

A BROKEN SOCIAL CONTRACT, NOT HIGH INEQUALITY, LED TO THE ARAB SPRING

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During the 2000s, expenditure inequality in Arab countries was low or moderate and, in many cases, declining. Different measures of wealth inequality were also lower than elsewhere. Yet, there were revolutions in four countries and protests in several others. We explain this so-called “inequality puzzle” by first noting that, despite favorable income inequality measures, subjective well-being measures in Arab countries were relatively low and falling sharply, especially for the middle class, and in the countries where the uprisings were most intense. The increasing unhappiness, reflected in perceptions of declining standards of living, was associated with dissatisfaction with the quality of public services, the shortage of formal-sector jobs, and corruption. These sources of dissatisfaction suggest that the old social contract, where government provided jobs, free education and health, and subsidized food and fuel, in return for the subdued voice of the population, was broken. The Arab Spring and its aftermath indicates the need for a new social contract, one where government promotes private-sector jobs and accountability in service delivery, and citizens are active participants in the economy and society.

JEL Codes: D63, I30, H40

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1. INTRODUCTION

For decades, the Middle East and North Africa (MENA) had been making steady progress in reducing extreme poverty and inequality. The percentage of poor people in the region, already low, was declining on average (Figure 1). Not only did MENA reach the Millennium Development Goals related to poverty and access to infrastructure services (especially drinking water, sanitation, and internet connectivity), but it made important strides in reducing hunger, child and maternal mortality and increasing school enrollment (Iqbal and Kiendrebeogo, 2016). Inequality of opportunity declined in Egypt and some other MENA countries, according to Hasine (2011) and Assad *et al.* (2015). Expenditure inequality, measured by the Gini index, was either constant or declining in most MENA economies (Figure 2) and remained moderate by international standards (Figure 3).

Yet, starting in late 2010, there were revolutions in Tunisia, Egypt, Yemen, and Libya; a rebellion that has led to a protracted civil war in Syria; and widespread popular discontent in many other countries. The Arab Spring caught the world by surprise. Standard development indicators did not capture the growing

Note: The findings and interpretations in this paper do not necessarily reflect the views of the World Bank, its affiliated institutions, or its Executive Directors.

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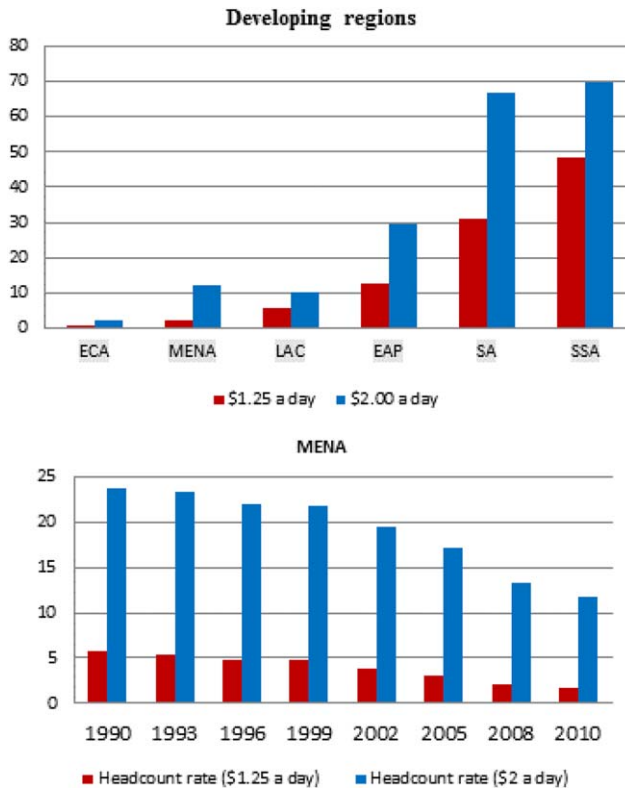


Figure 1. Poverty rates (% of population)

[Colour figure can be viewed at wileyonlinelibrary.com]

Source: PovcalNet, World Bank. Notes: ECA—Europe and Central Asia; LAC—Latin America and the Caribbean; EAP—East Asia and the Pacific; SA—South Asia; SSA—Sub-Saharan Africa.

discontent. Once the uprisings occurred, however, issues of equity and inclusion came to the fore of public attention. In particular, income inequality was cited as one of the factors behind the Egyptian revolution (Hlasny and Verme, 2016; Nimeh, 2013; Ncube and Anyanwu, 2012; Osborn, 2011).

The idea that income inequality is linked to revolutions can be traced to ancient times when social philosophers speculated that economic inequality is a fundamental cause of civil unrest (Muller, 1985). Today, while there is a recognition that tolerance for income inequality varies over time and across countries (Hirschman and Rothschild, 1973), high income inequality is considered bad for social consensus and political stability. Political instability in turn could harm investment, sustainable growth, and progress in human development (Burger *et al.*, 2015; Ostry *et al.*, 2014).

In this paper, we attempt to solve this Arab “inequality” puzzle, defined as the apparent disconnect between relatively low and sometimes declining inequality in the Arab world and the series of uprisings and revolts that spread through the region in 2010–11. First, we generate a more accurate assessment of economic inequality by combining different analytical approaches and data sources. We find that expenditure inequality in Arab countries has been moderate and has

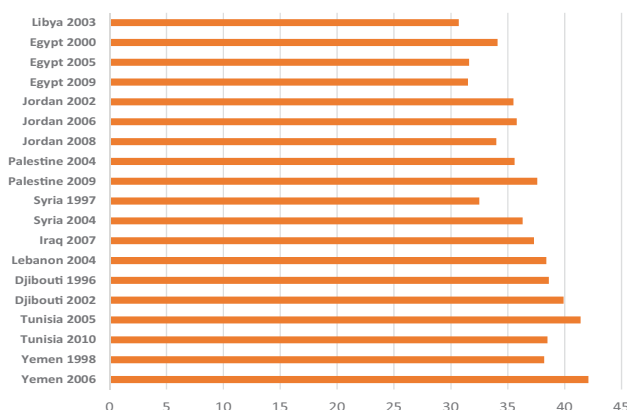


Figure 2. Expenditure inequality in Arab countries in the 2000s (percent)
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Source: Hassine (2015). Total expenditure per capita include expenditure on food, nonfood, housing and durables. Gini coefficient presented as a percentage.

declined in many cases during the 2000s (Hassine, 2015), and estimates of wealth inequality suggest that it is lower in MENA than in the rest of the world. Wealth concentration in publicly traded companies does not appear to be higher in MENA than elsewhere in the world and the gap between MENA and the rest of the world in terms of hidden foreign bank deposits has disappeared over the course of the last two decades (Johannesen, 2015). Importantly, expenditure inequality declined during the 2000s in Tunisia and Egypt—the two countries where the Arab Spring revolutions first took place (Hassine, 2015). In Egypt, although evidence from house prices suggests that the level of expenditure inequality was higher than that obtained based on household surveys (van der Weide *et al.*, 2016), the real story was the dynamics of middle-class incomes and the size of Egypt's middle class, which declined substantially by the end of the decade (Dang and Ianchovichina, 2016).

Second, we provide a clue to resolving the puzzle by exploring alternative measures of welfare, based on subjective data that capture people's views about their well-being on the eve of the Arab Spring. These measures of subjective well-being and determinants of life satisfaction indicate that on the eve of the Arab Spring, Arab people felt stuck. The middle class, in particular, was frustrated. Life satisfaction scores declined markedly just before the Arab-Spring events, especially for the middle class in the Arab-Spring countries.¹ This deterioration reflected perceptions of falling standards of living, related to the shortage of formal-sector jobs, dissatisfaction with the quality of public services, and corruption (Arampatzi *et al.*, 2015).

These sources of public dissatisfaction, especially among the middle class, suggest that there was a breakdown in the social contract between Arab governments and citizens that had persisted since independence. That contract consisted of the state's providing jobs in the public sector, free education and health, and

¹The Arab Spring countries are Tunisia, Egypt, Yemen, Syria, and Libya.

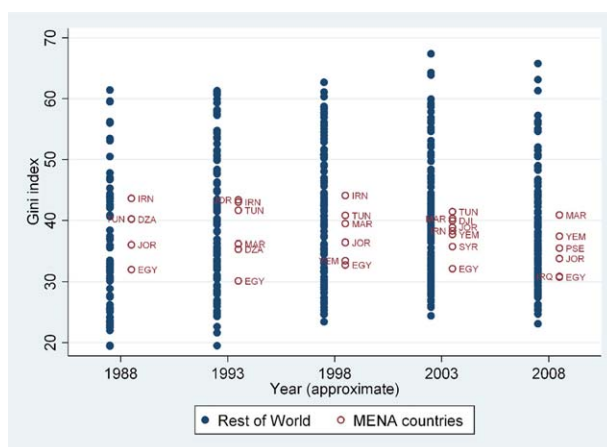


Figure 3. Inequality—over time and across the world
[Colour figure can be viewed at wileyonlinelibrary.com]

Source: Data used in Lakner and Milanovic (2013).

subsidized food and fuel to all citizens. Perhaps in return for the state's largesse, citizens kept their voices low and tolerated some levels of elite capture in the private sector. Starting in the 2000s, it became clear that this contract was not sustainable. In particular, the public sector could no longer be the employer of first resort. But the private sector did not generate enough jobs to absorb the large number of young people entering the labor force. The result was that MENA had the highest unemployment rate in the developing world. Moreover, while education and health were free, and energy and water subsidized, the quality of these services was so poor that many people resorted to the private sector for public services. The quality of available jobs in the private sector was also not as good as that of jobs in the public sector. People felt that they needed connections to those in power to obtain good quality jobs and many expressed concerns that they cannot move ahead no matter how hard they worked (Arampatzi *et al.*, 2015). Since the government was not keeping its part of the social contract, the citizens raised their voice in protest, toppling the leaders in four countries, and causing some governments to reform their constitutions.

The paper is structured as follows. Section 2 presents a picture of economic inequality and middle-class dynamics in the MENA region using different methods and data sources. Section 3 presents alternative measures of wellbeing and the sources of dissatisfaction on the eve of the Arab Spring. Section 4 links these findings and other evidence to the symptoms of a broken social contract, and describes the contours of a new social contract, to which MENA countries need to move to realize the dream of the men and women who rose up in 2010–11 to demand what was their due.

2. ECONOMIC INEQUALITY

Measuring economic inequality is a difficult task, particularly in developing countries and especially in the Arab world, where comprehensive administrative

information on income and wealth are generally unavailable. Inequality measures are often based on household surveys that suffer from several well-known shortcomings. Apart from the difficulty of recalling income and wealth information correctly, survey respondents may under-report expenditures or deliberately leave out income and wealth that result from illegal or informal activities. In addition, these surveys typically include only a few individuals at the very top of the income distribution, although capturing accurately the “top one percent” is crucial to estimating inequality (Alvaredo, 2011). In MENA, these difficulties are compounded by the fact that access to household surveys has been limited. Thus, it is not surprising that to date there are few regional studies on economic inequality in Arab countries.

2.1. *Expenditure Inequality*

A recent paper by Hassine (2015) fills this gap and presents an in-depth comparison of expenditure inequality across 11 economies in the region, using harmonized micro-data from 18 household surveys and three different consumption expenditure aggregates, taking into account temporal and, in some cases, within-country variations in the cost of living.

Hassine (2015) confirms the relatively low levels of expenditure inequality in the region during the 2000s (Figure 3), but finds that the coverage of items in households' expenditures has a significant effect on the Gini measures of inequality. The Gini index based on food and nonfood expenditures is on average 4.2 points higher than the Gini based on food alone; adding expenditures on durables and housing increases the Gini by about 0.5 points.

There are no discernible patterns in the evolution of inequality through time and relative to average welfare. Total expenditure inequality declined in Egypt, Jordan, and Tunisia, and increased in Syria, the Palestinian Territories, Djibouti, and Yemen, but the Gini index remained moderate in the region as a whole, averaging 0.385. Furthermore, there appeared to be no relationship between expenditure inequality and average per capita expenditures, or welfare. Both expenditure inequality and average per capita expenditures increased in Syria and the Palestinian Territories and decreased in Egypt. While there was an improvement in average welfare with a decline in inequality in Jordan and Tunisia, the opposite was observed in Yemen and Djibouti (Figure 4). Thus, the low income and high inequality pattern deepened in Djibouti and Yemen; growth was more broadly shared in Jordan and Tunisia, but in Syria and the Palestinian Territories growth exacerbated inequality; expenditures contracted in real terms in Egypt but most of the burden fell on top earners and the middle class and expenditure inequality declined in the second half of the 2000s.

In search for evidence of a higher level of expenditure inequality in Egypt and in the absence of tax data, Hlasny and Verme (2016) adjust the upper tail of the distribution using the Pareto distribution, often employed to describe the allocation of wealth and income in a society.² They find that expenditure inequality in Egypt does not increase substantially, possibly because their Pareto

²The Pareto distribution shows well that a larger portion of the wealth of a society is owned by a smaller percentage of people.

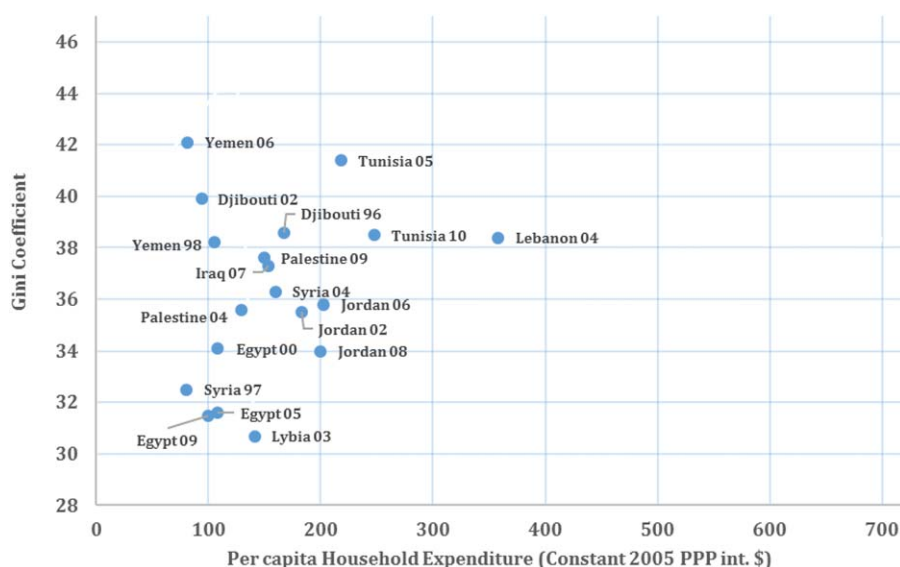


Figure 4. Expenditure inequality in MENA

[Colour figure can be viewed at wileyonlinelibrary.com]

Source: Hassine (2015). Total expenditure per capita include expenditure on food, nonfood, housing and durables.

distribution is fitted using the household survey, which underestimates the top tail. Van der Weide *et al.* (2016) attempt to get around this problem by estimating the upper tail of the distribution using market house price data from large metropolitan areas in urban Egypt.³ The advantages of this approach are that market house price data are publicly available and relatively easy to obtain using technology; there is no systematic tendency for the data to understate home values, in contrast to income data which may be under-reported on tax returns; and the top end of the distribution is captured well in these data as market price information is applicable to homes owned by the top tail. Van der Weide *et al.* (2016) then combine the top tail of the imputed consumption distribution with the bottom of the expenditure distribution obtained from the household survey. Their results provide evidence that inequality in urban Egypt is underestimated (Table 1) and suggest that the level of expenditure inequality in the Arab countries may be higher than previously believed.

Still, these results say nothing about the trend in income inequality in Egypt. Such evidence that exists points to expenditure inequality and inequality of opportunity declining in many Arab countries in the years preceding the Arab Spring (Verme *et al.*, 2014; Hassine, 2011). According to Assaad *et al.* (2015), the drop in inequality of opportunity is due to the declining standards of living of the middle class and their convergence to the standards of living of the poor. Findings in Dang and Ianchovichina (2016), who use synthetic panel

³They put together a dataset of real estate prices by extracting information from listings of homes for sale or rent, available at Egyptian websites.

TABLE 1
INEQUALITY MEASURES FOR URBAN EGYPT CORRECTED FOR MISSING TOP INCOMES

	Household Survey (HIECS)	Household Survey Corrected for Missing Top Incomes Using House Prices
Gini	0.364	0.470
Mean log deviation	0.217	0.278
Theil	0.258	0.420

Source: Van der Weide *et al.* (2016).

analysis, are in line with this conclusion. They find that in the 2000s the percentage of downwardly mobile Egyptians was much higher than the percentage of upwardly mobile ones and these welfare dynamics were even more pronounced in Yemen.

In nearly, all developing Arab countries, especially the four Arab Spring countries, the middle class was doing worse in relative terms than other income groups according to measures tracking changes in mean consumption in the 2000s (Table 2). In Tunisia, where the Arab Spring started, upward mobility was stronger than downward mobility but the incomes of middle class people grew on average at a lower rate than the incomes of the poorest citizens in the second half of the 2000s. Also, the incomes of the affluent top 20 percent declined by more than 5%. In Egypt, the mean consumption of those belonging to the middle 40 percent and the top 20 percent declined on average by slightly more than 1.5 percent per year in the second half of the 2000s. In Syria, the income growth of the middle class was much lower than the income growth of the affluent top 20 percent and the bottom 40 percent in the period between the mid-1990s and the mid-2000s. In Yemen, the spending of the middle class declined by almost 4 percent per year on average over the same period.

2.2. *Wealth Inequality*

Wealth inequality is higher than expenditure inequality, but harder to measure, especially in MENA where wealth information is scarce and data quality

TABLE 2
ANNUAL GROWTH IN MEAN CONSUMPTION BY INCOME GROUP, COUNTRY (%), PRE-2010

Country	Bottom 40%	Middle 40%	Top 20%
Syria	14.9	5.7	31.5
Tunisia	5.1	2.4	-5.4
Palestine	3.8	-0.3	2.2
Jordan	2.0	-0.7	-2.8
Egypt	-4.0	-1.6	-1.5
Yemen	-10.3	-3.8	17.3
Average	1.9	0.3	6.3

Source: Dang and Ianchovichina (2016). The 40th and 80th percentile of the income distribution in the first period are used as the thresholds that respectively identify the bottom 40% and the middle 40% for both periods.

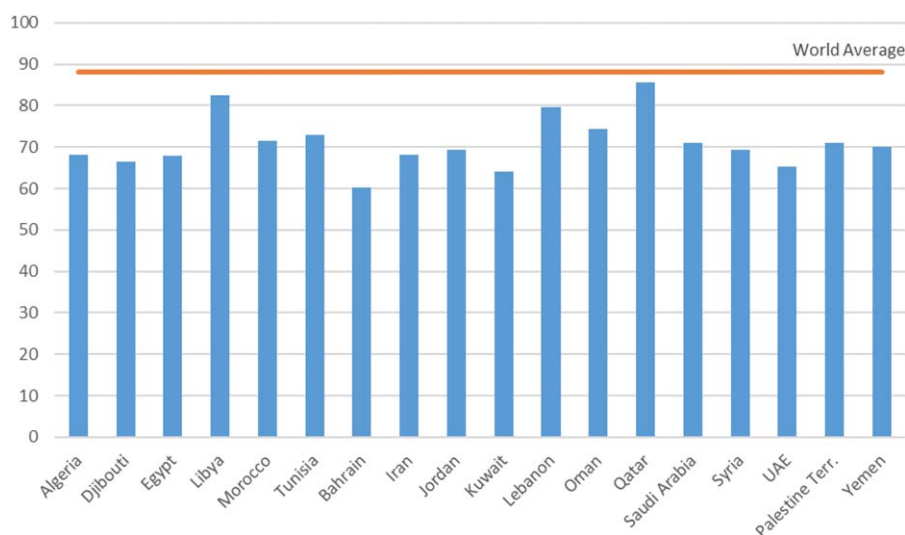


Figure 5. Wealth inequality (Gini coefficients)
[Colour figure can be viewed at wileyonlinelibrary.com]

Source: Credit Suisse Databook (2010).

poor (Credit Suisse, 2010). The Global Wealth Databooks that accompany Credit Suisse's Global Wealth Reports offer a description of the most comprehensive data used to estimate in a consistent way the wealth levels and the distribution of wealth within countries and across countries within regions and worldwide. According to the first issue of the Global Wealth Databook (Credit Suisse, 2010), estimates of wealth inequality in all Arab countries were considerably below the world average wealth inequality on the eve of the Arab Spring (Figure 5).

However, the data on MENA countries are sparse so the estimates of inequality were imputed using regression methods. We therefore turn to alternative sources of information and measures of wealth concentration at the top of the income ladder. One such source is the Forbes' data on the net worth owned by billionaires.⁴ According to these data, wealth concentration in the hands of billionaires has been lower in most MENA countries than in other countries at similar levels of development (Figure 6). To be sure, these data reflect mostly wealth in publicly traded companies and very few companies in the region are publicly traded (OECD, 2009). The 20 or so largest companies in most Gulf States, Egypt, Lebanon, and Morocco are not listed on national or world stock exchanges. Instead, they are either firms privately owned by prominent families or state-owned firms. Wealth concentration would go up if we were to include the wealth of Arab billionaires in private companies and the wealth owned by current and former heads of state and their families. In short, this measure underestimates the number of billionaires and the wealth owned by them.

Another way to gauge the extent of wealth inequality in the Arab world is to estimate the size of wealth hidden by citizens of Arab countries in foreign tax

⁴The list is regularly updated and available at <http://www.forbes.com/billionaires/list/>.

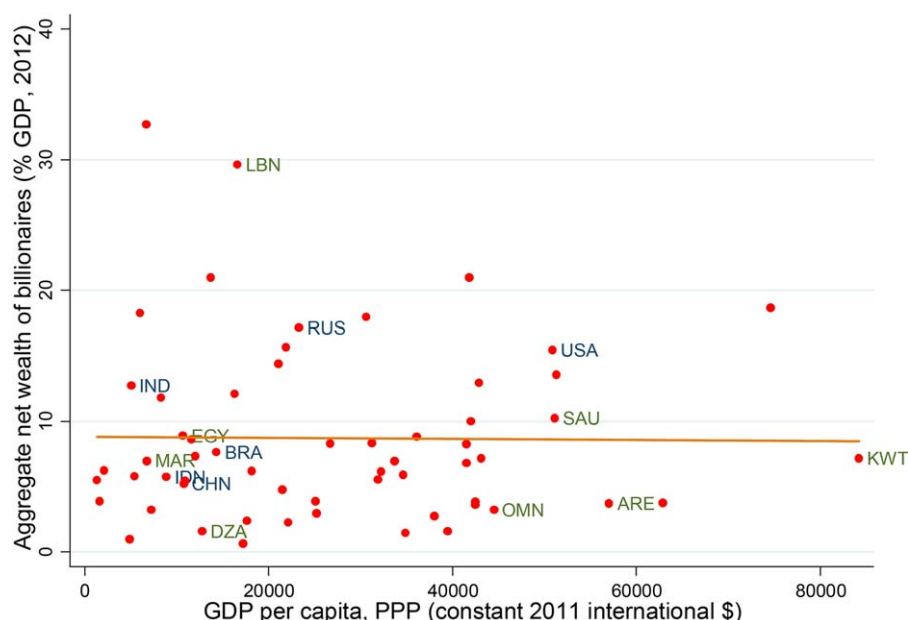


Figure 6. Wealth concentrated in the hands of billionaires
[Colour figure can be viewed at wileyonlinelibrary.com]

Source: Ianchovichina *et al.* (2015) based on Forbes database of billionaires and World Bank data on GDP.

haven bank deposits, available in a dataset from the Bank of International Settlements (BIS) on cross-border bank deposits. The dataset contains information on foreign-owned bank deposits in 43 countries—representing all major financial centers, including tax havens—at the bilateral level. The focus on bank deposits in tax havens is warranted for at least a couple of reasons. First, haven deposits offer advantages to individuals wishing to hide their wealth, notably banking secrecy and legal arrangements that nominally sever the tie between the assets and their owners. Such arrangements are likely to be most appealing to individuals who desire to hide their wealth status because the wealth may have been acquired through informal or illegal means. Second, bank accounts in foreign banks typically involve fixed costs that are prohibitive for individuals at lower wealth levels. The data on bank deposits in tax havens therefore offer insights about the hidden wealth of the wealthiest individuals whose households are under-represented in household surveys, even when these surveys have been corrected for missing observations at the top end of the distribution.

There are however important limitations to this dataset. It covers only bank deposits and excludes other types of hidden wealth such as bonds or equity owned through the haven accounts. Zucman (2013) estimates that bank deposits account for roughly one quarter of the financial wealth of the world's wealthiest individuals. The dataset does not distinguish among deposits belonging to individuals, firms, and governments, and assigns deposits to counterpart countries on the basis of immediate rather than ultimate ownership. For example, if a resident of Tunisia owns a corporation in Panama, which in turn holds a bank account in

Switzerland, the BIS statistics will record the Swiss account as belonging to a resident of Panama. Corporations, trusts, and other similar arrangements are frequently used by owners of hidden wealth to add layers of secrecy (FATF, 2011). Johannesen (2015) controls for this problem by excluding deposits recorded as belonging to havens because such deposits are very likely to reflect sham structures rather than true ownerships by haven residents.

Using this dataset, Johannesen (2015) finds that historically hidden wealth has been considerably larger for MENA countries than elsewhere, but this difference has diminished rapidly in recent years (Figure 7). Furthermore, he finds no correlation between the shares of haven deposits in GDP and the level of expenditure inequality in MENA (Table 3). This suggests that hidden-wealth inequality and expenditure inequality are different concepts. Haven deposits capture a dimension of inequality that may have no relationship to the inequality captured by the survey measures. The size of haven deposits may also be indicative of other factors such as corruption, tax evasion, capital controls, and domestic financial sector development. In sum, while existing measures of inequality may underestimate the true extent of economic inequality, the error due to the existence of hidden wealth in haven bank deposits has diminished over time and is currently not likely to be much larger in MENA countries than in the rest of the world.

The evidence emerging from this body of research suggests that anger over economic inequality could not have triggered the Arab Spring. This conclusion is consistent with the profile of developing MENA countries as high-redistribution economies.⁵ The post-independence, state-led economic model followed by most MENA countries contributed toward poverty reduction and equity, but the model that guaranteed formal public sector jobs and adequate public services became unsustainable (Devarajan and Mottaghi, 2015). Fiscal imbalances grew, reflecting disappointing growth in the 1980s and growing recurrent expenditures on public wages and subsidies. Substantial increases in commodity prices in the 2000s and fast-growing domestic demand increased the fiscal cost of subsidies and provided impetus for subsidy reforms (Devarajan *et al.*, 2014). Most governments, however, continued to offer subsidies, as reforms were often partial or reversed under public pressure (World Bank, 2011a, 2011b).

3. SUBJECTIVE WELL-BEING ON THE EVE OF THE ARAB SPRING

Measures of expenditure inequality draw attention to the welfare of the poor and vulnerable, but they have proven of limited value in understanding the factors behind the Arab Spring uprisings. The main problem is that these measures do not capture aspects important to an individual's welfare such as quality-of-life, expectations about the future, and other issues not reflected or not measured well with objective data. Environmental quality, institutional quality, public safety, the fairness of the justice system, control of corruption, for example, have significant

⁵Benabou (2000) argues that with imperfect credit and insurance markets some redistributive policies can improve ex ante welfare and the popular support for redistribution decreases with inequality. Therefore, there might be multiple steady states: mutually reinforcing high inequality and low redistribution or low inequality and high redistribution.

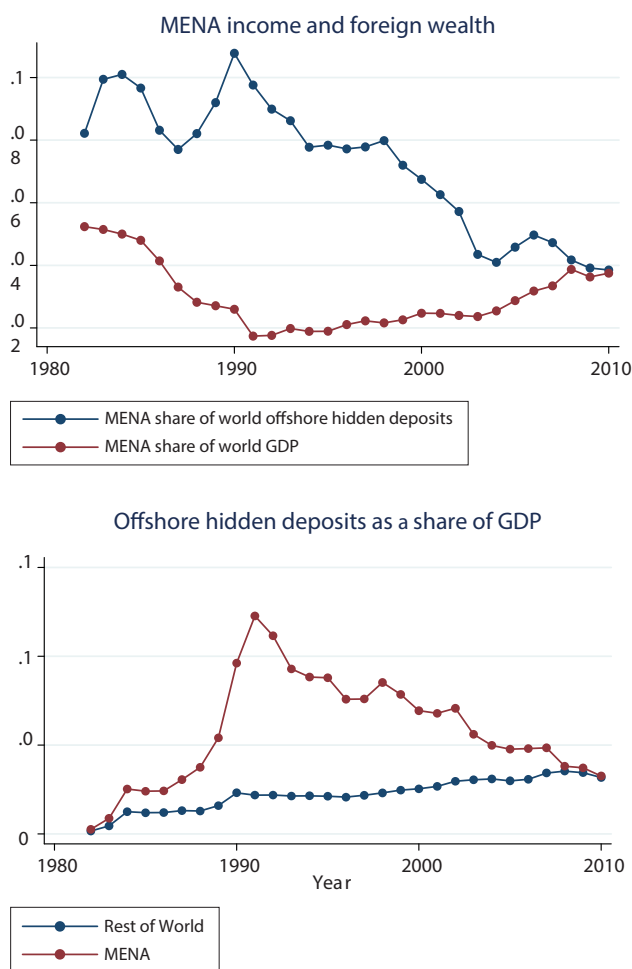


Figure 7. Hidden bank deposits
[Colour figure can be viewed at wileyonlinelibrary.com]

Source: Johannesen (2015).

influence on the quality of people's lives and, therefore, their standards of living and welfare, but are not well-captured in household expenditure data used to calculate traditional welfare measures.

Expectations also play a role in welfare evaluations but are not reflected in welfare measures. They may change over time as people calibrate their life evaluations based on changes in the "ideal" they have for their personal life ("reference point") and changes in domains important to their happiness (e.g. perceptions of corruption grow) or the importance of these domains for their personal wellbeing (e.g. control of corruption becomes more important to people's quality of life). Importantly, Gurr (1971) argues that "relative deprivation", defined as a discrepancy between expectations and reality in well-being, is a predictor for political instability and collective violence by social groups.

TABLE 3
CORRELATION BETWEEN THE RATIO OF HAVEN DEPOSITS TO GDP AND THE GINI COEICIENT

	All countries	Low income	Mid income	High income	MENA	Non-MENA
Gini coefficient	0.000297 (0.000283)	0.000102 (0.000417)	0.000413 (0.000414)	0.00205* (0.00106)	-0.000723 (0.00674)	0.000398* (0.00024)
Constant	0.0115 (0.0113)	0.0153 (0.0165)	0.00617 (0.0172)	-0.035 (0.0351)	0.0721 (0.236)	0.00584 (0.00959)
Observations	113	38	58	18	7	106
R ²	0.010	0.002	0.017	0.189	0.002	0.026

Source: Johannesen (2015)

Finally, objective indicators may not give a complete picture of how the economy evolves. Unemployment statistics, for instance, may improve as more people drop out of the work force; this translates into lower unemployment rates but indicates serious structural economic problems that force people to quit their active job search. Inflation may be underestimated if the quality of the products in the reference basket is allowed to deteriorate or the mix of goods and services is not updated to reflect changes in preferences. Household expenditure increases in countries with deteriorating quality of public service may not signal improvements in welfare as citizens are forced to pay for private services in order to avoid going to low-quality public service providers.

3.1. *Subjective well-being*

The “Cantril Ladder” scores capture people’s views on how closely their life fits their standard for a good life. The higher the score on the ladder, the closer one’s life is seen to their ideal life (identified with the maximum score of 10). The Cantril Scale scores offer a way to measure subjective wellbeing and are ideal for welfare analysis, especially in Arab countries, for a number of reasons. By relying on the scores rather than on monetary measures or indexes that reflect index-maker’s opinions on what matters most,⁶ one gives voice to the people and places primary importance on people’s evaluations of their own lives. The responses factor in both monetary and non-monetary factors affecting subjective well-being and therefore can be used in analyses aimed at understanding the value people attach to a comprehensive set of factors and circumstances that improve their lives and contribute to their unhappiness.⁷

Life satisfaction data from various sources show that just before the emergence of social discontent in the Arab world, average levels of subjective well-being, measured using the “Cantril Ladder” scores, were relatively low and declined steeply in Arab Spring countries prior to the Arab Spring uprisings in 2011 (Figure 8). Average life satisfaction levels were particularly low in Syria,

⁶Since there is uncertainty to what degree index-makers’ opinions matter, it is hard to treat an index as an overall measure of well-being or assess the extent to which variations in individual components are affecting overall scores.

⁷Population-based samples in each country enable cross-country comparisons.

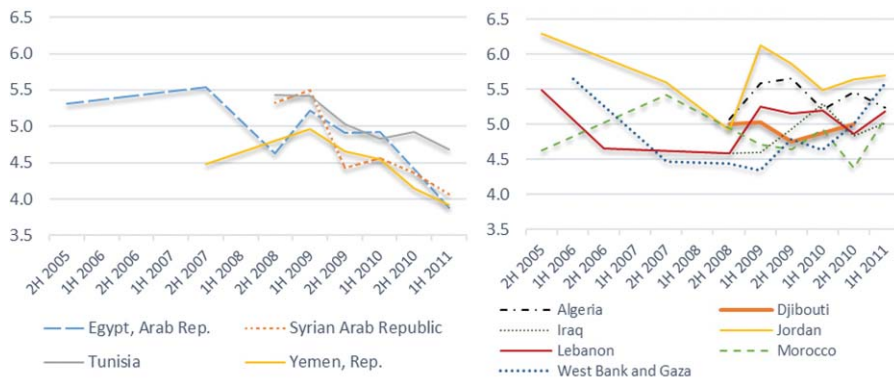


Figure 8. Evolution of life satisfaction during the second half of the 2000s

[Colour figure can be viewed at wileyonlinelibrary.com]

Source: Gallup World Poll data. Note: Not enough data points for Iran, Islamic Rep., and Libya.

Yemen, and Egypt.⁸ Arampatzi *et al.* (2015) call this phenomenon of declining levels of happiness during a period of moderate-to-rapid economic growth, the “unhappy development paradox.”

At the end of the decade, the MENA region was the only region in the world with a high incidence of large declines in average subjective wellbeing (Figure 9), with steeper declines for the top 60 percent of the population, representing mostly the middle class, than the bottom 40 percent, representing the poor and vulnerable (Figure 9). This syndrome was especially pronounced in the Arab-Spring countries—Syria, Libya, Tunisia, Egypt, and Yemen. The ranks of the unhappy swelled in nearly all Arab countries (Dang and Ianchovichina, 2016).

Using a reduced-form life-satisfaction model that incorporates individual perceptions about social conditions, personal characteristics, and other factors (shown to influence happiness), Arampatzi *et al.* (2015) assess the relative importance of different explanations of declining life satisfaction in developing MENA in the run-up to the Arab Spring. They narrow the social domains influencing life satisfaction in the region to three main areas: dissatisfaction with standards of living (or quality of life), unemployment, and “wasta” (or the inability to get ahead without connections) (Figure 10). The same factors cited as reasons for the Arab Spring uprisings (Figure 11) appear to have negatively and significantly affected life satisfaction in MENA in the period immediately preceding the Arab Spring uprising.⁹ They are also clearly linked to the “relative deprivation” theory of Gurr (1971). Better educated than their parents, young people expected to do

⁸The period right after the global financial and economic crisis of 2008 was a difficult one for most economies in the world. The MENA region was affected by this crisis but to a much smaller extent than other parts of the world (World Bank, 2011a). Still, the economic recovery in MENA was also much less vigorous than the recovery in countries that suffered sharp output contractions. The same factors that helped MENA countries avoid severe recessions – a large public sector and limited links to the global economy – constrained their growth recovery.

⁹In addition, in line with the empirical literature on happiness, Arampatzi *et al.* (2015) find that income, marriage and children, and advanced education are all positively and significantly associated with life satisfaction.

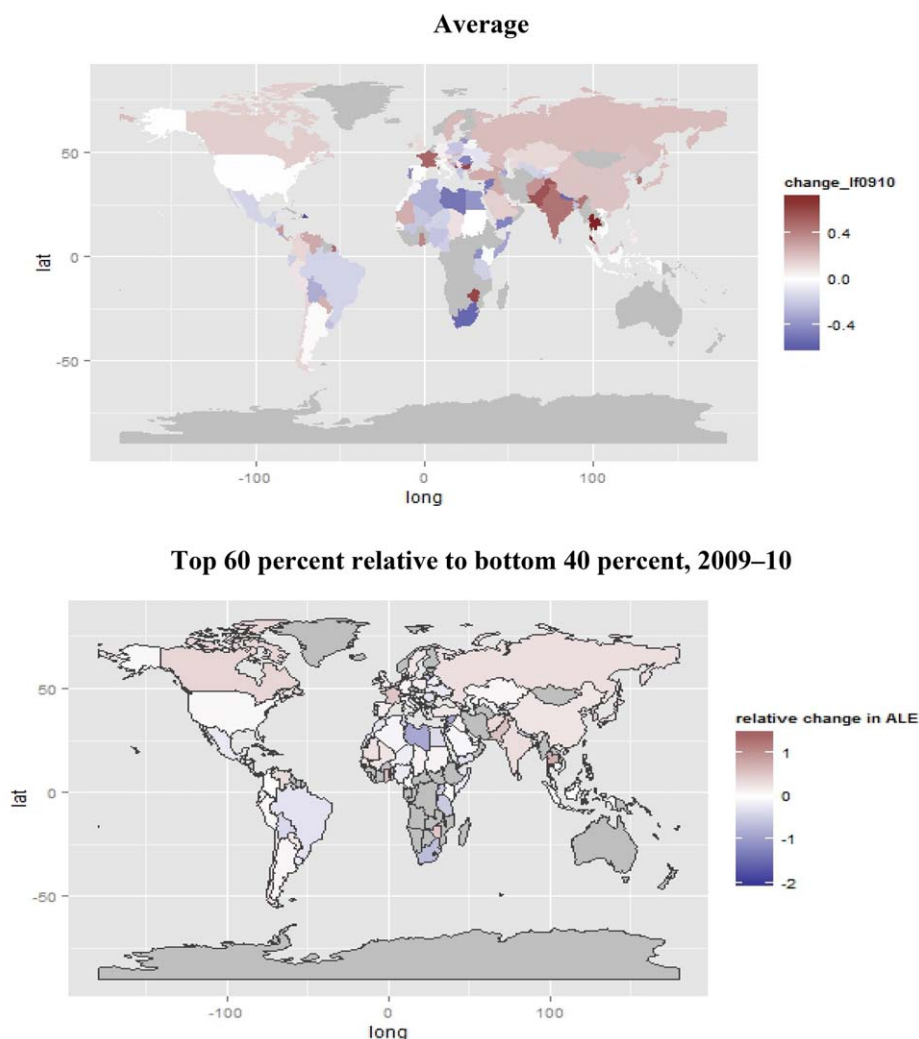


Figure 9. Change in life satisfaction, 2009–10
 [Colour figure can be viewed at wileyonlinelibrary.com]
 Source: Ianchovichina *et al.* (2015) based on Gallup World Poll data.

better than the previous generation but instead struggled to find good quality jobs and were disappointed that no matter how hard they worked they could not get ahead (Arampatzi *et al.*, 2015). Jobless young men could not hope to get married without a stable source of income. Huge progress in reducing and, in some cases, eliminating gender gaps in education, and steep declines in fertility rates, suggested that Arab women were more prepared than ever before to participate in the labor market and contribute to economic life. The reality, however, was that unemployment rates among women were much higher than those among men (Figure 12) and female labor force participation rates remained low (Figure 13).

These results are echoed in statistics showing a rise in dissatisfaction with the quality of government services in developing MENA, in general, and the Arab

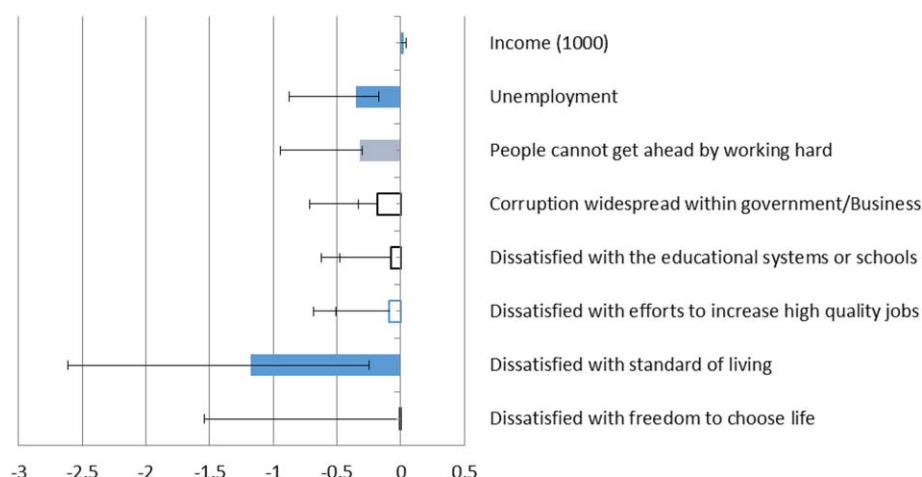


Figure 10. Effects of different domains on life satisfaction in the Arab World
[Colour figure can be viewed at wileyonlinelibrary.com]

Source: Arampatzi *et al.* (2015).

Note: Dark blue, light blue and white denote 1% significance level, 5% significance level, and no significance, respectively.

Spring countries, in particular. The percentage of people dissatisfied with the availability of affordable housing rose most dramatically prior to the Arab Spring uprisings, but there was also increase in the incidence of people dissatisfied with public transportation, quality healthcare, and availability of quality jobs. In Arab Spring countries, deterioration in average life satisfaction was also mostly driven by the increase in the percentage of people dissatisfied with their living conditions and the increased importance of perceptions about corruption for life satisfaction.

4. A BROKEN SOCIAL CONTRACT

To understand why, despite improvements in objective indicators, people were dissatisfied with the quality of their lives, we note that all MENA countries had more or less the same social contract since independence. The government was the main employer. As a result, the public sector dominated formal-sector employment (Figure 14). The state provided free education and health, and subsidized food and fuel, the latter often dominating public spending (Figure 15). In return for the state's largesse, citizens kept their voices low, and government's accountability to citizens was weak (Figure 16).

This social contract delivered results. The food subsidies, although expensive and poorly targeted, did keep the poor fed. The public-sector worker's salary also served as a safety net for a large number of family members. Access to education and health improved faster than anywhere else in the developing world (Iqbal and Kiendrebeogo, 2016). As a result, poverty rates fell, with extreme poverty—the percentage of people living on less than \$1.25 a day—among the lowest in the world.

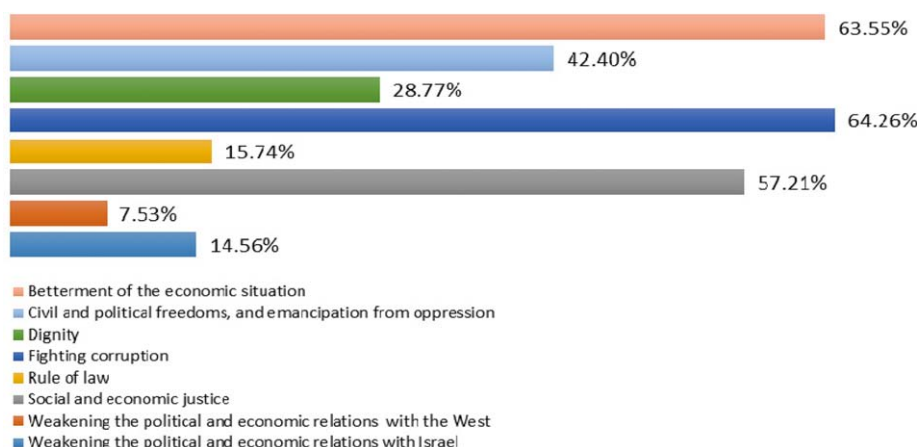


Figure 11. Main reasons for the Arab Spring uprisings
[Colour figure can be viewed at wileyonlinelibrary.com]

Source: Arab Barometer (2012–4).

However, starting in the 2000s, it became clear that this social contract was not sustainable. In particular, the fiscal deficits associated with public-sector employment and high subsidies were becoming unsustainable. Governments slowed down, and in some cases, stopped hiring workers. Unfortunately, the private sector did not create jobs fast enough to absorb the large number of young people entering the labor force. MENA had the highest unemployment rate in the developing world, with the rate for young people and women about double the average (Figure 12).

Furthermore, the unemployment rate was higher among educated people, presumably because they had sources of support to enable them to “queue” for the scarce but lucrative public-sector jobs. Meanwhile, those without these sources of support found work in the informal sector—at very low wages, without the security and protection of formal-sector jobs. Many women, not wanting to work in these threatening settings, dropped out of the labor force entirely. MENA today has the lowest female labor force participation rate in the world (Figure 13).

Why, when the public sector was cutting back, did the private sector in MENA not grow and create jobs? A closer look at some countries such as Tunisia

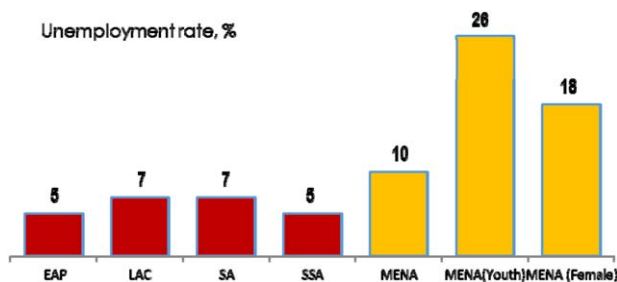


Figure 12. Unemployment rates

[Colour figure can be viewed at wileyonlinelibrary.com]

Source: World Development Indicators (2014).

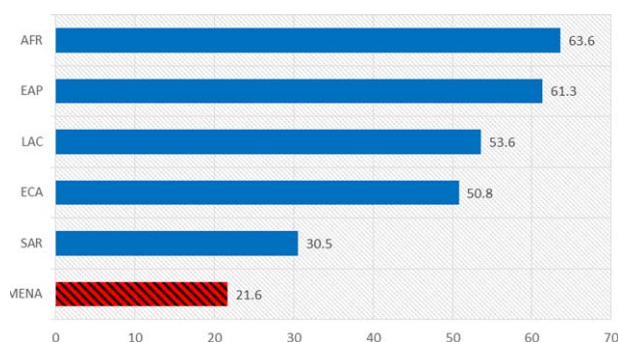


Figure 13. Female labor force participation rates
[Colour figure can be viewed at [wileyonlinelibrary.com](#)]

Source: World Development Indicators.

and Egypt reveals a pattern that may be representative of the whole region. Almost all the jobs created were in young, one-person firms, also known as “startups” (World Bank, 2014). The problem was that these startups hardly ever grew into small or medium-sized firms, which are typically the engines of job creation. Even ten years later, 95 percent of startups were either still startups or had closed down.

Perhaps the most frustrating aspect is the reason why these startups never grew. In both Tunisia and Egypt, there is considerable evidence that the presence of old, large firms with monopoly power stood in the way of small-enterprise growth. And the reason these firms enjoyed monopoly power was that they were connected with political elites (Schiffbauer *et al.*, 2015; Rijkers *et al.*, 2017). For instance, in Tunisia, former President Ben Ali’s family had interests in the

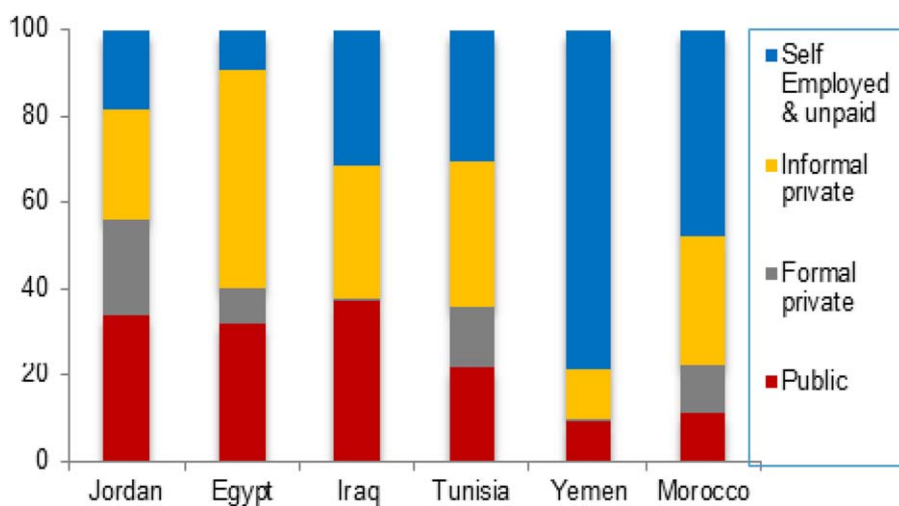


Figure 14. Distribution of employment
[Colour figure can be viewed at [wileyonlinelibrary.com](#)]

Source: Gatti *et al.* (2013).

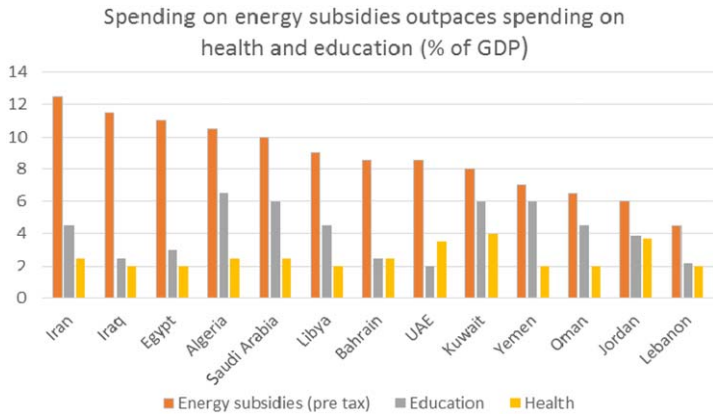


Figure 15. Allocation of public expenditures
[Colour figure can be viewed at wileyonlinelibrary.com]

Source: International Monetary Fund (2014).

banking, telecommunications and transport sectors.¹⁰ These sectors were protected from competition by regulations that prohibited foreign investment. The resulting high prices of these services made it very difficult for small firms—all of whom need banking, telecoms and transport inputs—to compete in world markets. In short, crony capitalism stood in the way of private-sector job creation in Tunisia. A parallel study of Egypt found that, every time a connected firm enters a sector, that sector’s rate of job creation falls by 1.4 percent (Schiffbauer et al., 2015). Note that these findings help explain why the middle class, having been educated and now seeking formal-sector jobs, were the most dissatisfied with the standard of living in their countries.

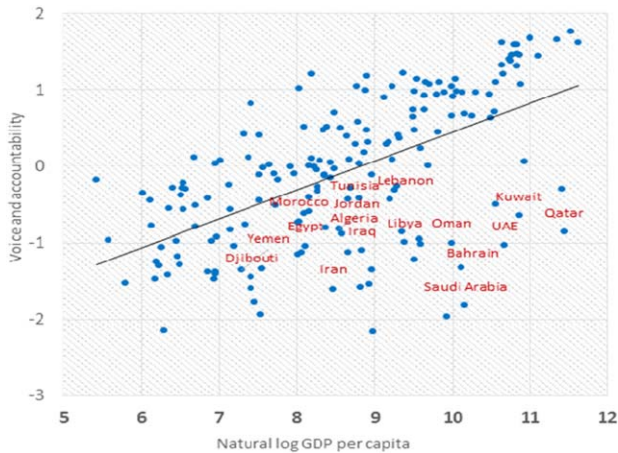


Figure 16. Voice and Accountability
[Colour figure can be viewed at wileyonlinelibrary.com]

Source: World Development Indicators (2014).

¹⁰While they accounted for 1 percent of employment and 3 percent of output, the “Ben Ali firms” represented 21 percent of net profits in the economy (Freund *et al.*, 2014).

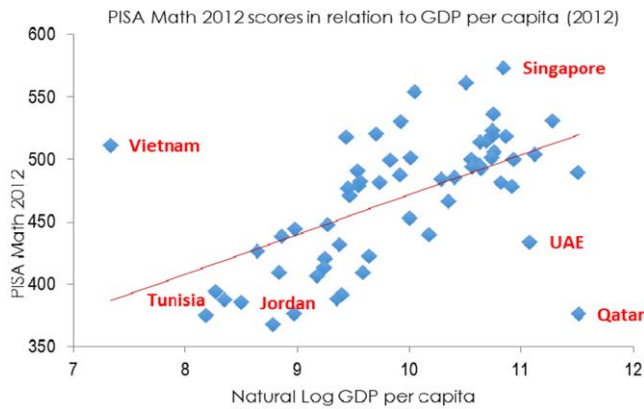


Figure 17. Learning outcomes
[Colour figure can be viewed at wileyonlinelibrary.com]

Source: PISA Math 2012.

In addition to failing on the jobs front, the old social contract was unraveling in a second dimension. While health and education were provided for free, and energy and water subsidized, the quality of these public services was so poor that people ended up paying the private sector to obtain them. For instance, although school enrolment rates were almost universal, the learning outcomes were disappointing. On internationally-comparable standardized tests, children in MENA performed significantly below students from much poorer countries (Figure 17).

One reason is that teacher absenteeism rates in public schools in MENA were among the highest in the world (Brixi *et al.*, 2015). Since teachers were paid whether or not they showed up in the classroom, many chose to work elsewhere. Similarly, doctors in public clinics in Egypt were found to be absent 32 percent of the time; the comparable figures for Morocco and Yemen are 27 and 37 percent, respectively. Seeking quality education and health care, people were sending their children for private tutoring (the proportion of students receiving tutoring in Egypt was 70 percent), and going to fee-paying private clinics for health care. As one woman in Egypt put it, “you can go to a private clinic and lose your money or go to a public clinic and lose your life” (World Bank, 2013).

Likewise, the web of fuel and energy subsidies led to under-spending on maintenance, which in turn meant that MENA had the highest incidence of electricity cutoffs in the world (Devarajan and Mottaghi, 2014). And diesel fuel subsidies gave farmers an incentive to use water pumps to such an extent that MENA is now the most water-scarce region in the world. Of course, on top of all this, there is plenty of evidence that these subsidies benefitted the rich much more than the poor, while crowding out spending on genuine public goods.

In short, the frustration with the lack of formal-sector jobs and poor quality public services, as shown in the analysis of the life satisfaction surveys, is evidence of the government’s failing to keep its side of the social contract. Reflecting their unhappiness, the citizens raised their voice and demanded greater accountability in the uprisings surrounding the Arab Spring.

Unfortunately, the events since the Arab Spring have been so turbulent that the underlying problems that caused it remain. Civil wars in four countries, terrorist attacks in several others, and a precipitous drop in oil prices have slowed growth in the region to a trickle (Devarajan and Mottaghi, 2016). Unemployment is higher today than it was in 2010 and dissatisfaction rates have risen further since 2010, particularly in the Arab Spring countries (Dang and Ianchovichina, 2016). The quality of services has deteriorated, exemplified by the “You Stink” garbage crisis in Lebanon in the summer of 2015.

However, since we now have a better understanding of the causes of the dissatisfaction that led to the Arab Spring (and possibly its aftermath), we also have an idea of the solution to the crisis. MENA needs a new social contract, one where the government promotes, rather than hinders, private-sector job creation; and where public services are designed so that the providers are accountable to the beneficiaries. Concretely, this means implementing competition policies in domestic industries so that small firms can grow; making teachers and doctors accountable to students and patients, possibly through community associations and voucher-systems where the money follows the student and patient; and replacing fuel and energy subsidies with targeted cash transfers to the poor, with everyone paying market prices for these private goods.

To be sure, this change cannot happen overnight, nor should it be applied in all countries today. The civil-war countries, for example, will need to resolve the conflict first. But as a guiding principle, the contours of the new social contract could go a long way towards helping the people of MENA realize the vision that many of them bravely fought for during the Arab Spring of 2011.

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