

## UNDERSTANDING REVOLUTION IN THE MIDDLE EAST: THE CENTRAL ROLE OF THE MIDDLE CLASS

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The paper presents the outlines of a coherent, structural, long term account of the socio-economic and political evolution of the Arab republics that can explain both the persistence of autocracy until 2011, and the its eventual collapse, in a way that is empirically verifiable. I argue that the changing interests of the middle class would have to be a central aspect of a coherent story, on accounts of both distributional and modernization considerations, and that the ongoing transformation can be best understood in terms of their defection from the autocratic order to a new democratic order, which is still in formation. I then review what the evidence says in two central parts of the emerging narrative, for the case of Egypt: first, by looking directly at changes in opinion and asking whether these are consistent with the predictions of the theory. And second, by examining the corporate sector before and during the uprisings of 2011 in order to understand better the performance of “crony capitalism”, and to evaluate whether it may have affected the incentives of the middle class to defect.

*Keywords:* Arab Spring; middle class; youth bulge; distribution; modernization; crony capitalism; world value survey.

### 1. Introduction

The Arab world is at a crossroads, facing enormous challenges as well as opportunities that can lead to either a gradually improving democratic path, or an authoritarian retrenchment. In the absence of an understanding of the social, political, and economic transformations that have led to the recent uprisings sweeping across the region, it will be difficult for the analyst to try and predict the future, and for the policy analyst to provide useful policy advice. It will also be challenging for the multitude of new actors that have suddenly become more influential to navigate the stormy waters of the ongoing transitions.

A shared frame may be emerging intuitively, but it has not yet been brought together into a coherent and logical framework. Many of the characteristics of the recent Arab uprisings are puzzling and do not fit easily with popular intellectual frames. Why did they occur at the end of 2010, when there were no apparent direct triggers such as declines in subsidies or shifts in foreign alliances, rather than sometimes in the 1990s when the welfare state started being rolled back? Why did

the revolutions start in Tunisia and Egypt, the countries with some of the highest economic growth in the region in the preceding few years, rather than in countries such as Syria or Yemen where the economic conditions have been more dire and political repression more severe? Why were they initiated by secularist middle class youth, the supposed beneficiaries of the modernizing republics, rather than by the long-standing Islamic opposition?

The goal of this paper is to develop a coherent, structural, long term account of the socio-economic and political evolution of the Arab republics that would explain both the persistence of autocracy until 2011, and its eventual collapse, in a way that is empirically verifiable. Different analysts would approach such an ambitious question in different ways. Some would stress contingencies and agency, and undeniably, there are circumstantial elements in the particular timing of the uprisings in Tunisia and Egypt. But I contend here that there were also structural and hard-to-influence factors that opened up a window of opportunity that the main actors of the ongoing transformations took advantage of.

One leading family of structural narratives focuses on a slow transition from socialism, where the roll-back of the state, which was started in the mid-1980s, ultimately led to the break-down of the social contract underlying the autocratic bargain. While such accounts cannot claim that the roll-back is the proximate cause of the insurgency given the long delay, an understanding of why (and how) transitions were delayed, which mechanisms were used by autocrats to remain in power even as market forces chipped at their authority, and which contradictions emerged in this late autocratic 'equilibrium' characterized by selective repression and co-optation, as well as cronyism, is needed to form the basis for analyzing why the system ultimately collapsed.

A second type of account puts particular segments of society — the youth, or the middle class, as the driving force for change — two logical arguments can be made in these accounts, one that emphasizes the emancipative effects of rising education, and the other rising levels of grievances, connected with rising inequality and the lack of good jobs to match increased skill levels. These hypotheses which have been used to explain the transition to democracy in various parts of the world can be molded into consistent accounts that fit to Arab realities, but they also require empirical validation: have the opinions of these groups about the desirability of democracy changed over time? Are the youth or the middle class leading opinion change? Can the change in opinions towards democracy be correlated with either a rise in aspirations or grievances, or both?

A third type of consistent account is to view the past as a fight between secularists and Political Islamic parties, which is ultimately won by the latter whose rising popularity ended up bringing them to power. But not only is this account at odds with the way the revolts unfolded — it rests on the presumption that Political Islam became more popular over time, which is a proposition that can be tested empirically using opinion poll surveys.

Finally, a related fourth issue concerns the rationality of the will to change. An angry middle class or generation of youth can rebel out of anger. It may be too much to ask insurgents to hold rational expectations and to rebel in order to bring about a better future. But at the very least, we would expect them to be convinced that the alternative to the existing autocratic regimes is a favorable bet, with possible outcomes that dominate the situation that they are rejecting. While it may well be that the improvements that they are seeking are not in the economic but in the social realm (liberty, agency, dignity), all the talk about crony capitalism, the scarcity of good jobs, and rising inequalities would lead the analyst to at least suppose that the performance of the pre-revolution economic regime was also at stake. Here too, there is an area wide open for investigation — the challenge is to understand how the neo-liberal economic regimes of the last decade functioned and how well they performed.

As suggested above, in sifting through these accounts and fitting them into a coherent whole, some relationship with reality and with verifiable facts will be important. In this article, I offer contributions to this search by examining what three types of data say about important elements of such an account, with a focus on Egypt: first, by looking at what standard economic data can say; second, by examining opinion survey data to gauge the desire for change and correlate it with underlying beliefs in areas such as inequality, where economic measurements suffer from well-known weaknesses; and third, but looking at corporate and stock market data carefully to test the existence and uncover the possible inefficiency of ‘crony’ capitalism.

The paper is to a large extent the summary of my recent work in the area. Section 2 critically reviews the theoretical models used to characterize the region in light of the stylized facts and of the more global literature on transition, and it outlines a broad framework more adapted to the conditions of the region. It argues that the uprisings should be seen as episodes where the middle class (thereafter, MC) shifted its allegiance from the autocratic to a democratic order. Section 3 examines the evidence available from opinion poll surveys on the evolution of the MC opinions relating to economics and social policies in Egypt. Section 4 examines corporate data in Egypt and finds considerable support for the thesis that cronyism was prevalent, and some showed more limited support for the thesis that this was bad for growth. Section 5 concludes by summarizing the outlines of the emerging account, and outlines areas for future research.

## **2. Theoretical Frameworks**

In this section, I review selectively the recent literature on Middle East politics, both contrasting it with the global literature on transition, and confronting it with stylized facts of the recent Middle East past. I then present the contours of the various models developed in other regions undertaking the third wave of democratization, setting up the stage for the empirical investigation of the next sections.

Discussions about the impact of oil, rents more generally, or Islam on democracy have been at the heart of the analysis of the politics of the Middle East for the past two decades. The Rentier state model was developed to describe Arab development (e.g. Beblawi and Luciani 1987) and empirical work has uncovered relations with oil (e.g. El Badawi and Makdisi 2012, Ross 2001) — these ideas have become influential to describe the political economy of natural resources elsewhere. Coherent game theoretical models with rational behavior and interactions between an autocrat and citizens leading to an autocratic, or elite bargain were also developed (see for e.g. Desai, Olofsgard and Yousef 2009). In these types of models, citizens surrender their political rights to strong autocrats in exchange for economic security. The intuitive appeal of this long honored tradition of Middle East scholarship — it goes back to Marx and Wittffoegel — is that the extractive nature of oriental governance (such as in the Ottoman Empire in the past) did not allow the development of social classes that in theory, would lead to modernization. In its more recent manifestation, this literature has continued the tradition of not looking deeply at social transformations within societies, given that it is this presumed immobility that allows and reinforces the Faustian elite bargain. Since the “Presidents for Life” (in Roger Owen’s terms (2012)) seemed unmovable, the analytical focus to study the effect of the major reduction in state expenditures experienced since the *Infitah* of the 1980s had rightly been placed on the various ways in which the regimes have managed to maintain themselves in power using political tools such as cooptation and repression.

### 2.1. The roll-back of the state

A look at key economic performance indicators for the Arab developing countries as a group, from 1980 to 2008, depicted in Figure 1, shows clearly that the roll back of the state began 25 years ago. Government expenditure shot up in the 1970s on the back of rising oil wealth in the region, but they fell precipitously in the 1980s, reaching 22% GDP in the early 1990s, a low figure by international standards. The

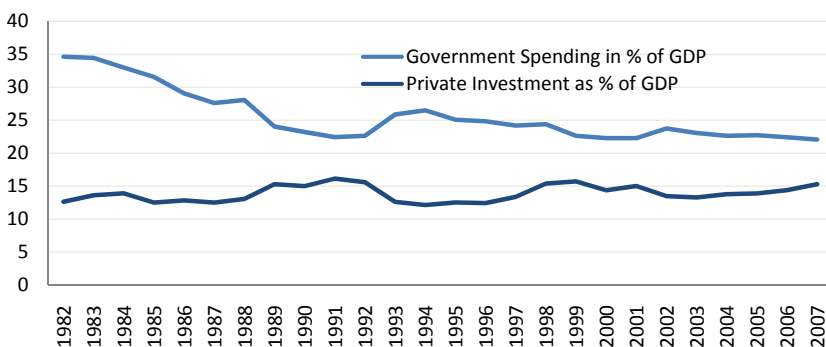


Fig. 1. Key macroeconomic indicators for all developing Arab countries.

Source: World Bank Indicators. Averages over all Arab developing countries.

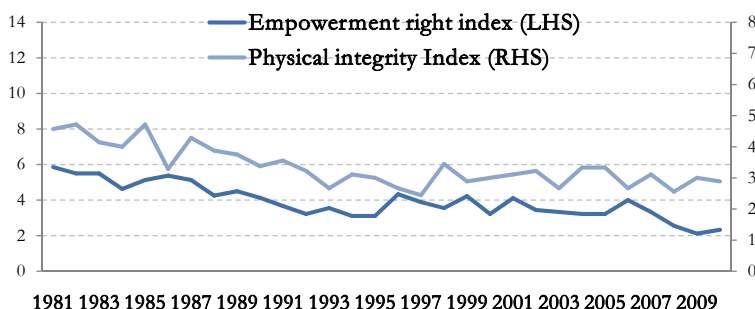


Fig. 2. Repression and freedom indices for all Arab countries.

Source: CIRI, average for all Arab countries.

reforms in the Arab world tended to hurt the poor (subsidies to agriculture were deeply cut for example) as well as the MC (especially in lower public sector wages and a stop to hiring), and they led to protests and bread riots across the region, but fell short of leading to democratization. This period consolidated the alliances between the autocrats and elite capital. By the mid-1990s, the old social contract was already dead (Diwan and Walton 1998).

In the Latin America of the 1980s, similar structural adjustments had led to a near synchronous wave of democratization. But in the Middle East (ME), the autocratic rulers did not open up the political space in order to reduce the social pressures stemming from the decline in economic resources. Figure 2, which depicts the evolution of an index of political rights (Political Empowerment Index, see Cingranelli and Richards or CIRI 1999) between 1980 and 2010, suggests that in fact the opposite happened. The region was politically less open in 2010 than in the mid-1980s, with the average score for the region falling from about 6 in 1980 to 1.2 in 2010 on a scale from 0 to 14, with 0 depicting complete dictatorship.

## 2.2. Repression and co-optation

The literature on the ME had described in detail how (and in some cases why) different regimes chose to respond with a different mix of cooptation and repression to maintain their control (Schlumberger 2007, Posusney and Angrist 2005). The autocrats sought to maximize the use of their dwindling assets, dividing citizens into two groups, one of which benefited from cooperation while the other was subject to repression. Figure 2 also depicts average levels of repression in the region, as measured by the index of Physical Integrity (also from CIRI), on a scale from 0–8 where 0 is maximum repression. Over the period, the average value of the index for the Arab countries fell from 4.5 to 2.9.

That repression has become an essential tool in the preservation of autocratic regimes since the late 1990s is also attested by the level of spending on security matters. Autocrats also sought to strengthen their coalition by co-opting the MC.

Co-optation was achieved in large part through direct economic benefits in the form of subsidies for goods that are consumed relatively less by the poor, such as petroleum and energy (earlier, subsidies for small scale agriculture and for basic food items that benefit the poor had been reduced or eliminated).<sup>a</sup> At the same time, the fiscal regimes seem to have become more pro-rich over time: tax rates have been relatively low and generally regressive, and universal services have decayed in most countries.

By while these considerations are suited for analyzing the past, they are not as useful as tools to describe the current political winds of change blowing through the region. Indeed, why did the careful balance of repression and cooptation suddenly collapse in recent years in the Arab republics? The youth bulge had actually peaked earlier, around 2000, economic growth rates were recovering from the global crisis, and subsidies were not being cut, quite the opposite. There is a rich global literature on transition to democracy which has emerged in the shadow of the “third wave” of democratization that has engulfed Latin America, Africa, Asia, and Eastern Europe in the past two decades. They suggest several promising lines of research to understand recent change in the region. First, there are two major theories that are of interest as possible structural explanations of the social phenomena that led to the uprisings in Egypt (and elsewhere in the Arab Republics): modernization (or the rise in aspirations), and distributional conflict (or the rise in grievances). Each has a “youth” version that has also been applied to Arab environment, and both will be reviewed here. There are other various accounts that stress fights within the elites groups, including the army, the role of foreign support, which stress contingencies, agency, and games between members of the governing coalition. Finally, there are also many claims which appear in the regional literature about the role of political Islam in leading, shaping, or slowing change that need to be put to the data. Let us review each of these ideas below.

### 2.3. *Modernization theory*

A popular theory, developed under the umbrella of the World Value Survey (WVS) enterprise, views democratization as a long term phenomena that is driven by social “modernization”. Various analyses of the WVS data-sets have found that there are two main dimensions of cross-cultural variation in the world: (i) traditional values vs. secular rational values; (ii) survival values vs. self expression values. The former emphasizes modernity as a move away from religion, family ties, and deference to authority towards greater rationality, while the latter emphasizes a move away from economic and physical insecurity towards rising levels of agency, trust, and tolerance. This literature shows that greater emancipation from traditional and survival values fosters democracy. This is typically accomplished through generational

<sup>a</sup>In the last decade these subsidies grew to become about 200% the combined budget of health plus education in 2009 in Egypt, and 150% in Tunisia. The situation in Syria and Morocco is also similar. These subsidies went predominantly to the MC and the rich — in Egypt, 46% of the benefits for example accrued to the top decile in 2010 (Abouleinem *et al.* 2009).

replacement, with younger generations usually leading change (Tilley 2002). In the WVS sample of countries, Muslim and Arab countries tend to have the highest scores on traditional and on survival values (Inglehart and Welzel 2010). When structural variables, including connections with globalization are taken into account, one still finds that the Muslim countries of the Middle East have been lagging on this emancipation path, but much more on gender equality rather than on democratic values (Esmer 2002, Norris and Inglehart 2002), leading some authors to argue that the social dominance of Islam accounts for much of this specificity, although it is also found that higher education does have some impact in closing the emancipation gap (Alexander and Welzel 2011). In this view of the world, the current wave of democratization in the Arab world would be related to the weakening of traditional authority and religion, driven by education, urbanization, and economic growth, which would have made these societies “ready” for democracy, and awaiting a political opportunity to coordinate social efforts towards democratization. Testing such a theory revolves around finding a rise in the support for democracy and other modern values among the educated, and possibly the youth. In particular, we would expect differences on the main issues of desirability of democracy, and the role of political Islam (PI).

#### **2.4. Distribution theory**

The main alternative structural theory of democratization is based on distributional conflict. In these models, the poorer segments of the population favor taxation and redistribution, which the rich oppose (as in Gandhi and Przeworski 2006). As a result, there is an incentive for the rich elite to govern in an autocratic way, and for the poorer segment to attempt to take over. Starting from a socio-political equilibrium, when inequality rises, the system comes under stress. The equilibrium can shift to either a more repressive authoritarianism, or to a redistributive equilibrium.<sup>b</sup> In models of democratic transitions (such as those examined by Acemoglu and Robinson 2006), the distributive motive for change is expanded to endogeneize the very existence of democratic governments. When elites are confronted with mobilization from below, they can make short term concessions to diffuse the threat, but they can also be expected to default on these promises when mobilization subsides. Democratic institutions therefore, provide a means for the elite to commit credibly to a more equal distribution of income in the future (because reversals are costly) when faced with credible challenges. As a result, when low income groups mobilize in favor of redistribution, they do so by militating for a more democratic order.

In such models, there tends to be a special role for the middle class — a class that is formally defined as being simply in between the poor and the rich — which may be in the autocratic coalition in the initial autocratic equilibrium, but which can cause

<sup>b</sup>In such models, the equilibrium will tend to shift to one with rising repression when the initial level of inequality is high (because the rich have more at stake), and to a democratic equilibrium when it is low but rising.

the equilibrium to shift by splitting away from the autocratic coalition and forming a coalition with the poor. This would tend to happen when inequalities rise in ways that make the MC become more “like the poor”. The introduction of the MC in distributional games also reduce the incentives of the elites to fight back with more repression as they can credibly expect that the MC will moderate the demand for redistribution in the democratic equilibrium. Whether an MC exists as a self-recognized group with the ability to define and defend its interests remains of course a question that needs to be answered at the country level.

In a recent wide-ranging empirical review of the past two decades, [Haggard and Kaufmann \(2012\)](#), show that about half of the recent transitions are explained by distributional concerns — the other half is divided between cases where it was driven by splits within the ruling elites, and cases where elites perceived democracy to serve their own interests.

## 2.5. *What happened to inequality?*

In this account, the recent uprisings have been driven by a rise in inequality — in the countries where inequality was not large to start with (Egypt and Tunisia), the elites did not fight back (unlike what happened in Yemen and Libya, countries with larger levels of inequality). Making inequality a core driver to the understanding of the Arab Spring is tempting, as this stems from the central role of inequality in the history of the region, as it travelled from socialism and populism towards capitalism, and ended with what is commonly described today as a regime of crony and unequal capitalism, which is perceived to have generated unacceptable inequalities, directly by supporting the growth of a class of super-rich, and indirectly by being unable to create sufficient good jobs for the newly educated middle class. Admittedly, there is no direct evidence that inequality has risen sharply in the recent past in Egypt on the basis of distribution data. Generally, household surveys reveal that consumption inequality (as measured by Gini coefficients for example) has risen moderately in Egypt, from about 0.3 in the 1990s, to 0.35 in the 2000s ([Bibi and Nabli 2010](#), [Belhaj 2012](#)). But there are two reasons to think that these statistics only describe a limited part of reality.

First, household surveys are notorious for under-counting the rich. There are many indications of a rise in the income share of the 10% richest in society, which are perceived to have benefited most from a more market oriented economy, and of the top 1%, which have benefitted most from the rampant crony capitalism of the last decade. By some estimates, the top 10% in Egypt possibly commands 30–40% GDP.<sup>c</sup>

Second, grievances are likely to be connected to changes in the inequality of opportunities, rather than the inequality of incomes only. Over time, the roll-back of

<sup>c</sup>Between 1998 and 2006, GDP rose by 60% in nominal terms, while consumption stayed essentially at the same level all along the distribution according to household surveys, suggesting that large parts of the increase may have accrued to the under-counted rich, and very little has trickled down to the rest of society.



the state had reduced the role of the state as an employer — from a height of 40% of the labor force, by 2009, only 25% of the labor force worked for the state. Recent studies show clearly that as a result, the large waves of more educated workers (average years of education had risen from 2 years in the 1980 to 8 years by 2009) entering the labor market were faced with an increasingly unfair situation where relationship (“wasta”) and status were more important than diplomas in landing into the good jobs. With no new jobs in the state, these new entrants had to divide themselves between the formal private sector, which did not grow in proportional terms, and where wages are higher than in the public sector, and a large and growing informal sector, where wages are lower than in the public sector (Asaad 2007). Empirical research has only recently started to focus on this type of inequality, but recent work by Assaad is starting to show that unlike simple consumption Ginis, such measures show a dramatic increase in recent years.

The main implication of a distributional theory of change is that as inequality rises, opinions would increasingly lean towards redistributive policies, and by a preference by the MC for democracy, possibly leading to a split and a new equilibrium (if the elites do not fight back). The shift in opinions would normally be formed along class lines, but a variant would have them formed along age lines, with the youth rebelling against the older “insiders” to change the system in their favor.

The (probable) rise in inequalities and relatively low performance of Arab economies in terms of job creation are now being related to the type of state-business relations that had developed over time in the region. The liberalization of market, especially the credit markets, seems to have led to a concentration of economic power in the hands of the few firms with good connections to the state (see in particular the pioneering work in Heydemann (2004)). It may be that such forms of capitalism were not conducive to economic dynamism, and that they also biased politics. But the literature of the economic impact of the type of state-business relations that had grown in the ME is not developed enough to allow one to make such allegation in any convincing way. State-business relations can either support a dynamic capitalism or lead to a low equilibrium of corruption and low investment. What is needed at this stage is to study the performance of Arab capitalisms in more depth to understand both their (lack of) performance, and the mechanisms leading to this. We focus on this theme in Section 4.

## **2.6. Political Islam**

The set of concerns which is quite specific to the Middle East revolves around issues related to Political Islam (PI). The tenets of PI include some social values which are strongly espoused by some and not by other members of society (such as beliefs related to the role of Shari’a in legislation, gender issues, freedom of speech as it relates to the “sacred”). PI has been in the past one of the main organized opposition movement, militating at various points in time against autocracy, secularism, unpopular foreign alliances, or corruption — and it was at times severely repressed

and it operated largely outside the formal system. One view would be to read the recent political changes as a “victory of PI”. But given the diversity of opinions within PI, this is a simplistic approach. In recent years, some groups within the broad range of parties espousing PI have moderated their messages and came to accept the democratic game. Indeed, it was only in 2004 that the Muslim Brotherhood in Egypt managed to commit publicly to abide by a constitutional and democratic system, calling for the recognition of “the people as the source of all authority”, and committing itself to the principles of the transfer of power through free elections, the freedom of belief and expression, the freedom to form political parties, and the independence of the judiciary (Shahin 2005).<sup>d</sup> At the same time, insurgent groups have declined.

So the more interesting question is to figure out how Political Islam has been connected to the social change leading to the uprisings? There are many possibilities, and rather than forming specific hypotheses, my approach will be to explore what the data says. As a mobilizing force, PI can resolve coordination problems around the forum provided by Mosques, as coordination is typically a central constraint in social movements. As an ideology, there are several competing narratives. PI can counter modernization with conservative values — for example on gender issues, and it can be used to neutralize distributional concerns by favoring quietism (values promoted by Sufi and Salafi groups among the poor). But it can also support middle class redistributive goals (as the Youth branch of the Muslim Brotherhood), or it can support middle class devout but economically conservative private sector oriented individuals (which seems to be the attitude of the Muslim Brotherhood). An altogether different possibility is that the moderation of PI facilitated the defection of the MC — Diwan (2012) argues that democratization was delayed in many countries of the MENA because the rise of PI, especially in its early militantist and armed fashion, scared secularists into supporting the autocratic orders, even where economic benefits fell. But here too, dynamic factors have been at play as more moderate Islamic parties took root.<sup>e</sup>

## **2.7. Divisions among the elites**

Finally, some see the success of the uprising in Egypt in toppling the Mubarak regime as mainly driven by the support it received from the army and its western backers. This view would suggest that the main driver was a split within the elites, especially among

<sup>d</sup>Similar processes of moderation took place in Turkey and Tunisia. Demiralp (2009) describes the process leading to AKP’s increased moderation by a combination of lessons from repression, opportunism, and the growth of a friendly MC. In Tunisia, Al-Nahda committed publicly in 1981 that: “We have no right to interpose between the people and those whom the people choose and elect” (quoted in Osman (2010)).

<sup>e</sup>Some analysts claim that state repression was used strategically to push PI into extremism. A case study example is from Egypt, where state repression increased after the election gains of the Muslim Brotherhood in the 2005 elections, when it started to appear as a credible alternative to the ruling regime. This pressure created deep divisions within the MB over whether it should abandon the political process (Osman 2010, Bubalo et al. 2008).

those supporting the group of cronies which has been in power since 2005 or so and the traditional army/security complex elites. That these actors were influential is beyond doubt, but the question is rather whether their actions were driving forces, or whether they decided to side with existing social forces for change. I do not pursue this line below, being more interested in exploring structural reasons for change, but clearly, finding little empirical support for the two main theses described above would advantage the view of a central role for the army and for the regime's foreign supporters.

## **2.8. *The middle class***

Before closing this section, it is useful to characterize more the MC, given that it appears to be the main competitor to the youth as the main actor for change in Egypt and the Arab republics. The emergence of a modern middle class, people who grow out of poverty thanks to public education and state jobs, was a defining element of the post-colonial Arab Republics of the 1950s, which ushered leaders such as Bourguiba and Nasser, bringing in the Attaturkian model of modernization based on secular and nationalist ideologies. Since then, Arab autocrats have valued keeping MC-led parties in the governing "political settlement", either within the governing coalition, or as part of the legal opposition, due to their important legitimizing role. For the Arab autocrats, losing their MC anchors is tantamount to losing all legitimacy and turning into naked dictatorships with no operational narrative. In this broader frame, the authoritarian bargain of the past decade can be best characterized as an alliance between elite capital and elements of the MC that delivered economic benefits to the coalition members, including in the form of subsidies.

There are indications that the MC has been hurt by the economic liberalizations of the 1990s, and especially by their acceleration in the 2000s. Beside the direct effect from the labor market discussed above, the interests of the MC have been hurt in many ways by the roll back of the state and the rise of neo-liberalism.<sup>f</sup> In addition, low public sector wages also fueled petty corruption in areas such as health and education, generating another important source of discontent. More research is needed to understand more clearly the changing welfare of the MC. In the WVS data that we analyze in the next section, the survey asks respondents to identify the class they belong. This measure provides a broad, self-assessed measure of well-being that goes well beyond income in capturing life-long income, aspirations, and ownership of assets of various sorts. Comparing data from 2000 and 2008 for Egypt shows that the size of the MC has shrunk from 65% to 58% of the population in favor of the poor.<sup>g</sup>

<sup>f</sup>In Egypt, real wages in the public sector declined over time. The minimum wage, which anchors all wages, has declined from 60% of per capita GDP in the early 1980s to a mere 13% in 2007 (Abdelhamid and El Baradei 2009). This can be also seen at the macro level — by 2009, 25% of the Egyptian labor force worked for the state but earned a total wage bill of less than 9% of GDP, implying average wages were below GDP per capita, which is very low by international standards.

<sup>g</sup>The WVS also suggests that the average financial satisfaction of the poor deteriorates, that of the MC remains stable, and that of the rich rises during the period, further bolstering a sense of rising inequality during the period.

But besides its size, the nature of the MC has also changed over time. Until recently, Middle Eastern scholars did not seem to believe that the MC could play an active role in leading political change. Its effective influence on policies was low as it was mainly made up of civil servants and employees of state owned enterprises, which reduced its ability to play the role of an “autonomous actor”. A new market oriented MC rose in late 1990s in response to economic liberalization. The newcomers tended to be small merchants and industrialists, often in the informal sectors, that have benefited from the market oriented reforms, as well as the small but expanding skilled labor of the formal private sector labor market. This group has been politically more active than the old (see [Nasr 2009](#)) — for example, it played an important role in securing the success of the Iranian revolution in 1979, and the rise of the AKP in Turkey.<sup>h</sup>

To conclude this section, let me stress the limits of the discussion above: the models presented may well be coherent, but other models will as well, and so empirical evidence needs to be looked at.

### **3. Attitudes Towards Democracy**

I now attempt to test which of the theories described above applies best to Egypt by looking at the structure and evolution of opinions. I use the World Values Survey (WVS), which is a research project that aims to understand, and measure people’s perceptions, opinions and beliefs all over the world. The survey allows us to evaluate the change in perceptions, opinions, and beliefs in a systematic way. Although the WVS encompasses opinion on a wide spectrum of issues relating to social life, such as religiosity, globalization, happiness, financial satisfaction and environment, the discussion below focuses on the questions about attitudes towards democracy, economic policies, and role of religion in politics. A relatively large sample size (about 3,000 respondents in each survey) and careful sampling methods along dimensions of urbanization, age, gender, and income allows us to exploit the micro-information contained in the database. I focus on the 4th and 5th waves of the survey, which are collected in 2000, and in 2008, two years before the uprisings. The questions that I use are outlined in the Annex.

The use of opinion polls to test theories of social change needs to be justified. One can surely try to test the universal appeal of particular theories by examining cross-country variations, and indeed, many studies have attempted that such as [Haggard and Kaufmann \(2012\)](#) which was cited earlier. But clearly these approaches have their own limitations, such as the inability to find good controls, or the possibly highly contingent occurrences of change. The other alternative is to try to test these theories at a country level, using implications in terms of patterns of

<sup>h</sup>Indeed, the AKP benefitted handsomely from the alliance with the support provided to SMEs and the rise of what became known as the Anatolian Tigers, SMEs that drove growth in Turkey in the past decade ([Demiralp 2009](#), [Gumuscu 2009](#)).

variations between *individuals* and between various types of sub-groups (by age, class, education, etc.). For this type of work, one actually needs to rely on opinions, since what's at stake are variables such as perceptions of inequality, preferences for democracy, or even feeling of belonging to particular social classes — for example, when considering whether revolutions are caused by changes in inequality, unless the rise in inequality is *reflected* in perceptions of rising inequality, it would not motivate people to rebel. Moreover, by looking at micro opinion data over individuals and over time, one should be able not just to observe the rise of “revolutionary” fervor, but also, to pinpoint who the leading agents of change are, and possibly, what drove them to change. Individual opinions can tell us about the importance various social actors attach to inequality, which provides an important angle to test the validity of particular hypotheses by checking if the underlying mechanisms are at play — to stay with the same example, the theory of revolution as redistribution would suggest that the poor should be more interested in redistribution than the rich. If the reverse is observed, then we should be looking for another theory to explain change.

That the last poll we use is in 2008, two years before the uprisings raises some concerns, as opinions in 2008 may not be similar to those in early 2011. The next survey should be available in 2013, and it would be important to update this study then.<sup>i</sup> In the meanwhile, one can hope that the 2008 survey is representative of long term trends, compared to opinions collected during the recent period of turmoil, which would likely be noisier. But it is also important to note that the 2008 survey was taken before Egypt was hit by the global financial crisis, which led in time to a large fall in real wages (Roushdy and Gadallah 2011).

### **3.1. Preference for democracy**

Let us start by looking at how preferences for democracy (PfD) evolved over the period. I construct this variable from responses to a question where respondents are asked to choose their first and second choice from a list of four options that include (i) “giving people more say in important government decisions”, (ii) “maintaining order in the nation”, (iii) “fighting inflation”, and (iv) “protecting freedom of speech”. I code the response as support for democracy when respondents rank option (i) ahead of option (ii). Because they had to make a choice, respondents tended to rank democracy lower than in other unconstrained questions that simply ask whether they like democracy — the latter are not very informative and tend to show an over-whelming support for democracy. An examination of the data reveals three striking regularities.

Let us start by contrasting the evolution of the PfD national averages in Egypt, Iran, Jordan, and Morocco, the only MENA countries covered by the WVS. While

<sup>i</sup>The 6th wave of the WVS, which was supposed to be collected in 2012, has not yet been collected, not having been approved by the new authorities yet.

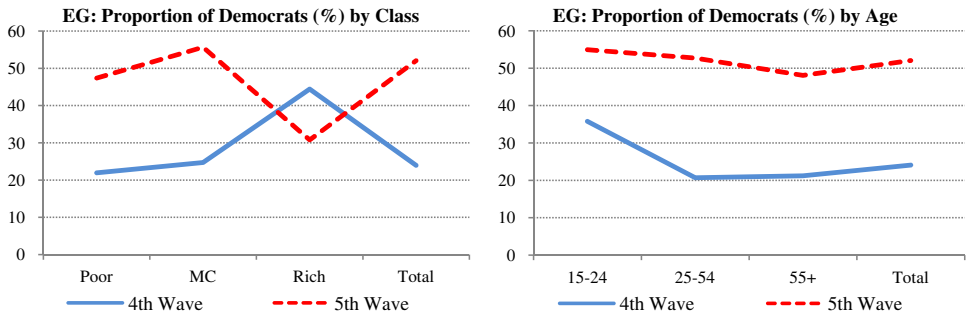


Fig. 3. Preference for democracy, by class and age.

there is a remarkable shift of opinions in Egypt, with the PfD variable jumping from 24% to 52% of the population over the period, support for democracy remains relatively flat in the other countries. The comparison suggests that the Uprisings in Egypt do seem to represent a deep social wave that is specific to that country. This remarkable shift of opinions can be partly explained by the high support for “order” in 2000, when the Islamic insurgency was still strong, and to the results of the 2005 elections which saw for the first time the participation of the Muslim Brotherhood in the electoral process.<sup>j</sup>

Second, let us look at the PfD in Egypt according to class and age (see Figure 3). It is immediately apparent that the rising support for democracy is very much a class phenomena — in particular, there is rising support among the poor and the MC, but declining among the rich. The middle class seems to play a leading role, supporting democracy more than the poor (by about 10 points), with more than 50% of the class in favor. This seems to suggest that while distributional factors are at play in 2008 (with the rich broadly against democracy, as suggested by the distribution theory), modernization forces may be providing an additional push for the MC to support democratization. There may also be factors that reduce the willingness of the poor to support a change in the status quo, such as risk aversion or ideological attitudes. These are themes and hypotheses that we will pursue further below.

Third, the youth do not seem to hold opinions in 2008 that are much different from their parents on the desirability of democracy, unlike the situation in 2000, when they were much more democratic than their elders. So to the extent that the underlying forces driving opinions are connected to skilled youth unemployment, a major phenomenon for the MC, it seems that Egyptian MC parents became as unhappy as their children about the lack of job opportunities — and this pushes them to favor regime change and democracy. It can be verified, with regression

<sup>j</sup>PEW surveys also collect this type of information around the world. Its first survey in Egypt in 2005 (55% in support of democracy over order) is consistent with the score of the 2008 WVS. Very few countries see scores as low as those seen in Egypt in 2000 — they include Russia, Ukraine, and Pakistan, countries where high insecurity push people to have a high preference for “order”.

Table 1. Logit regression for preference for democracy.

Dependent variable: Preference for democracy	2000	2008
Age	−0.167*** (−4.96)	−0.0276 (−0.95)
MC	−0.108 (−1.15)	0.280*** (3.66)
<i>N</i>	2893	3050

\*\*\* $p < 0.01$ , \*\* $p < 0.05$ , \* $p < 0.1$ .

analysis, that these results are not spurious means comparisons, but that actually do represent an association between individual characteristics. I use Logit functional forms.<sup>k</sup>

(1) Probability of support for Democracy =  $f$  (class dummies, age).

The results, shown in Table 1, which were apparent in the graphs are confirmed — there is initially a strong age effect that goes away by 2008 and is replaced by a strong MC effect, which did not exist in 2000.

### 3.2. *Preferences for equality*

Is the rise in support for democracy connected with a change of opinions about distributional concerns? Let us look at what the survey reveals about individual preferences for equality (PfE). The related survey question asks respondents to rank (on a scale of 1 to 10) whether income inequality is good for incentives (low score), or incomes should be made more equal (high score).<sup>l</sup> Answers to the question thus reveal opinions on how public policy should deal with inequality — at the risk of caricaturing, we can refer to people with high scores as “leftists” and people with low scores as “rightists”. Figure 4 suggests that PFE monotonically decreases with class, as suggested by a distribution view of the world, and this holds in both periods, that over time, all classes move to the “left”, and that again, that there are no important age effects. But while the increase PfD and the rising PfE happen in parallel, we still need to check whether they are connected at the individual level. Moreover, we are also interested in understanding why the poor have a high PfE and a low PfD relative to the MC. To understand how individual characteristics connect and

<sup>k</sup>To account for class structure, rather than using an ordered variable, given the discontinuities observed in the behavior of the MC, I use dummies for the MC and for the Rich, relative to the Poor. The coefficient for the Rich dummy is not shown, as it does not turn out to be significant in all regressions.

<sup>l</sup>In the actual survey, the scale is the reverse, but we have inverted it to ease the interpretation of the results. Note that the exact level of this indicator depends on how we code the information. Because opinions are very much clustered around the levels 1–3 in 2000, I take in the graphs any score above 3 to indicate a shift towards a preference for equality. In the regression analysis however, I code the variable in 4 levels for greater precision.

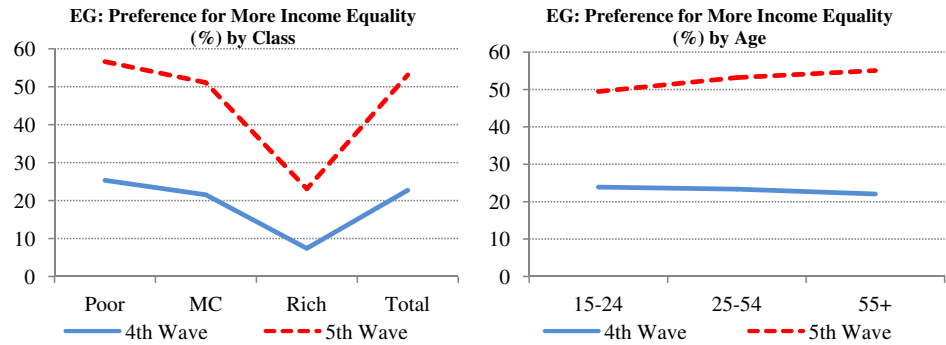


Fig. 4. Preferences for equality, by class and age.

measure the potential effects of modernization and distribution separately, I run a Logit regression, where I include education and the PfE variable plus interactive terms to discriminate between MC and poor among the “leftists”:

(2) Probability of PfD =  $f$  (education, PfE, PfE\*MC).

The results are in Table 2 below and support the “dual MC effect” hypothesis:

- Supporting the modernization thesis, we find that education fosters support for democracy.
- While the “Left” supported democracy in 2000 as much (or as little) as the “Right”, by 2008, leftists supported democracy more than rightists, and moreover, poor leftists supporting democracy more than MC leftists (the interactive term is negative). This confirms that distributional concerns are after all, as suggested by theory, more important for the poor than the middle class — this becomes apparent when controlling for education.

This leaves the possibility that rightists too may have a strong support for democracy, especially if they are over-represented among the educated. Indeed, in the sample as a whole, leftists are not more likely to be democratic than rightists in 2008.

Table 2. Logit regression for preference for democracy.

Dependent variable: Preference for democracy	2000	2008
Education	0.163*** (5.43)	0.0861*** (3.53)
PfE	0.0841 (1.46)	0.136** (0.87)
PfE*MC	-0.0343 (-1.27)	-0.130*** (-3.51)
N	2893	3009

+PfE variable is coded at 4 levels. \*\*\* $p < 0.01$ , \*\* $p < 0.05$ , \* $p < 0.1$ .



Table 3. Logit regression for PfE.

Dependent variable: PfE	2000	2008
Age	-0.0690* (2.40)	-0.0280 (1.05)
Class*	-0158* (0.096)	-0.239*** (0.072)
Education	-0.079 (1.31)	-0.105*** (4.85)
PI	-0.0312 (0.36)	-0.0217 (0.43)
Observations	2788	2940

Class variable here takes the value of 1 for the poor, 2 for the MC, and 3 for the rich. \*\*\* $p < 0.01$ , \*\* $p < 0.05$ , \* $p < 0.1$ .

So we need to get a better feel about the characteristics of those that turn left. To do so, I run the following ordered Logit regression:

(3) Probability of support for  $R/L = f(\text{class, age, education, PI})$

The results in Table 3 show that the support for the “left”: (i) is higher among the youth in 2000, but this age effect disappears in 2008; and (ii) decreases with class (in both periods). Moreover, we find that (iii) in 2008, more educated people tend to lean to the right (and uneducated people to the left), which suggests that while education increases support for democracy, it does so more through the aspiration that through the grievances route, i.e. on the “right” rather than on the left. The variable PI is not significant — on average, secularists and Islamists are as likely to be on the left as on the right.

The last two sets of regressions confirm that there are two paths to democracy — going left and democratic (more intense among the poor) for distribution reasons, or going right and democratic (especially among educated and richer people), driven by modernization reasons. It is because they are at the intersection of both concerns then that the MC emerges as the main champion for democracy.

### 3.3. The influence of political Islam on democratization

What role did PI play in paving the way, or obstructing, these individual paths towards democratization? Can PI, as a movement or an ideology, explain the conservatism of the poor that was noted above (especially in 2000), or can it explain the progressivism of the MC (especially in 2008)? Or perhaps the adherents of PI are those that continued to oppose democracy in 2008? Or is adherence to PI unrelated to opinions about democracy?

To explore the drivers of public opinions towards PI, I construct the variable PI from a question where people are asked if they believe that “religious authorities provide answers to social problems” (where no = 0 and yes = 1). National averages show a decline in popular support for PI, although it remains a majority

view — from 81 in 2000 to 60% of the respondents in 2008 adhere to PI as defined here. Moreover, the composition of groups along these dimensions changes massively between the two periods. In 2000, a very large 62% of the population supported both autocracy and PI, but this group shrinks to 28% in 2008. It is as if the acceptance by the Moslem Brotherhood in 2004 of the democratic rules of the game has thrown many citizens into turmoil and has confronted them with choosing new political orientations. There are two major social transformations that are apparent in the re-composition of the political field: a move towards secular beliefs (+22.6% of the population), and a move towards democracy (+26.6%). Those that were religious autocrats in 2000 “move” to become mainly PI and secular democrats in 2008 (only a few select to become secular autocrats). The shift in support for democracy then needs to be explained by composition effects and changes in preferences within groups — both of these show very large shifts. I run the following ordered Logit regression, with multiplicative effects to separate the impact of PI on the poor and the MC:

$$(4) \text{ Probability of Preferences for democracy} = f(\text{PI}, \text{PI} \cdot \text{MC})$$

The results in Table 4 confirm that adherents of PI did not support democracy in 2000 as much as secularists. By 2008, the pattern is the same, except that the MC group that espouses PI becomes, like secularists, a force for democratization. It seems as if PI acts as a conservative veil for the poor only, preventing them from expressing their class interests, but this effect does not operate among the MC after 2008, either because they are better educated, and/or because they are more likely to be influenced by more moderate parties within the PI umbrella. This supports and refines Tessler’s (2012) findings that support for PI is congruent with rising support for democracy — what we find is that this applies only to the MC but that the poor who supports PI do not support democracy as much.

To try to understand the composition effect, i.e. what determines PI orientation, I run the following regression:

$$(5) \text{ Probability of support for PI} = f(\text{age, class, PfE, education}).$$

The results in Table 5: attraction to PI rises with age and with class, and falls with education. In relation to distributional tendencies, the results reveal that individuals

Table 4. Logit regression for preference for democracy.

Dependent variable: PfD	2000	2008
PI	−0.349** (0.130)	−0.246** −0.095
PI*MC	0.055 (0.102)	0.390*** −0.097
N	2789	2976

\*\*\* $p < 0.01$ , \*\* $p < 0.05$ , \* $p < 0.1$ .

Table 5. Logit regression for preference for PI.

Dependent variable: PI	(2000)	(2009)
Age	-0.186* (0.087)	-0.157* (0.069)
Class	0.325** (0.108)	0.368*** (0.078)
PfE	-0.019 (0.092)	-0.058 (0.052)
Education	-0.154* (0.072)	-0.115* (0.058)
Observations	2788	2940

\*\*\* $p < 0.01$ , \*\* $p < 0.05$ , \* $p < 0.1$ .

espousing PI tend to be equally divided among the right and the left as the PfE effect is not significant.

So overall, it seems that bringing PI into the equation reveals that rather than two, there were actually four distinct paths to democracy in Egypt, with each attracting different types of people that had left the autocratic PI mainstream orientation of 2000. Within each path, support for democracy rises, but it also faces particular types of opposition forces, resulting in different propensities to become democratically oriented within the group. It is noteworthy that four “democratic” candidates during the first round of presidential elections in 2012 came to represent each of these views.

### 3.4. *Bottom line on the transition hypotheses*

The data clearly does not support any of the youth-driven theories of change, including the youth version of modernization, and the youth version of grievances driven change. On the other hand, much of the analysis has shown that both the class based version of modernization and distribution theories draw strong support. Between 2000 and 2008, both grievances increased, and the aspirations of a more educated population rose simultaneously. This concurrence explains why the MC, which is at the interception of both forces, turned out to be the main champion for democratization. In effect, if demand for democracy came in surging, it was not only for circumstantial reasons, but also because of the coincidence of large social change of the past decade, together with the rise of inequalities in the late crony capitalism phase.<sup>m</sup>

## 4. State-Business Relations and Networks of Privilege

The popular discontent that led to the uprisings can be traced to two main elements of economic policy: the roll-back of the state, alluded to above, and the consolidation

<sup>m</sup>The circumstantial reasons that are often cited include the reduced Islamic militancy, the “democratic” choice make by the Muslim Brotherhood in 2005, and the looming presidential election of 2012.

of close relations between the state and particular elements of the business elites under economic liberalism. The central question of why the Arab region has underperformed in terms of job creation, given what looked on paper as impeccable market reforms, has been debated for years. Some have argued that the market reforms have not gone far enough; others, that economics had become dominated by networks of privilege (Heydemann 2004) or even crony capitalists (Sadowski 2001) with myopic short term interests that have stifled competition, innovation, and ultimately job creation. Conceptually, there is nothing intrinsically bad about close state-business relations. Khan in particular describes how industrial policy can foster accumulation and the development of new sectors, as had happened with Korea's Chaebols for example (Khan 2010). To the extent that they have the right incentives to perform, close state-business relations can form the basis for dynamic capitalism and an effective state. But they can also become sources of influence, corruption, and other forms of rent-seeking that distorts economic and political incentives.

Popular perceptions of business elites have become quite negative in the region. Cronyism is now seen as the key characteristic of the economic opening that started in the 1990s and accelerated in the 2000s, and at the source of many ills including the job deficit, the rise in inequalities, and distortions to politics which has prolonged the life of the autocrats. The perceived "corruption" of the political and business elites was a key driving force of popular discontent. For example, the Pew survey reveals that in 2010, corruption was the top concern of Egyptians with 46% listing it as their main concern, ahead of lack of democracy and poor economic conditions (Pew 2011). This is confirmed by the Transparency International ratings — for example, Egypt moved from a rank of 70/158 in 2005 to 115/180 in 2008. We now know that this was not just about perceptions.

In both Tunisia and Egypt, the ongoing trials of leading businessmen is starting to shed light on the ways in which influence was yielded for private gains — the granting of monopoly rights to close associates of the rulers, the selling of public firms and land at reduced prices, and the manipulation of the financial markets for the benefits of a few insiders. In Tunisia, the Ben Ali and Trabulsi families monopolized business opportunities. Similar stories about favoritism and insiders abound in Syria, Libya, Yemen, and Algeria, where political cronies seem to control large chunks of the private sector. In Egypt, it seems that the trend was accelerated in the last decade with the "businessmen" cabinet headed by Ahmad Nazif (2004–2011). Two iconic cases being investigated now illustrate the nature of privileges. The first is that of Ezz Steel. Ahmad Ezz, a very successful businessman who dominated the steel industry after 2000, is now accused of having lobbied on behalf of his firm on issues related to raising external tariffs to increase protection in the steel sector, as well as relaxing anti-monopoly constraints, from his position as MP and Chair of the Budget Committee in Parliament (which among other things oversees the work of the Competition Commission and trade policy), member in the very influential Policy Committee of the NDP (chaired by Gamal Mubarak), and his position as NPD secretary for Organisational Affairs. A second example, again involved in

several court cases now, is that of Palm Hill Corporation, the second largest real estate developer in Egypt. The main owner of Palm Hill, Ahmed El-Maghrabi, was Minister of Housing in the Nazif Cabinet, and has been accused of exploiting his ministerial position to sell Palm Hills large tracks of land in various areas in various parts of the country, giving his firm a large competitive advantage over competitors, and at an exceptionally cheap price.

But despite these perceptions (and given that these court cases are ongoing), it may or may not be true that ‘cronyism’ was bad for growth and jobs. In the model I outlined above for example, there is a possibility that the transitions have been caused more by ‘push factors’ (the rejection of repressive policies) than by ‘pull factors’ (the expectations that the economy would be managed better by a democratic regime). If this was the case, the economic challenges of the future would be much harder to overcome.<sup>11</sup>

The big question that needs to be addressed then is that of the economic performance of neo-liberal economies under autocracy, relative to the counter-factual imagined by the MC then they rebelled. This is by no means an easy task. But at a minimum, one should be able to describe more objectively and quantitatively some of the characteristics of the *ancient regime*, and to develop a clearer sense of the impact of ‘cronyism’ on economic performance. This suggests three main areas for research: is there evidence of favoritism? How do the connected operate in an economy that is ostensibly liberalized and thus out of reach of governmental dictates? More ambitiously, are there objective ways of evaluating the impact of the types of state-business relations that were developed in the 2000s in the region on economic and political performance?

The literature on Arab capitalism is still in its infancy. There has been more work on Egypt (e.g. Skafianis 2003, Roll 2010), Morocco (Henry 1997), and the Gulf (Hanieh 2011), and recent work by Steve Heydeman and associates (Heydeman 2006) but essentially, it has remained difficult to get direct measurements of the extent of favoritism, and there has been no serious attempts to statistically evaluate its socio-economic impact. A recent study of the Egyptian stock market around the momentous events of 2010 (Chekir and Diwan 2012) shed some light on these issues.

The advent of the stock market is relatively recent in Egypt. The market only really took off in the last decade of Mubarak’s reign, when his son Gamal Mubarak, working closely with a group of young economic experts and of ambitious businessmen, took it on himself to define a new vision for Egypt, and by doing so, started to redefine the political program of the aging ruling party. After the socialism of Nasser (1958–1968), the timid opening of Sadat in the 1980s, and the State capitalism of the first Mubarak’s period up to the early 2000s, a new effort was under way to modernize Egypt’s private sector — or so did the official narrative go. This effort

<sup>11</sup>But equally, if the pull factors were more salient, the main challenge ahead would be making a political settlement between secularists and Islamists work.

included a push to create an internationally competitive corporate sector in the midst of a renewed effort at stabilization, privatization, trade reforms, and at the center, the liberalization of the financial market, after a costly state financed capitalization. The period saw the emergence of a new class of capitalists backed by state favors. They were prime beneficiaries of the privatization drive and they spearheaded the development of new sectors and the modernization and expansion of old ones. The rising businessmen were well connected and some occupied important post in Government, the ruling party, Parliament, and various influential boards and Committees (Osman 2010).

#### 4.1. *The value and nature of favors*

In our paper (Chekir and Diwan 2012), we do three things: first, we evaluate the value of connections through an event study around the time of the revolution; second, we compare the past corporate performance of connected and unconnected firms; and finally, we ask discuss the broader economic impact of privileges. We use a publicly available database of the corporate performance, and stock prices, of the 100 largest Egyptian companies that are traded on the Egyptian stock exchange. In the study, we rely on what appears to be extensive market knowledge in Egypt of the inner working of these firms to identify 22 firms among them as being closely connected to the state. These firms operate in all sectors. In 2002, their size was about the same as the other firms on the exchange, but by 2010, their median size had increased to a phenomenal seven times the median of non-connected firm, while the latter has barely grown.

In conducting our event studies, we follow a well established literature (for examples see Fisman, 2001 on Indonesia, Ramalho (2003)) for Brazil, Boubakri *et al.* (2008) for a global data-set). As an event study, the revolution of January 2011 presents a near perfect case. It was largely unexpected. When the stock market reopened again in February 2011, it was quite clear that these firms' high level connections had lost most, if not all, their value. As a result, the securities of all these firms must have been re-priced. While our main focus is the uprising that started on December 15, 2010, we also look at three documented events related to rumors about the health of President Mubarak (March 2010, August 2007, and June 2004). In each of the events, the price of connected firms fell by more than those of the non connected ones. But these differences in price movement do not necessarily reflect only differences in levels of connections. They also reflect other differences, such as differential leverage to market or to revolution specific risks. We thus made two corrections, one related to the sensitivity of firms to the aggregate shock experienced by the economy, and the other, to their sensitivity to sector specific shocks connected directly to the revolution. We estimate regressions for each of the events separately of the type:

$$(6) \text{ CAR}(i) = a + b\text{PC1}(i) + c\text{SEC}(i) + x(i)$$

Table 6. Event analysis 4 events (cumulative abnormal returns with fixed effects).

Variables	Dec 2011	March 2011	2007	2004
Connected	-0.241*** (0.0666)	-0.0232* (0.0136)	-0.0818* -0.0464	-0.0336 (0.0250)
Land	-0.0899* (0.0491)	0.0100 (0.0100)	-0.00219 -0.0327	0.000427 (0.0185)
Constant	0.188*** (0.0276)	-0.0190*** (0.00557)	0.000236 -0.0191	-0.0182* (0.0107)
Observations	111	106	89	81
R-squared	0.173	0.036	0.042	0.028
Nbr sectors	15	15	15	15

\*\*\* $p < 0.01$ , \*\* $p < 0.05$ , \* $p < 0.1$ .

Source: Chekir and Diwan (2012).

Where CAR is the excess return of security  $i$ ,<sup>o</sup> PC is the CFs indicator (a dummy that takes the value of zero for NCFs and 1 for CFs), SEC is a vector of sector dummy variables, and  $x$  is the error term.

The main results are in Table 6. They confirm that connected firms have lost more value than others during these events *on account* of their connections. In particular, in the weeks following the Egyptian uprising of January 2011, the stocks of the group of connected firms fell on average by 20 percentage points on account of their connections, in addition to market-wide and sector effects experienced by all firms. This can be considered to be a lower bound of the value of connections, since after Mubarak was removed, there was still a chance that his regime will continue. Moreover, some of the privileges received by connected businessmen such as access to cheap privatization seem to have accrued before they have floated their companies on the stock exchange.

We then looked at the corporate performance of connected firms in the five years before the revolution to ascertain directly how they may have benefitted from their connections. A large literature has looked at how firms may gain from political connections, with most studies finding strong debt effects, and to a lesser extent, tax, market power, bail-out, and state favor effects (see Cull and Xu (2005) for China, Johnson and Mitton (2003) for Malaysia, Khwaja and Mian (2005) for Pakistan, and Leuz and Oberholzer-Gee (2006) for Indonesia, Boubakri *et al.* (2008), and Faccio *et al.* (2006) for a global panel). These studies generally show that connected firms have higher leverage, pay lower taxes, have stronger market power, are bailed out more often, and that more of this happens in more corrupt and poorer countries. In terms of magnitudes, Faccio (2010) who looks at a global panel that includes several thousand firms in 47 countries finds a significant leverage effect with a size of 0.03 to 0.07 (depending of strength of connection) and at up to 0.17 for Thailand and about 0.10 for

<sup>o</sup>The CARs are based on estimation of a market model as follows  $CAR(i) = R(i) - \text{beta}(i) * R_m + e(i)$  where  $R_m$  is the market return.

Russia and Malaysia (the countries where the effect is largest), a sizable but generally not significant tax effect, and a significant extra market share secured by connected firms is about 6%. In her sample, CFs are on average 3 times larger than NCFs.

Given data availability, we were able to investigate empirically differences in four dimensions: their market shares in the sector where they operated, their debts, the taxes they paid, and their profitability. But again, these apparent differences may be due to fact that CFs tend to be large and that large firms enjoy special treatment by the credit market, or that they are over-represented in sectors that use up a lot of debt, or that have large returns to scale. To control for these factors, we run the following median regressions:

(7)  $LHS = f(\text{connectedness, case 30, year, sectors, error})$

where the LHS dependant variables are in turn the firms' debt to equity ratio (total debt to shareholder equity), market share (measured in terms of size of firm's total assets relative to the total of those in the firm's sector), tax payments (and also dividend yield and growth in fixed assets which we will discuss less). The results are in Table 7.

First, we found that connected firms had a larger market share than their non-connected competitors (an average advantage of 8% of the market). Second, we also found that they were able to borrow much more than their competitors, with an extra leverage of 25 points on average over the period, but with this advantage rising significantly over the period (they end up with an average debt to equity ratios of 1.7 compared to 0.8 for their competitors). Third, and unlike what is often claimed on the basis of occasional examples, we found no evidence that connected firms paid fewer taxes than non-connected firms, which seems to indicate that some institutions were more prone to favoritism than others. It must be noted that in all these cases,

Table 7. Panel regression for corporate characteristics (OLS with fixed effects: sectors and years).

Variables	D/E	Tax ratio	Market share	RoA
Connected	0.209*** (0.0571)	0.00800 (0.00988)	0.0874*** (0.0193)	-2.103** (0.888)
case30	-0.0784 (0.0532)	0.0232** (0.00985)	0.0504*** (0.0195)	2.024** (0.914)
Constant	0.681*** (0.0572)	-0.155*** (0.0105)	0.117*** (0.0262)	4.116*** (0.927)
Observations	445	428	988	566
R-squared	0.117	0.108	0.378	0.069

\*\*\* $p < 0.01$ , \*\* $p < 0.05$ , \* $p < 0.1$ .

Note: D/E is Shareholder equity (book) minus intangible assets over total liabilities; market power is share of total assets of a firm over the total assets of all firms in the industry; div yield is the dividend per share over the price per share; annual growth of long-term fixed assets; Tax ratio is tax over net income.

Source: Chekir and Diwan (2012).



we also control for firm size, and so these effects are independent of firm size (for example, the 30 largest Egyptian firms, which belong to the “Case 30” group, pay more debt, and have a larger market share on account of this size effect).

How do we interpret these findings? The banking sector was liberalized in Egypt early in the 2000s, and while banks were seeking good customers, which ended up being in large part these connected firms (at the end of the period, the 22 firms received 80% of the private credit going to the 100 firms that we analyze) they are unlikely to have been influenced by political considerations. Instead, the connected firms must have managed to expand their market share significantly due to their connections, including for example their privileged access to information, and their ability to resolve business difficulties as they arose due to their influence on the economic governance bodies, that they were able to get government contracts more easily, and that they were generally protected against predation by the bureaucracy — all cases of oiling the wheels of their business.

We also found that connected firms have lower profitability than non-connected firms — for example, their return on book assets is only 4% as opposed to 6% for non-connected firms. Here too, this is after controlling for any size effect (and indeed, we find that the largest firms get an extra 2% return on assets). This is a very significant finding. Closer examination of the data shows that for most of the period, RoAs of connected and unconnected firms were the same, but that the return of the former dipped after the 2008 global recession, because their huge expansion made them very leveraged on good economic growth. The main conclusion however is that despite their preferential status and in some cases monopoly power, and despite their disproportional access to funds, these firms were not more profitable than the average firm. So at the very least, one can say that if the favors were intended as Industrial Policy, then this was not particularly successful.

#### ***4.2. Implications of the economy and polity***

It is not possible to tease from the data why the profitability of the connected firms was not higher, given the privileges they enjoyed, but we can speculate. One possibility is that they were run inefficiently (their owners and managers were selected because they were trusted rather than skilled), and their purpose is either to deny the heights of the economy to potential regime opponents. Another possibility is that they “tunneled” their profits, partly to bankroll the ruling party, and partly to themselves — indeed, the main figures became very rich, and were the main reason for the perception of a large rise in the 1% in Egypt during this period.

In this regime, capital flows went to relatively inefficient sectors, reducing economic growth directly. During this period for example, SMEs were starved for credit, but they ended up delivering a disproportionate share of the new jobs (Assaad 2009). Moreover, it is also possible that this unfair competition reduced the dynamism of the economy as a whole. What matters most at the end is whether a dynamic form of capitalism was emerging or whether the economy was stuck in a low investment trap.

That private investment in Egypt never went beyond 15% GDP, with large capital flight (Kar and Curcio 2011) militate for the second interpretation, as was the stagnation of non-connected firms in our sample. This suggests a large and rational ‘pull factor’ was operating during the Uprising in Egypt in the sense that the revolutionaries must have been right to believe that a democratic regime could deliver better economic outcomes, and equally, that the new post-uprising regimes have a lot of ‘growth space’ in their policy agenda.

## 5. Conclusions

In this paper, I tried to sift through theoretical and empirical considerations to piece together a coherent and empirically sound narrative of the socio-political and economic transformations that have occurred in the past few decades in the Arab Republics, and that could be useful to explain both the autocracy of the past, and the ongoing transformation.

The arguments developed above connect economic development (especially fiscal policies, and the rise of crony capitalism), social change (rise in both aspirations and grievances), and political change (a more autonomous middle class splitting away from the autocratic coalition). The overall picture that emerges includes:

- The roll-back of the state in the mid-1980s, but with no democratic opening, leading to the rise of an elite capitalistic class allied with security circles, enforcing its dominance with the use of security tools to repress its opposition and economic tools to co-opt the middle class.
- The closer state business relations within a ‘liberal’ environment and a police state did not develop into a successful industrial policy, but rather, into an economic system of gift exchange with moderate performance, which taxed growth and thus did not create sufficient good jobs; but that also generated additional grievances by unbalancing politics, and leading to a rise in the 1%-type inequality.
- This gave rise to an autocratic, low equilibrium that lasted three decades which was supported by the West, with the MC co-opted and afraid of a take-over by political Islam, and with the poor repressed and neutralized by state-fed religious conservatism.
- Increased fiscal pressures, driven in large parts by rising subsidies and lower tax revenues led to deteriorating social services and lower public investment, further hurting the poor and the marginalized regions and leading to a rise in class identification.
- The MC evolved as a champion of change, driven by both grievances (lack of opportunities for its educated youth, and an anger for increased inequalities which it shared with the poor), and aspirations (rising education leading to increased demand for democracy, which it shared with the richer parts of society).
- The uprisings were not driven by increased support for PI — quite the contrary, and moreover, there was an increase democratization of PI over time.

To substantiate further such a broad account would require more research, both at the country level, and in particular areas. In particular, very little work has been done to uncover the political economy of the transformation over time of state budgets in Arab countries, and their increased regressivity. More work is also needed to understand more precisely the evolution of Arab capitalism in its varying types. Various aspects of the parallelism in the evolution of Arab countries need to be looked at carefully. In particular, the surprising coincidence in the rise of cronyism everywhere over time could be understood in relation to repression and the rise of police states, and possibly the influence of Gulf investments in the region. The recent contagion effects also need to be investigated in light of the many similarities in the structural characteristics driving change in these countries, including the evolution of PI and support from the West. This would go a long way to understand the common structural drivers, in addition to oil, and push back more forcefully essentialist arguments.

## Annex

The questions from the WVS and the variables generated for the analysis are as follows:

Preference for Democracy (PfD): PfD is generated by ordering of V71 and V72. If a respondent chooses 1 in V71 over other choices in V72, s/he is taken to prefer autocracy; if chooses 2 or 4 in V71 over other choices, s/he is categorized as preferring democracy. V71. "If you had to choose, which one of the things on this card would you say is most important? (Code one answer only under "first choice" and one under your second choice)." V72. "And which would be the next most important? (1) Maintaining order in the nation; (2) Giving people more say in important government decisions; (3) Fighting rising prices; (4) Protecting freedom of speech."

Preference for Equality (PfE): We use V116. "Now I'd like you to tell me your views on various issues. How would you place your views on this scale? 10 means you agree completely with the statement on the left (*Incomes should be made more equal*); 1 means you agree completely with the statement on the right (*We need larger income differences as incentives for individual effort*); and if your views fall somewhere in between, you can choose any number in between."

Political Islam (PI): We use V191. "Generally speaking, do you think that the religious authorities in your country are giving adequate answers *the social problems facing our society*" (Y/N).

Socio-economic groupings: We use V252. 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: (1) Upper class; (2) Upper middle class; (3) Lower middle class; (4) Working class; or (5) Lower class. Classes are redefined in the analysis as "Rich" (1), "Middle Class" (2 + 3) and "Poor" (4 + 5).

Education: We use V238. What is the highest educational level that you have attained?: (1) No formal education; (2) Incomplete primary school; (3) Complete primary school; (4) Incomplete secondary school: technical/vocational type; (5) Complete secondary school: technical/vocational type; (6) Incomplete secondary: university-preparatory type; (7) Complete secondary: university-preparatory type; (8) Some university-level education, without degree; (9) University-level education, with degree.

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