rule-based competitive private sector where success in business operations depends on efficiency and effectiveness rather than the strength of political connections.

Not all governance and institutional improvements are dependent solely on Governments, keeping in mind foreign and domestic non-State actors and foreign State actors, which were and still are intent on interfering in the Arab region. Citizens

and Governments should strive for stability and internal and regional security, through political agreement and peaceful solutions. The rule of law is the foundation upon which accountability, transparency and justice should be established. Moreover, short-term governance sector reforms can bring about quick and visible results, including constitution-building, free and fair elections, political participation and transitional justice.<sup>247</sup> Developing a governance system to support the developmental State through the public and private sectors is the next logical step, by improving the quality of public sector services and developing clear and effective rules and regulations for the private sector.

Lastly, a governance revolution is important to counter the fragmentation of middle class allegiances into diverse ideological or other collective identities along sectarian, tribal, regional and ethnic lines, which can be manipulated, as is the case in many Arab countries today, to generate a counter-force to development and State-building. This is practised overtly in some oil-rich countries and less overtly, but not less effectively, in countries like Iraq and the Syrian Arab Republic, which are supposedly secular States.

## VI. Conclusion

Part Five of the present report sets out measures that can drive the Arab middle class forward and allow the poor and vulnerable to become the middle class of tomorrow. This report argues that, although the Arab region is suffering from instability, development and economic justice policies must be discussed.

The following economic policy agenda is suggested for a regionally integrated Arab developmental State:

- a. Development-friendly macroeconomic management aimed at structural

transformation towards higher value-added goods and services sectors, which provides quality employment opportunities for the existing middle class;

- b. Emphasis on social protection floors to ensure equal opportunities and expand the middle class base from vulnerable and poor segments;
- c. A proactive and expanding fiscal policy mix that identifies resources to finance economic justice policies;
- d. An improved overreaching governance fabric, laying the foundation for a developmental State.

The choice of policies should not be ideological but pragmatic, aimed at increasing the pace of structural transformation and quality employment, and at allowing companies to become more competitive. While trade protection is increasingly becoming an unviable policy for most Arab countries, there are other instruments that can be utilized to provide support for domestic productive sectors, such as indirect and in-kind subsidies; financial instruments; land allocation; government procurement practices; public-private joint ventures; State funded and managed quality control, research and development, and technological support; and a more business friendly environment.

Part Five of this report shows that it is also necessary to explore regional measures to support national efforts aimed at enhancing productivity and competitiveness; and ways and means to turn Arab regional integration into an effective mechanism for the development of industries. State economic leadership in this respect is indispensable and its political role is salient. The crucial ingredient for development-friendly growth, therefore, is "a capable and largely developmentally oriented State."<sup>248</sup> This, in

turn, requires a mix of market and State solutions and a better understanding of the Arab region within the global production hierarchy.

Policies should be implemented to assist the upward social mobility of the poor and vulnerable. This report suggests that this can be achieved through economic justice, including the introduction of a social protection floor, that provides basic health and social services.

Fortunately, in many Arab economies, resources can be made available through taxation, military expenditure and energy subsidy reform. Their effectiveness, however, will depend on building a political coalition with the will to implement development policies outside the variants of conventional economic wisdom.

Lastly, a socially conscious developmental State is not possible without radical reforms to existing governance practices, so as to guarantee security, the rule of law, a merit-based public sector and a competitive rule-based private sector.

Such a system would be a far cry from the old authoritarian bargain, because it would be democratic, developmental, just and free. However, it would be strongly resisted by ruling elites and would also have external enemies, given that a successful merit-based open system would lead to a new social contract of mutual accountability, impeding the ability of rulers to listen to foreign demands as opposed to those of their citizens. Nevertheless, the success of such socially conscious developmental States hinges upon the direct and indirect support of the middle class. For the Arab region to move forward on this bright path, the middle class should not only be up for the ride, but must also be behind the wheel.

# Endnotes

## Part I

- <sup>1</sup> See bibliography for a full list of reports and publications.
- <sup>2</sup> Todaro and Smith, 2012; Davis, 2004; and Easterly, 2001.
- <sup>3</sup> Polanyi, 1944.
- <sup>4</sup> Stiglitz, 2013.
- <sup>5</sup> Lagarde, 2014.
- <sup>6</sup> See Carville and Greenberg, 2012; Tyler, 2013; Faux, 2012; Lofgren, 2013; and Pierson and Hacker, 2010.
- <sup>7</sup> See Parker, 2009; *The Economist*, 2011; *Financial Times*, 2013; *The Daily Star*, 2012; Kandil, 2012; Friedman, 2013; and Asian Development Bank, 2010.
- <sup>8</sup> Aristotle, 350 BC, p. 73.
- <sup>9</sup> Smith, 1776.
- <sup>10</sup> Marx, 1887.
- <sup>11</sup> Veblen, 1899.
- <sup>12</sup> Weber, 1964.
- <sup>13</sup> See Adelman and Morris, 1967; Landes, 1998; and Alesina, 1994.
- <sup>14</sup> See Easterly, 2001.
- <sup>15</sup> See Birdsall and others, 2000.
- <sup>16</sup> See Banerjee and Duflo, 2008.
- <sup>17</sup> Birdsall, 2007.
- <sup>18</sup> Goldthorpe, 1987.
- <sup>19</sup> Marx, 1971.
- <sup>20</sup> Althusser, 1970.
- <sup>21</sup> Marx, 1971.
- <sup>22</sup> Abu-Ismaïl and Sarangi, 2013.
- <sup>23</sup> *Ibid.*
- <sup>24</sup> Veblen, 1899.
- <sup>25</sup> Diwan, 2013.
- <sup>26</sup> Prasad, 2014.
- <sup>27</sup> Cammett and Diwan, 2013.
- <sup>28</sup> Kandil, 2012.
- <sup>29</sup> Diwan, 2013.
- <sup>30</sup> Such as the Arab Development Challenges Report (UNDP, 2012); Diwan (2013); and Promises of Spring (ESCWA, 2013c).
- <sup>31</sup> The figures for all nine countries were derived from the household expenditure surveys at two points in time, closest to 2000 and 2011, as available.
- <sup>32</sup> This country classification is based on gross national incomes (GNI) for 2011, following the grouping by World Economic and Situation Prospects (United Nations, 2013). However, the least developed countries are grouped together, as per the Arab Millennium Development Goals Report (2013).

- <sup>33</sup> Easterly, 2001.
- <sup>34</sup> Birdsall and others, 2000.
- <sup>35</sup> Ravallion, 2009.
- <sup>36</sup> Asian Development Bank, 2010.
- <sup>37</sup> Chun, 2010.
- <sup>38</sup> The African Development Bank, 2011.
- <sup>39</sup> Ferreira and others, 2013.
- <sup>40</sup> Kharas, 2010.
- <sup>41</sup> UNDP, 2013.
- <sup>42</sup> Birdsall, 2007.
- <sup>43</sup> Ali, 2011.
- <sup>44</sup> Ali, 2009.
- <sup>45</sup> Abu-Ismaïl and Sarangi, 2013.
- <sup>46</sup> It also understates poverty in Latin America and the Caribbean (Ferreira and others, 2013).
- <sup>47</sup> Deaton, 2010.
- <sup>48</sup> Reddy, 2009.
- <sup>49</sup> Given the problems associated with PPP rates, Deaton (2010) suggested the use of self-reported prices from expenditure surveys rather than converting prices into PPP, for any poverty estimation exercise.
- <sup>50</sup> UNDP (2006c, 2009a) for Syria, UNDP (2008) for Lebanon, World Bank and UNDP (2007) for Yemen and World Bank (2005, 2010) for Egypt.
- <sup>51</sup> El-Laithy and others, 2003.
- <sup>52</sup> Ravallion, 1998.
- <sup>53</sup> *Ibid.*
- <sup>54</sup> See empirical evidence in Kakwani and Son (2005).
- <sup>55</sup> Booz and Company, 2012.
- <sup>56</sup> Mohieddine, 2013.
- <sup>57</sup> See Sarangi and others (2014) for details of inconsistency in consumption surveys and poverty estimates across Arab countries.
- <sup>58</sup> ESCWA, 2014b; and World Bank, 2013.
- <sup>59</sup> World Bank, 2013.
- <sup>60</sup> Diwan, 2012.
- <sup>61</sup> Abu-Ismaïl and Sarangi, 2013.
- <sup>62</sup> It should be noted that these results are based on the latest surveys for each country, not taking into account the impact of the crises in the Syrian Arab Republic and Yemen.
- <sup>63</sup> UN-DESA, 2011.
- <sup>64</sup> Mohieddin, 2013.
- <sup>65</sup> Data for Oman are outliers and excluded from figure 17. Data for Lebanon are outliers and excluded from figure 18. Moreover, 2013 data for the Syrian Arab Republic are excluded from figure 17, and 2013 data for the Syrian Arab Republic and 2011 data for Yemen are excluded from figure 18, because of missing data.

## Part II

- <sup>66</sup> United Nations and League of Arab States, 2013.
- <sup>67</sup> *Ibid.*
- <sup>68</sup> Webometrics Ranking of World Universities, 2014.
- <sup>69</sup> Assaad, 2014.
- <sup>70</sup> Assaad, 2010.
- <sup>71</sup> These “other services” exclude services that come under high value-added sectors, such as trade, transport, finance and other modern service sectors. Consequently, the “other services” category mainly refers to low value-added activities.
- <sup>72</sup> Assaad, 2010.
- <sup>73</sup> Abu-Ismaïl and Sarangi, 2013.
- <sup>74</sup> Cichello and others, 2013.
- <sup>75</sup> Hlasney and Verme, 2013.
- <sup>76</sup> Deaton, 2003.
- <sup>77</sup> Ali, 2009.
- <sup>78</sup> Bibi and Nabli, 2010; and Alvaredo and Picketty, 2014.
- <sup>79</sup> Diwan, 2012.

## Part III

- <sup>80</sup> UNDP, 2010.
- <sup>81</sup> *Ibid.*, p. 33.
- <sup>82</sup> See, for example, Mohieddin (2011).
- <sup>83</sup> Meier and Stiglitz, 2001, pp. 14-15. Classical examples of development ideas and concepts based on visionary models of development include the vicious circle of poverty, the big push, the critical minimum effort and the low-level equilibrium trap. Almost all of these are currently being rediscovered, albeit in mathematical formulation. See also Meier (2005).
- <sup>84</sup> Reid, 2002.
- <sup>85</sup> ESCWA, 2013a; and ESCWA, 2014a. A social contract implies “a tacit agreement to trade social security for political compliance” (Cook, 1993, p. 1).
- <sup>86</sup> World Bank, 2004; and World Bank, 2007.
- <sup>87</sup> Youssef, 2004.
- <sup>88</sup> Delvin, 2010; and Youssef, 2004.
- <sup>89</sup> Youssef, 2004.
- <sup>90</sup> World Bank, 2004a, p. 2.
- <sup>91</sup> ESCWA, 2013b.
- <sup>92</sup> UNDP, 2009; and UNDP, 2012.
- <sup>93</sup> See UNDP 2006a; 2006b; and 2002b.
- <sup>94</sup> See Von Arnim and others, 2011.
- <sup>95</sup> Selvik and Stenslie, 2011, pp. 108-109.
- <sup>96</sup> Von Arnim and others, 2011.
- <sup>97</sup> Abu-Ismaïl and others, 2012b.

- <sup>98</sup> World Bank, 2013.
- <sup>99</sup> Von Arnim and others, 2010.
- <sup>100</sup> ILO and UNDP, 2012.
- <sup>101</sup> Abu-Ismaïl and others, 2012a.
- <sup>102</sup> ILO and UNDP, 2012.
- <sup>103</sup> World Bank, 2013.
- <sup>104</sup> Hansen, 1991.
- <sup>105</sup> ESCWA, 2014a.
- <sup>106</sup> Institut Tunisien de la Compétitivité et des Études Quantitatives, 2013.
- <sup>107</sup> ILO, 2014.
- <sup>108</sup> Tzannatos, 2011.
- <sup>109</sup> Wage data for Arab countries was compiled using ILO databases.
- <sup>110</sup> Richards and Waterbury, 2013.
- <sup>111</sup> ILO, 2012b.
- <sup>112</sup> World Bank, 2013.
- <sup>113</sup> Ibid.
- <sup>114</sup> IMF, 2013.
- <sup>115</sup> World Bank, 2013.
- <sup>116</sup> ESCWA, 2014a.
- <sup>117</sup> Prasad, 2014.
- <sup>118</sup> ESCWA, 2013b.
- <sup>119</sup> It should be noted that there are country variations within the Arab region; some least developed countries continue to struggle with education.
- <sup>120</sup> Montenegro and Patrinos, 2013; and UNESCO, 2012.
- <sup>121</sup> IMF, 2014.
- <sup>122</sup> Brookings Institute, 2014.
- <sup>123</sup> ESCWA, 2013b.
- <sup>124</sup> Latif, 2013.
- <sup>125</sup> ESCWA, 2013a.
- <sup>126</sup> Mokdad and others, 2014.
- <sup>127</sup> Clark, 2004.
- <sup>128</sup> Similar patterns are seen across economic classes: the middle class devoted 4 per cent of its household consumption to health, more than doubling in 2011 to 8.6 per cent.
- <sup>129</sup> ESCWA, 2013a.
- <sup>130</sup> Prasad, 2014.
- <sup>131</sup> Active contributors are individuals, from the working age population, who contribute to a retirement scheme, be it private or public.
- <sup>132</sup> Achy, 2013.
- Part IV**
- <sup>133</sup> Prasad, 2014.
- <sup>134</sup> Diwan, 2013.
- <sup>135</sup> Ibid.
- <sup>136</sup> El-Mikawy, 1999.
- <sup>137</sup> Noland and Pack, 2007.
- <sup>138</sup> ESCWA, 2013c.
- <sup>139</sup> Acemoglu and others, 2001; Easterly and Levine, 2003; Hall and Jones, 1999; Rodrik and others, 2004; and Acemoglu and Robinson, 2012.
- <sup>140</sup> Kaufmann and others, 2014.
- <sup>141</sup> Kuncic, 2014.
- <sup>142</sup> Cingranelli and Richards, 1999.
- <sup>143</sup> Diwan, 2013.
- <sup>144</sup> The Quality of Government Institute at the University of Gothenburg aims to “promote research on the causes, consequences and nature of Good Governance and the Quality of Government (QoG) – that is, trustworthy, reliable, impartial, uncorrupted and competent government institutions” (Teorell and others, 2013), and provides a dataset of freely available institutional quality indices, some composites and results of aggregation of other sources on institutional quality, such as the Institutional Quality Dataset. This dataset comprises more than thirty established institutional indicators for most countries across the world over a period of 21 years after 1990 from sources such as the World Bank, the International Country Risk Guide, Freedom House etc. Kuncic (2014) presents the average state of governance quality across the world – the new institutional world order in a cluster analysis.
- <sup>145</sup> Kuncic, 2014.
- <sup>146</sup> ESCWA, 2013c.
- <sup>147</sup> ESCWA, 2013b.
- <sup>148</sup> Kaufmann and others, 2014.
- <sup>149</sup> ESCWA, 2013b.
- <sup>150</sup> Khatib, 2013; and ESCWA, 2013c.
- <sup>151</sup> Amin and others, 2012, p. 42.
- <sup>152</sup> See Gehlbach and Keefer, 2011.
- <sup>153</sup> ESCWA, 2013c.
- <sup>154</sup> Ismael and Ismael, 2013.
- <sup>155</sup> El-Affendi, 2010.
- <sup>156</sup> Transparency International, 2013.
- <sup>157</sup> Arab Center for Research and Policy Studies, 2012.
- <sup>158</sup> ESCWA, 2013c; Heydemann, 2004; Cammett and Diwan, 2013; and Kienle, 2001.
- <sup>159</sup> WVS, 2014. The Survey was launched in 1981, with the first wave of questionnaires distributed in different years up to 1984; a second wave from 1989 to 1993; a third wave from 1994 to 1999; a fourth wave from 1999 to 2004; a fifth wave from 2005 to 2007; and, most recently, a sixth wave from 2010 to 2014. The inclusion of Arab countries began in the fourth wave, but the most extensive inclusion of the region happened in the sixth wave, as seen in table 3 of this report. The number of people interviewed in wave 6 of the Survey in Arab countries will range from a minimum of 1,000 in Palestine and Yemen to a maximum of 2,131 in Libya.
- <sup>160</sup> This method also makes the differences between country scores more pronounced, as it penalizes countries with a low sum of individual dissatisfaction points when it divides it by the maximum possible dissatisfaction points.
- Part V**
- <sup>161</sup> ESCWA, 2014a.
- <sup>162</sup> UNDP, 2012.
- <sup>163</sup> ILO and UNDP, 2013.
- <sup>164</sup> ESCWA, 2014a; and ESCWA, 2013c.
- <sup>165</sup> ESCWA, 2014a.
- <sup>166</sup> Stiglitz, 2013; Piketty, 2014; Wilkinson and Pickett, 2009; Deaton, 2013; and Sen, 1999.
- <sup>167</sup> UNCTAD, 2009.
- <sup>168</sup> ILO and UNDP, 2013.
- <sup>169</sup> ESCWA, 2014a.
- <sup>170</sup> Tzannatos, 2014.
- <sup>171</sup> World Economic Forum, 2012.
- <sup>172</sup> UNDP, 2012.
- <sup>173</sup> ILO and UNDP, 2013.
- <sup>174</sup> Ibid.
- <sup>175</sup> Islam and Chowdhury, 2006.
- <sup>176</sup> ESCWA, 2013d.
- <sup>177</sup> Sala-i-Martin and Artadi (2003) show that the investment rate in the Arab region increased from 17 per cent in the pre-oil shock period to 27 per cent in the post-oil shock period, and increased again to 28 per cent over the period 1981-1985.
- <sup>178</sup> Sala-i-Martin and Artadi, 2003.
- <sup>179</sup> Devarajan and others, 1996; and Sala-i-Martin and Artadi, 2003.
- <sup>180</sup> Pedrosa-Gracia, 2013.
- <sup>181</sup> Roy and Weeks, n.d.
- <sup>182</sup> ESCWA, 2013d.
- <sup>183</sup> Amsden, 1989.
- <sup>184</sup> Abu-Ismaïl and others, 2011.
- <sup>185</sup> Evans, 1995.
- <sup>186</sup> Chang, 2008.
- <sup>187</sup> Gallagher, 2008.
- <sup>188</sup> Abu-Ismaïl, 2011.
- <sup>189</sup> Nolan, 2009.
- <sup>190</sup> Abu-Ismaïl and others, 2011.
- <sup>191</sup> Chang, 2008.
- <sup>192</sup> Gallagher 2007; and 2008.
- <sup>193</sup> Chang, 2008.
- <sup>194</sup> ESCWA, 2013b.
- <sup>195</sup> ESCWA, 2014a.
- <sup>196</sup> McCallum, 1995; and Anderson and van Wincoop, 2003.
- <sup>197</sup> Javorcik, 2004; and Haskel and others, 2007.
- <sup>198</sup> ESCWA, 2013d.
- <sup>199</sup> ESCWA, 2013b.
- <sup>200</sup> See Article 22 of the Universal Declaration of Human Rights; Article 9 of the International Covenant on Economic, Social and Cultural Rights; Article 26 of the Convention on the Rights of the Child; and Article 11 of the Convention on the Elimination of All Forms of Discrimination against Women.
- <sup>201</sup> Bachelet, 2011.
- <sup>202</sup> ESCWA, 2012b.
- <sup>203</sup> World Bank, 2012c.
- <sup>204</sup> ILO, 2011.
- <sup>205</sup> UNCEB, 2009.
- <sup>206</sup> ILO. Available from [www.ilo.org/secsoc/areas-of-work/policy-development-and-applied-research/social-protection-floor/lang--en/index.htm](http://www.ilo.org/secsoc/areas-of-work/policy-development-and-applied-research/social-protection-floor/lang--en/index.htm).
- <sup>207</sup> ILO, 2012c.
- <sup>208</sup> ILO. Available from [www.ilo.org/secsoc/areas-of-work/policy-development-and-applied-research/social-protection-floor/lang--en/index.htm](http://www.ilo.org/secsoc/areas-of-work/policy-development-and-applied-research/social-protection-floor/lang--en/index.htm).
- <sup>209</sup> Morisse, 2013.
- <sup>210</sup> ESCWA, 2012a. Using an alternative estimate, it would have been 2.84 per cent of GDP in Egypt (Rabi, 2012).
- <sup>211</sup> ILO, 2008.
- <sup>212</sup> See Schwarz (2011). For an aid specific example see Kuncic (2011).
- <sup>213</sup> ESCWA, 2012a.
- <sup>214</sup> Megginson and Netter, 2001; Arocena and Oliveros, 2012; and Shen and Lin, 2009.
- <sup>215</sup> Development Committee, 2006.
- <sup>216</sup> Fattouh and El-Katiri, 2012.

- <sup>217</sup> Fattouh and El-Katiri, 2012.
- <sup>218</sup> Abouleinein and others, 2009.
- <sup>219</sup> Zaid and others, 2014.
- <sup>220</sup> Ibid.
- <sup>221</sup> IMF, 2013.
- <sup>222</sup> Fattouh and El-Katiri, 2012.
- <sup>223</sup> Abu-Ismaïl and others, 2011.
- <sup>224</sup> Abu Ismaïl and others, 2012a; and ESCWA, 2014a.
- <sup>225</sup> ESCWA, 2014a.
- <sup>226</sup> Moore, 2007.
- <sup>227</sup> Kaldor, 1963.
- <sup>228</sup> United Nations, 2005.
- <sup>229</sup> Achy, 2010.
- <sup>230</sup> Prasad, 2008.
- <sup>231</sup> Gottschalk and others, 2009.
- <sup>232</sup> ESCWA, 2012a.
- <sup>233</sup> OECD, 2006.
- <sup>234</sup> Karlsson and others, 2004.
- <sup>235</sup> SIPRI, 2014.
- <sup>236</sup> SIPRI, 2014.
- <sup>237</sup> Gaub, 2014.
- <sup>238</sup> Ibid.
- <sup>239</sup> Nasr, 2013; ESCWA, 2013c; and Prasad, 2014.
- <sup>240</sup> Jones, 2007, pp. 186-7.
- <sup>241</sup> Birdsall and others, 2000.
- <sup>242</sup> Barro, 1999.
- <sup>243</sup> Heydarian, 2014.
- <sup>244</sup> North, 1990.
- <sup>245</sup> Nabli, 2007.
- <sup>246</sup> El-Affendi, 2010, p. 31.
- <sup>247</sup> UNDP, 2012.
- <sup>248</sup> Lin and Chang, 2009, p. 6.

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The present report studies the Arab middle class; an important social group that is relatively little understood despite the fundamental role it has played in shaping the economic and social development outcomes in the Arab region. This report contributes to the ongoing debate about factors that led to the Arab uprisings and the difficult transitions to democracy that followed the departure of long-standing dictators by marking elements influencing middle class allegiances, specifically those that weakened their well-established alliances with ruling regimes. The report is motivated by the conviction, on the basis of past development experiences, that a new Arab development model can only succeed if the middle class plays a lead role in designing and implementing processes of economic transformation and political transition. Studying the middle class is therefore crucial to interpreting the past, understanding the present and reading the potential future development prospects of the Arab region.

This report introduces three novel approaches aimed at charting a path for sustaining, empowering and enlarging the middle class. The first is related to the measurement of the middle class based on a definition that takes into account both the quantity and quality of their consumption expenditure. The second relates to the profiling of the Arab middle class using variables such as education, employment and mobility, in addition to multidimensional poverty. The third novel approach lies in using these results to provide a narrative of the socioeconomic context of the decade leading up to the uprisings, from a middle class perspective. The report concludes that the empowerment of the Arab middle class could pave a way out of the current development and governance debacle towards an Arab developmental State.