

The Political Economy of Distribution in the Middle East: Is There Scope for a New Social Contract?

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1. Introduction

- 1 If there ever was a social contract in the Arab world's low- to mid-income countries, it has frayed badly in recent decades—and, as the uprisings that have taken place since 2011 have shown, has in some cases altogether broken down. This is not because regimes have not tried to provide for their citizens: despite relatively low levels of economic development, most Arab countries have developed large ambitions to distribute resources among their populations in the post-second World War era. Compared to other economies in the developing world, Arab countries stand out in

particular regarding the scale of government employment and the provision of subsidies, notably but not only on energy products.

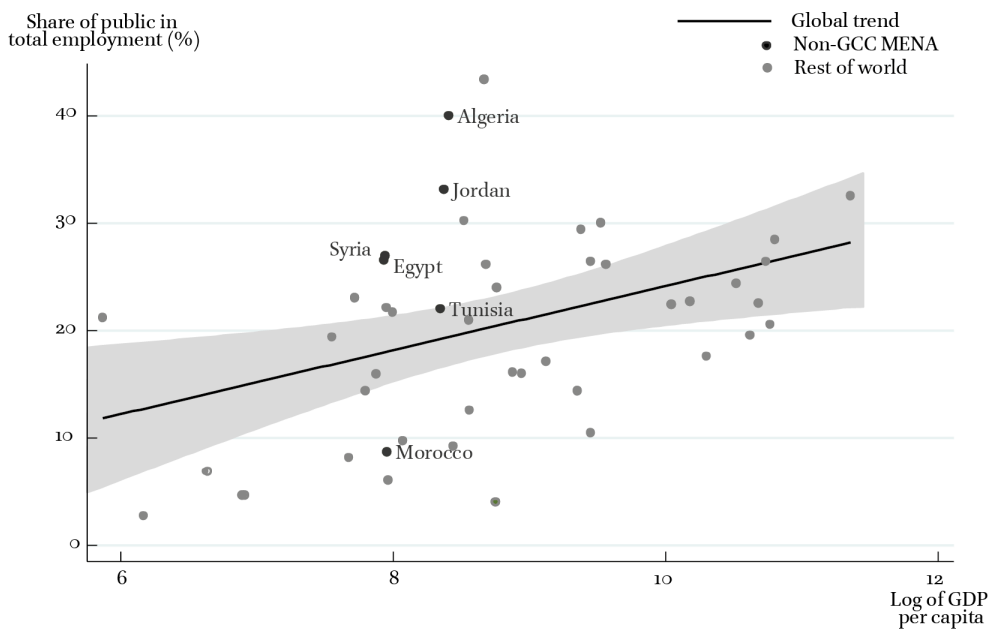
- 2 This distributional regime has however proven fiscally unsustainable, economically distortionary and, most importantly, ineffective in reducing income inequalities as it has created insider–outsider dynamics and benefited the privileged most of all. It did not prevent socio-economic grievances from spreading in the run-up to 2011—and yet, as a first reaction to the regional uprisings, most regimes increased patronage through public employment or subsidies even more. Some Arab governments have recently tackled subsidy reforms in a piecemeal fashion. Wider-reaching thinking about which new type of social contract might replace the unfair and unsustainable old distributional regimes is lacking however. In fact, there is little encompassing analysis of the existing regimes of wealth (re)distribution to start with.
- 3 To contribute to filling these gaps, this contribution will provide an overview of the current distribution regime in core Arab countries in the Maghreb and the Mashreq, and will then discuss potential policy alternatives, with a particular focus on a regime of direct, unconditional cash grants. In the description of the status quo and the analysis of the distortions it creates, the text draws on a variety of detailed studies on Middle East and North Africa (MENA) energy subsidies and on more recent work on (the weakness of) conventional social safety regimes.
- 4 There is less literature on public employment, and no literature pulling the different aspects of distribution together in a comparative fashion. The political economy implications of current distribution patterns in particular have gone unanalysed; this contribution will propose that the current regime not only benefits insiders and creates multiple segmentation of labour markets, it also weakens links between business and citizens. A high-level descriptive overview and political economy analysis of the Arab welfare regime is hence the first main objective of the contribution.
- 5 In its subsequent discussion of an alternative social contract, the chapter can again draw on a well-developed literature on energy subsidy reform and on potential strategies for compensating for energy price increases, including cash grants. There is less literature on public employment reform and its economic implications, and practically nothing on the wider political economy implications of distributional reform. The chapter's second core contribution will hence lie in the latter area, focusing on the potential impact of a more inclusive and less distortionary distributional and welfare regime on social stratification, and on relations between state, business and citizens.
- 6 The contribution primarily focuses on non-Gulf Arab countries in the Maghreb and the Mashreq.¹ I have written a separate paper on rent distribution in high-rent countries around the world, of which the GCC monarchies are leading representatives (Hertog, 2014b). Many of the arguments presented here, however, apply in a modified fashion also to the Gulf Cooperation Council (GCC) countries; notably those on economic distortions, labour market segmentation and cash grants as a viable distributional alternative. While the fiscal situation is less pressing for GCC members, and there is correspondingly more leeway to experiment with alternative distribution regimes, the scale of subsidies and government over-employment and the resulting distortions are if anything more dramatic.

2. Current Distributional Structures

2.1. Public Employment

- 7 Public employment has been a critical tool of wealth distribution across the Arab world since independence. Populist-authoritarian republics in particular – such as Egypt, Syria and Algeria – have historically tried to guarantee government jobs for all nationals. This ambition has been scaled back since the 1970s, as the share of public employment has been stagnating and real public sector wages have declined. Yet in international comparison, most countries on which we have data retain a quite high proportion of government jobs to total employment (Figure 5.1).

Figure 5.1. Public employment shares in international comparison.

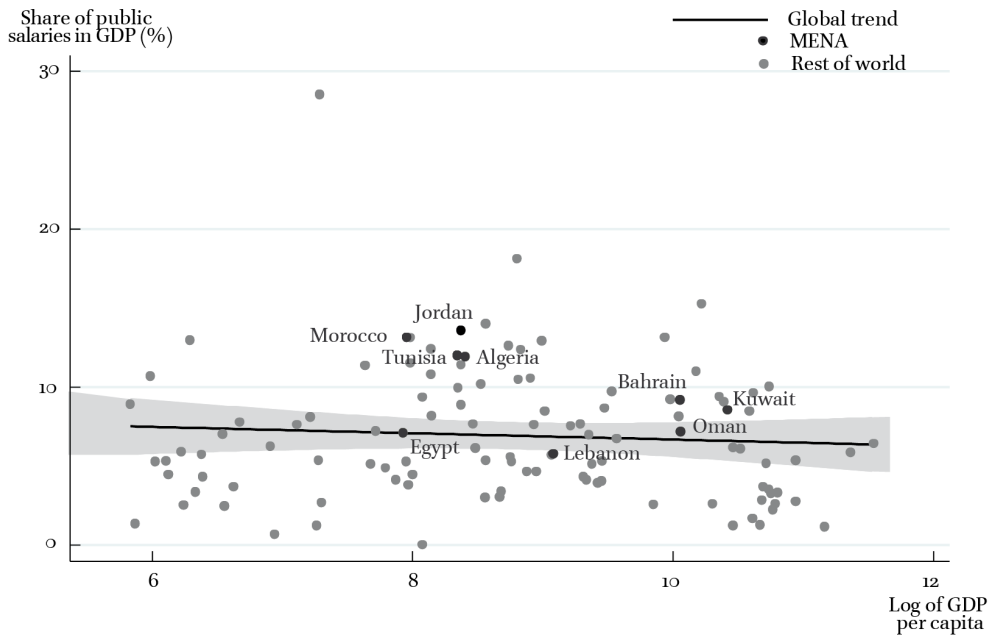


Note: GCC countries are left out of this graph, as the large-scale presence of foreign workers in the private sector makes a direct comparison of private and public employment problematic. We know however that in all cases bar Bahrain, more than half of citizens are employed by the respective governments (Hertog, 2014a).

Source: Author, calculated from ILO, World Bank Development Indicators, and national data.

- 8 Morocco is a conspicuous exception and is also, as we will see, the Arab country with the smallest subsidy provision. Among core Maghreb and Mashreq countries, Morocco stands out in having been less ambitious in both distribution and public service provision and in relying more strongly on private-driven development. As Figure 5.2 shows, however, public salaries represent a large share of the gross domestic product (GDP), which seems to reflect a concentration of resources on smaller cadres of better-paid public servants. In Egypt, by contrast, salaries are spread thin among a much larger government workforce. Altogether, however, Arab public salary expenditure—just like employment numbers—lies above international averages (the exception of Lebanon in Figure 5.2 will be briefly discussed below).²

Figure 5.2. Public salary expenses in international comparison.

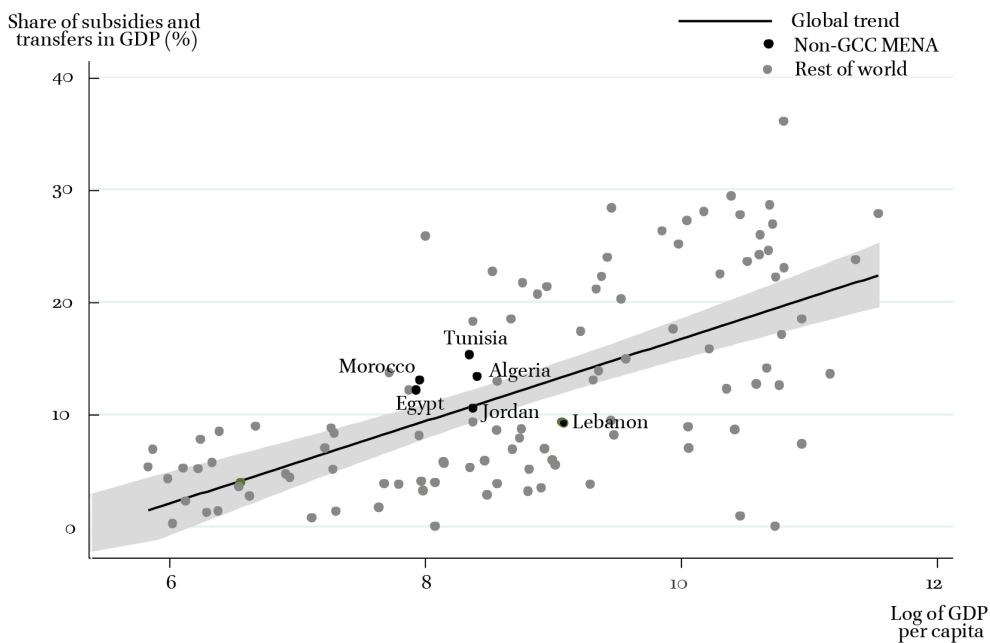


Although available data are patchy, in the cases where we have data, salaries in government, long-term stagnation notwithstanding, typically are higher than in the private sector, especially compared to the informal sector (Bodor, 2010; Yousef, 2004) ³.

Source: Author, calculated from ILO and World Bank Development Indicators data.

- 9 Figure 5.3 shows that government subsidies and transfers, to the extent that they are recorded as government expenditure, also tend to be somewhat above the average for countries with similar incomes.

Figure 5.3. Government subsidies and transfers in international comparison.



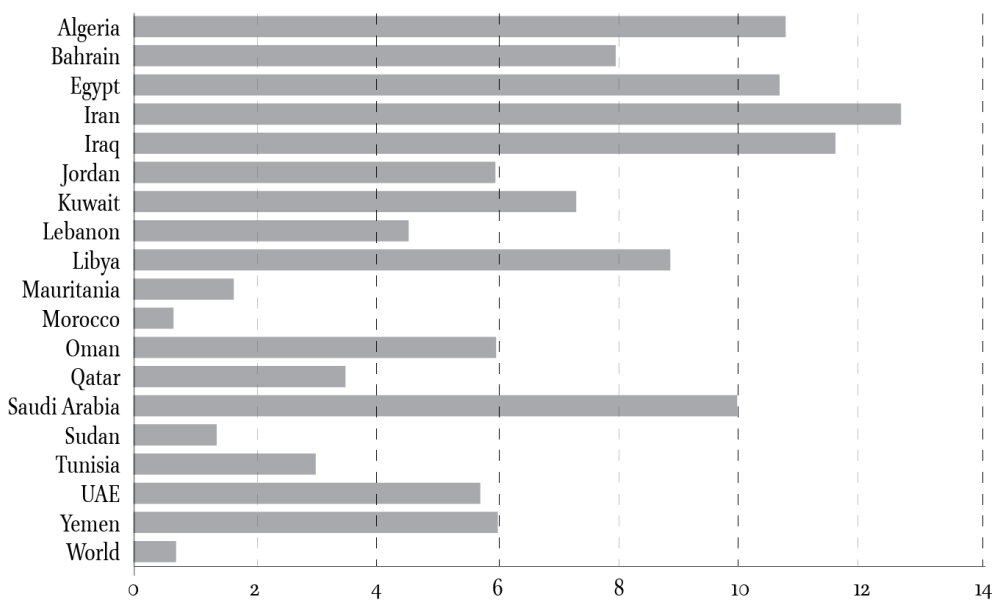
Source: Author, calculated from World Bank Development Indicators data.

- 10 As accounting rules for subsidies are often unclear, and energy subsidies in particular are often under-reported, one can dispute how meaningful these figures are (energy subsidies are discussed separately below using International Monetary Fund (IMF) data). It is clear however that this budget item for the most part does not comprise conventional social safety systems in MENA, the volume of which is only estimated to be 0.7 per cent of GDP (Levin, Silva, and Morgandi, 2012).

2.2. Subsidies

- 11 While information on public employment is patchy, more research has been carried out on subsidies in the Arab world, particularly on energy subsidies. With energy subsidies that are on average 12 times higher than in the world at large according to 2011 IMF estimates, the region stands out even more—and this includes energy importers, where subsidies have a direct fiscal impact rather than the harder to define opportunity costs of energy subsidies for energy exporters (Luciani, 2012). Among the core Arab countries, Morocco alone has managed to reduce energy subsidies to a fiscally manageable level (Figure 5.4). Although the 2011 figures are inflated by the high international energy prices of that year, Arab countries continue to devote much more resources to the provision of cheap energy than do most other developing countries.

Figure 5.4. Pre-tax energy subsidies as % of GDP in 2011.



Source: IMF, 2013b.

- 12 The subsidies consist of cheap transport fuel, electricity and gas. Average diesel prices in MENA are lower than in any other region of the world and only half of US prices. Electricity subsidies average 2 per cent of GDP (Sdravovich et al., 2014).
- 13 Most MENA governments also continue to provide food subsidies that represent an average of almost 1 per cent of GDP and are considerably higher in formerly 'progressive' republics like Tunisia, Algeria, Egypt, Syria and Iraq.

2.3. Historical Roots

- 14 While this chapter cannot engage with the historical roots of Arab distributional systems in any detail, some preliminary remarks are in order: First, the historical protagonists of mass employment and subsidisation arguably were the Arab nationalist republics, whose populist-authoritarian leaders aspired to the creation of a new middle class and the removal of old bourgeois elites, and who tried to leverage the state apparatus as the main driver of economic development (Henry and Springborg, 2010; Heydemann, 1999; Richards and Waterbury, 2007). The heavy statist legacy of these republics remains visible in the aforementioned employment and subsidy statistics but also in the heavy and cumbersome bureaucratic penetration of the lives of citizens and businesses, as evidenced by international statistics on government effectiveness and ease of doing business.
- 15 The stronger commitment to food subsidies among republics in particular reflects an agenda of redistribution. It is noteworthy that while Tunisia started to shed its socialist ambitions from the 1960s on and has gone further in liberalising than its former nationalist republican peers, it too retains large food subsidies as a core ‘socialist’ legacy.
- 16 It is likely that the populist-distributional policies of the nationalist republics put pressure on other countries in the region to play catch-up. The ideological competition between Arab nationalism and conservative monarchism from the 1950s on (Kerr, 1965) forced monarchies to step up their own distributional efforts—a decision visible in the GCC countries’ employment and subsidy policies, but also in similar policies in much poorer Jordan, which was positioned at the fulcrum of regional ideological competition for much of post-second World War Arab history. Morocco, as a more peripheral monarchy with deeper historical roots, appears to have been under less pressure to play catch-up.
- 17 The one republic that never quite embarked on a path of nationalist state-building is Lebanon (Henry and Springborg, 2010). Despite considerable energy subsidies, it is also the country with the smallest distributional footprint in the region. Its unusually weak statehood however contributed to its descent into a civil war in the 1970s that itself was shaped by the ideological and power rivalries of the region. At least in the classical period of ideological rivalry in the region from the 1950s to the 1970s, distributional state-building may have been a condition of regime survival.
- 18 The availability of both natural resource and strategic rents in the region did of course help states to engage in over-employment and, especially, provision of cheap energy. As the experience of other regions shows, however, rents do not automatically generate such structures: sub-Saharan African or South East Asian oil states for example have much lower levels of energy subsidies and tend to have smaller state apparatuses.

2.4. Lack of Other Social Safety Mechanisms

- 19 While public employment and subsidies are costly and distortionary, most Arab governments offer comparatively little by way of social security policies. This might be another legacy of authoritarian-populist state-building, in which elites saw direct state employment as a tool not only of distribution but also of reshaping and controlling

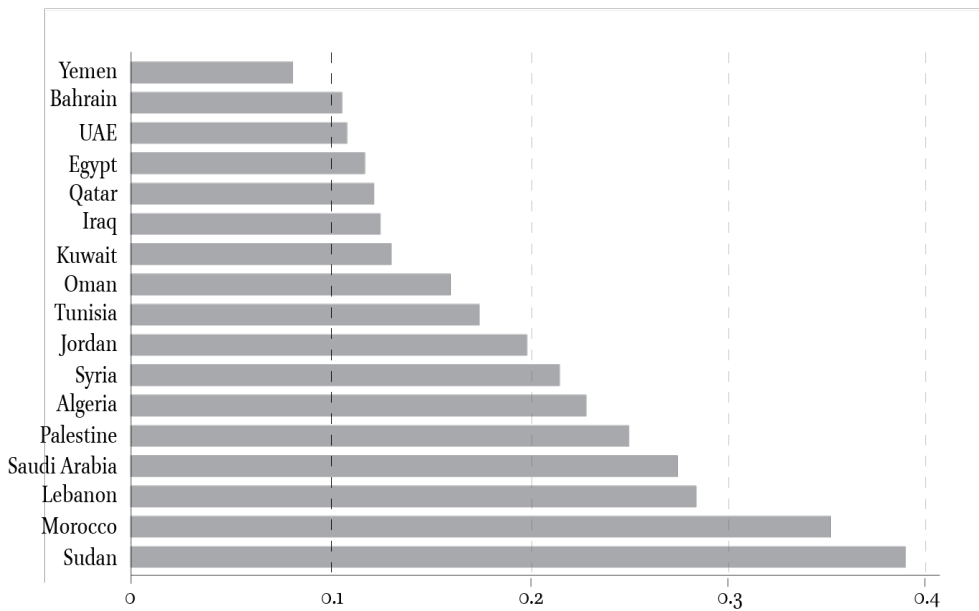
society—an objective for which mundane policies like unemployment assistance and income support grants for the poor were less suited. The tangible nature of directly provided, subsidised goods might also make them more attractive to authoritarian rulers.

- 20 As mentioned above, non-contributory social safety programmes only amount to an average of 0.7 per cent of GDP across the Arab world (Levin, Silva, and Morgandi, 2012). Those few programmes that do exist are, moreover, remarkably ineffective: World Bank research shows that they fail to reach two-thirds of individuals in the poorest quintile, a coverage rate that is less than half the world average, including in regions not generally associated with generous welfare benefits, like Latin America or Central Asia.
- 21 As with subsidies, ineffective targeting means that a considerable share of social safety resources actually go to the non-poor.⁴ In every one of the 11 Arab countries included in the World Bank study, the size of general food and fuel subsidies dwarfs that of social safety spending. It appears that in the Arab world, public employment and subsidies function as a substitute rather than a complement for conventional welfare tools. As we will see, the Arab approach to sharing wealth is as costly as it is ineffective in realising objectives of equity and poverty alleviation. It also appears path-dependent, in the sense that early decisions to distribute resources through particular channels have—even if the political reasons for these decisions might now be obsolete—proven hard to reverse, while decisions to deepen the existing pattern of distribution are taken more easily.

2.5. Distortionary Economic Impacts

- 22 Because Arab distributional regimes involve in-kind distribution rather than distributing money as is the case with most modern social safety nets, their distortionary economic impact is particularly pronounced. To the extent that government employment is surplus to requirements—and there is much anecdotal evidence that some of it is—it takes human resources out of the private labour market where they might be more productive. Due to higher wages and shorter working hours, the general preference for government employment is widespread among Arab citizens. As Figure 5.5 shows, in every single Arab country polled by Gallup, the majority of respondents prefer government over private employment. As one might expect, private sector preference is relatively strongest in the least distributive states—Lebanon, Morocco and Sudan.

Figure 5.5. Preference for government employment in the Arab region.

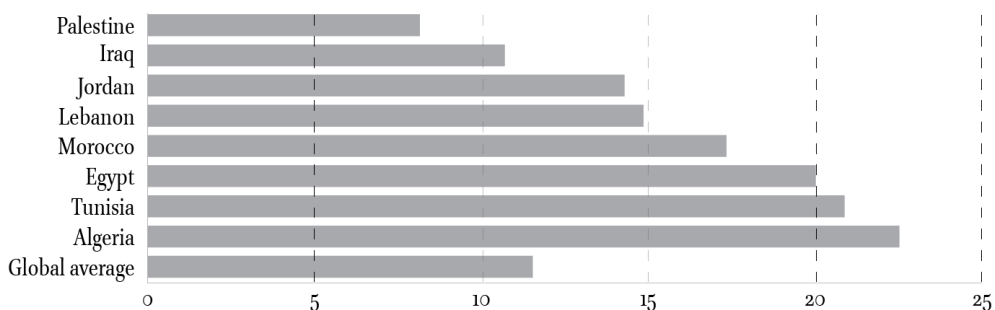


Note: Gallup poll, conducted in the Arab world in several waves, asking respondents whether for similar pay and conditions they would prefer to work for the government or private sector; 0=preference for government, 1=preference for private sector.

Source: Gallup/Ishac Diwan.

- 23 A preference for government employment, and government recruitment based on formal credentials, arguably lead to educational decisions that are suboptimal for the private labour market. While it has become a much more remote prospect for most young jobseekers, educational systems are still geared to preparing participants for government employment, with an excessive focus on tertiary education and on subjects of limited relevance for the private economy (Adams and Winthrop, 2015; World Bank, 2008). Figure 5.6 shows, for example, that—according to UNESCO statistics—a disproportionate share of Arab students study arts and humanities subjects. This is unusual in the content of developing economies and probably best explained as a legacy of public sector oriented ‘credentialism’, where the formal level of education matters more than the subject studied (Salehi-Isfahani, 2012). Public sector over-employment also creates overhead costs that arguably represent a deadweight loss to society.

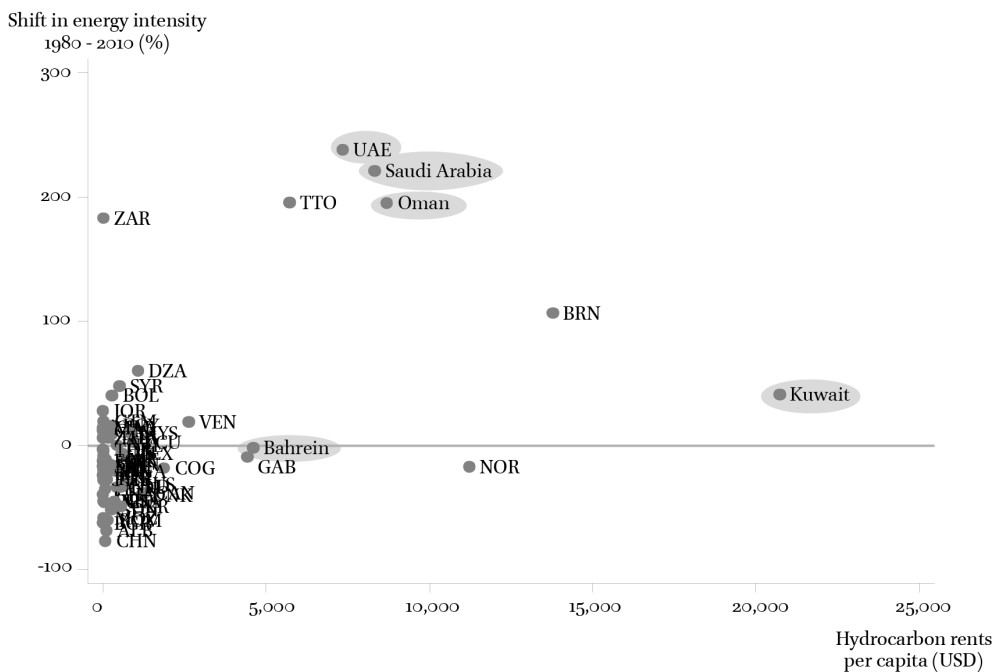
Figure 5.6 Share of students in arts and humanities in select Arab countries.



Source: UNESCO UIS data centre (<http://data.uis.unesco.org/>)

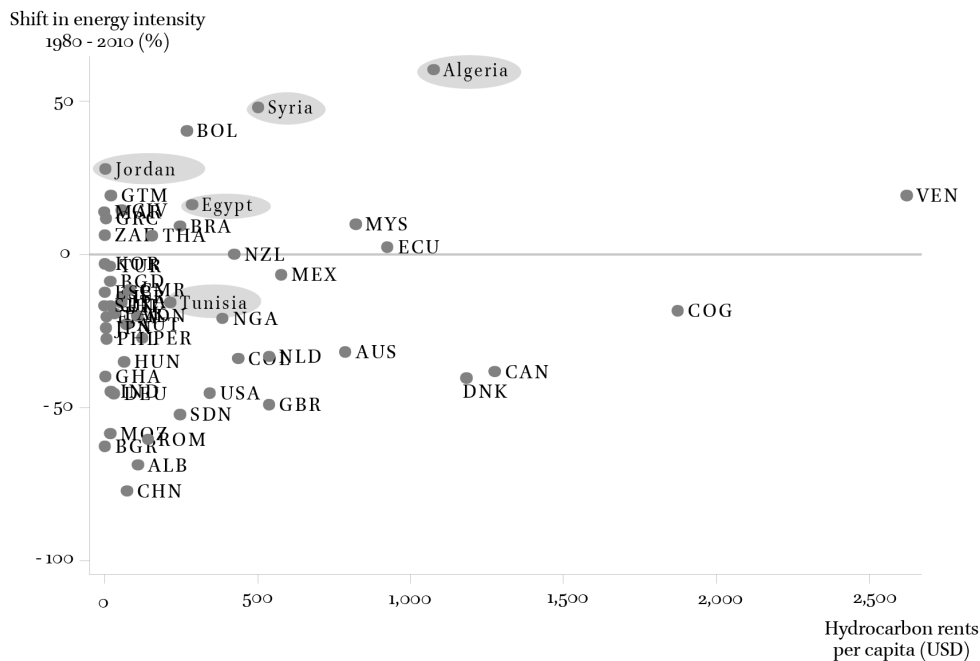
- 24 Distortions in economic behaviour are even more obvious in the field of energy subsidies. IMF research shows that the energy intensity of economic output in the MENA region is not particularly high in global comparative terms (although it is higher among oil exporting countries). Different from most other world regions, however, energy intensity has stagnated over the last decade among MENA oil importers and has increased among oil exporters, while it has declined in all other regions bar Latin America, which itself has seen a commodities boom. Low energy prices hence give no incentives for energy conservation but instead lock in costly and increasingly unsustainable consumption structures. The IMF also documents the energy-intensive bias of Egyptian industry despite the fact that Egypt is a labour-surplus country; the IMF argues that low energy prices create a bias towards capital-intensive industries that fail to absorb the large numbers of jobseekers in the MENA region (Sdrlevich et al., 2014, 23, 65).
- 25 Figures 5.7 and 5.8 show various countries' shifts in energy intensity from a longer perspective—from 1980 to 2010—with 2010 oil and gas rents per capita and year on the x axis. MENA countries are circled. We see that:
1. High-rent countries around the world have generally experienced a decline in energy efficiency.
 2. Mid-rent countries have not experienced such a decline in general, but mid-rent cases in MENA (Algeria, Egypt, Syria) have, although less dramatic in scale.

Figure 5.7. Rents per capita and shifts in energy intensity (energy used per unit of GDP) 1980-2010.



Source: Author, based on World Development Indicators.

Figure 5.8 Rents per capita and shifts in energy intensity since 1980 without high-rent countries.



Source: Author, based on World Development Indicators.

- 26 Particularly in energy-importing countries, low electricity prices also tend to create undersupply and shortages, as energy producers—which are often state owned—struggle to recover their costs. Energy subsidies also lead to negative environmental externalities. Fuel subsidies in particular cause smuggling, while electricity subsidies undermine incentives to develop alternative energies, which in principle have significant potential in the hot and sunny MENA region.
- 27 While food subsidies are smaller in scale, they have also created distortions—perhaps most famously in Egypt, where at least until partial reforms in 2014, subsidised ‘baladi’ bread was so cheap that it was regularly used as animal fodder (*Reuters*, 2015).

3. How the Distributional System Creates Social Stratification

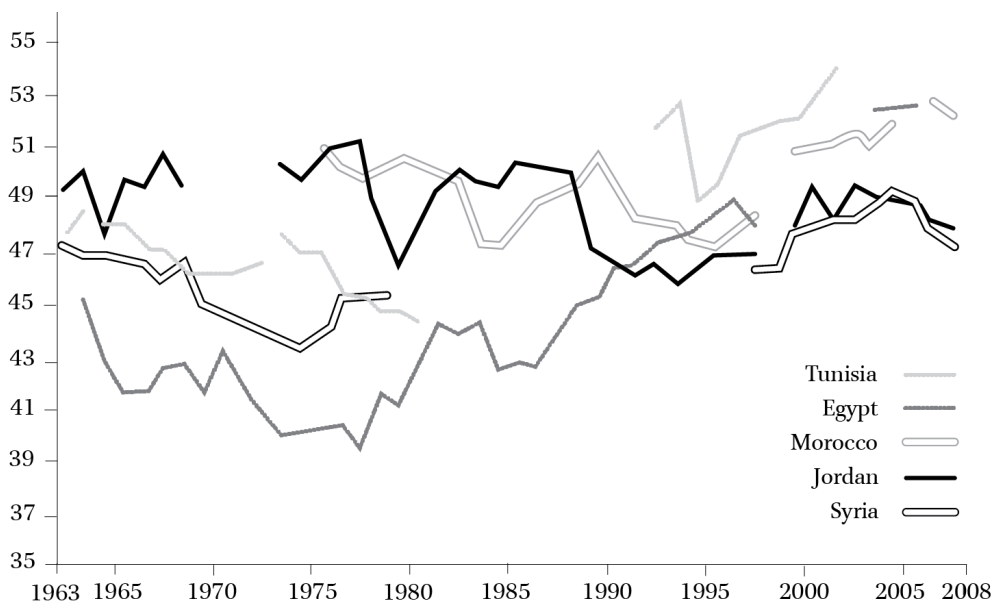
- 28 In addition to economic distortions, the current wealth-sharing regime also has undesirable and arguably unintended distributional consequences. These are well documented for energy, but less so for public sector employment.

3.1. Labour Market Consequences

- 29 Public employment is a scarce, lumpy, private good. Given the fiscal constraints of all but the very richest Arab countries (Kuwait, Qatar and the UAE), it has to be rationed. It tends to benefit the more educated, who are usually of a privileged economic background to start with (Assaad and Krafft, 2014; Dougherty, 2014). There is also a widespread perception that nepotism and corruption play a role in the allocation of public jobs (El-Gammal, 2013), which reflects such allocation’s potential to be used as a discretionary tool of political patronage, and creates further inequities in access.

- 30 Excessive public sector employment has contributed to a triple segmentation of labour markets between public, formal private, and informal private—a structure that itself contributes significantly to inequality. To—among other aims—make private employment competitive with public employment, Arab governments have created fairly wide-ranging labour market regulations and high barriers to dismissal from formal private employment. As a result, however, all non-GCC Arab countries bar Jordan rank—according to the World Economic Forum—in the bottom fifth of 144 countries with regards to ‘labour market efficiency’ (Jordan ranks 97th). While intended to protect employees, regulation has instead created a huge informal sector, which ranges in size from 25 to 45 per cent of non-GCC Arab economies (IMF, 2011, 45), and in which jobs are precarious and badly paid.
- 31 Together with the high share of government employment, this means that formal private employment—the mainstay of developed labour markets—remains a residual category across the Arab world. Arab public employment and labour market policies have, probably unintentionally, created an unequal ‘double insider’ system.
- 32 There are no estimates for the impact of public employment on income distribution in the Arab world, but given its scarce and relatively privileged nature it is likely to contribute to inequality, especially since it has been more strongly rationed from the 1970s on. It might not be coincidence that the cases with the strongest estimated increases in inequality since then appear to be republics that once made the more expansive distributional promises and relied more strongly on public sector employment, notably Egypt and Tunisia (Figure 5.9) (Syria, despite rampant crony capitalism, retained more of its statist economy until recently). While some of this inequality could result from the structural adjustment programmes these countries underwent, it is also clear that the rationing of public sector employment—and the resulting unequal access to opportunities—was a fiscal inevitability even in the absence of structural adjustment.

Figure 5.9. Gini coefficients of selected Arab countries.



Source: Estimated Household Income Inequality dataset, University of Texas Inequality Project.

3.2. Regressive Energy Subsidies

- 33 The negative distributional consequences of subsidies are better understood and documented: it is widely known for example that most energy subsidies are regressive in that they benefit larger and richer consumers disproportionately. The IMF has shown that the bottom 40 per cent of the population receive only between 3 and 20 per cent of diesel and gasoline subsidies in eight different Arab countries. The regressive effects of LPG and electricity subsidies are somewhat less dramatic, but in no single case do the poor receive their proportional share. The picture for food subsidies is somewhat better; but even for these, many individual policies disproportionately benefit richer strata (Sdravovich et al., 2014).
- 34 The staggering opportunity costs of energy subsidies are illustrated by comparing them to government capital spending and education and health budgets. In many Arab countries, subsidies are larger than total capital spending, and in all 11 MENA oil exporters analysed by the IMF, subsidies in 2011 were larger than education and health budgets respectively, and sometimes larger than both budgets combined. Among oil importers, Jordan and Lebanon maintained energy subsidies that were larger than capital spending, education, and health, respectively; in Lebanon they were larger than the education and health budgets combined, while in Egypt they were larger than all three budget items combined (Sdravovich et al., 2014, 18).

3.3. State, Business and Citizen in the Distributional System

- 35 A subtle but potentially important political economy consequence of the Arab distributional regime is that it weakens the link between the business class and citizens: few citizens aspire to private employment and those who are privately employed often operate in the informal sector. At the same time, business remains state-dependent in many ways—through the provision of cheap energy but also due to high levels of administrative protection (World Bank, 2009). Together with a legacy of cronyism and corruption—themselves potentially facilitated by heavy state intervention, and over-staffed and unaccountable bureaucracies—this arguably explains the prevailing low trust placed in Arab businesses. According to the 2010-14 World Values Survey, 20 per cent of respondents in the ten non-GCC Arab countries polled have ‘no trust at all’ in big companies, compared with a figure of 10 per cent in the rest of the world. This likely helps to explain the lack of leadership that Arab business showed during, and has shown since, the regional uprisings.
- 36 At the same time, in eight out of ten non-GCC Arab countries—all bar Jordan and Morocco—public trust in government institutions, including the civil service, is lower than in other countries with comparable levels of development. This demonstrates that the region’s comparatively expansive but lopsided welfare regime fails to generate political buy-in. While the state hence plays a dominant role, it does so in an ineffective way, failing both to steer the economy towards higher productivity and job creation, and to create equitable social outcomes or inspire public trust.

3.4. Attempts at Change

- 37 Whether seen from the standpoint of efficiency or of equity, there could hardly be a worse way of distributing wealth than through subsidised energy, particularly in the Arab region's energy-importing countries. Public sector employment as a tool of welfare is somewhat less economically irrational, but more distortionary of politically sensitive labour markets.
- 38 The above problems, albeit rarely looked at in an integrated fashion, are not unknown to regional policymakers. Facing increasing fiscal constraints, poorer Arab countries made some attempts at partial subsidy reform before 2011 (Sdrlevich et al., 2014; IMF, 2013a; Devarajan et al., 2014). These however were abandoned with the uprisings. Instead, both old and new regimes relapsed into ingrained patterns of patronage spending, showing how deeply entrenched the old distribution regime has become. The post-Mubarak transitional government in Egypt ordered rises in subsidies and public sector salaries, and the transitional government in Tunisia new public sector jobs; while in Syria Assad has increased the heating oil allowance for public workers and augmented government salaries. The Jordanian government increased subsidies as well as salaries and pensions, while Morocco temporarily doubled its subsidy budget (Hertog, 2011).
- 39 These steps have proven unsustainable and have since been partially rolled back. Egypt, Jordan, Morocco, Tunisia and Yemen have initiated partial pricing reforms of transport fuels and electricity since 2012 (Sdrlevich et al., 2014).
- 40 It is encouraging that most of these reform efforts have been accompanied by some form of compensatory policy. These include cash transfers to families below a certain income threshold in Jordan, plans to strengthen existing social safety nets in Morocco, a 'lifeline' electricity tariffs for small consumers and a new social housing programme in Tunisia, and expanded coverage of the Social Welfare Fund in Yemen. The reform process generally is piecemeal however and the compensation strategies often diffuse and not clearly enough linked to, and financed through, the savings achieved. Reforms are also limited to energy subsidies in particular, while public employment and labour market regulations remain untouched. The initiatives hence fall short of the big-picture thinking that is necessary for moving towards a new social contract and a distributional regime that are both more efficient and inclusive.

4. Potential Alternatives to Current Distributional Regimes

- 41 The unfairness, inefficiency and fiscal non-sustainability of the current systems are obvious. Most economists agree that the Arab world needs further energy subsidy reform and a thorough reform of the public sector, moving governments towards needs-based hiring and potentially a smaller public workforce. But the regional reform debate touching on these issues remains disjointed, focused on individual sectoral problems, and typically apolitical. The discussion of reform is seldom related to the underlying political economy of distribution that has been constraining reform options.

- 42 As a result, no answers are offered to how the frayed social contract embedded in existing regimes can be reshaped to become more economically and politically sustainable. If distribution structures are to be reformed, however, Arab citizens will require an alternative, inclusive welfare regime that goes beyond small-scale, sector-specific compensatory measures. Reforms that fall short of this are unlikely to be politically acceptable and are hence likely to remain piecemeal.
- 43 While some of the recent energy reforms in Arab countries have been accompanied by compensatory measures such as ration cards or cash grants for needy households, both reforms and compensation policies have been smaller scale and partial—and there has been no serious thinking devoted to how to make public sector reform politically palatable. There is a need for more ambitious thinking that combines a reduction of traditional forms of patronage with the creation of new wealth sharing and social security institutions that will foster a more inclusive, less economically distortionary social contract.
- 44 This contribution cannot provide a comprehensive answer in this search for a new contract—but it can hopefully contribute some larger-picture ideas that take into account not only economic but also social and political constraints to reform. In this spirit, the following section will propose direct, unconditional cash grants as a comprehensive alternative to subsidised energy and public sector over-employment. A move towards cash grants would both remove the economic distortions created by the current distribution system and provide a fairer and more inclusive wealth-sharing regime, helping to alleviate the deep socio-economic segmentation of Arab societies.

4.1. The Long Run: Modern Social Security Systems

- 45 As we have seen, most Arab governments have devoted considerable resources to existing patronage mechanisms. Even if only some of the savings derived from dismantling these structures were available to be spent on new welfare institutions, the resources at the disposal of governments would be considerable, and far above the current scale of social security provision.
- 46 In the long run, Arab countries should build up conventional social security mechanisms such as means-tested income support, unemployment assistance, unemployment insurance, and active labour market policies such as retraining and job placement services. In the short run, these are not an option, as putting them in place will require considerable capacity-building efforts. Compensation for any distributional reforms in the sectors of energy and public employment, however, will have to be immediate: both to protect the livelihoods of vulnerable populations and to make reforms politically feasible. Savings from reforms should be immediately ‘ring-fenced’ for social spending, to ensure they are not just frittered away and used to plug holes in national budgets.
- 47 What could instant social spending look like? There is one simple option that has been widely discussed for advanced countries and for resource-rich developing countries, but not to date for the lower-income parts of the Arab world: direct, unconditional cash grants for all adult citizens. These would be particularly easily justified and implemented in the Arab world’s oil-rich states. But the potential windfall from distributional reform in most of the hydrocarbon-poor Maghreb and Mashreq countries makes them a serious option there too.

4.2. The Short Run: Cash Grants to All Citizens

- 48 Universal, unconditional cash grants have been debated at some length as the most appropriate way of sharing national wealth in resource-rich developing countries, and governments as diverse as those of Alaska, Bolivia and Iran have had encouraging experiences with such schemes (Hertog, 2014b; Sandbu, 2006; Segal, 2011). There is also an extensive literature about the potential advantages of unconditional cash grants over conventional welfare mechanisms in advanced, capitalist countries (for an overview see Van Parijs, 2000).⁵
- 49 There are numerous general arguments for cash grants, and these arguments apply with at least equal force to the Arab world's poorer countries: compared to existing subsidy systems that privilege insiders and rich households they are more equitable (Sandbu, 2006), distort consumption decisions less, and are more transparent (Moss, 2010). Compared to means-tested support systems, they are easier to administer, generate smaller overheads, and are less prone to stigmatisation and errors of exclusion (Segal, 2011). In the Arab world, the administrative capacity for means testing is particularly limited, as tax systems generating household income data are weak.
- 50 Cash grants could keep at least part of the state's resource revenues out of the hands of self-interested politicians, thereby reducing corruption (Baena, Sévi and Warrack, 2012; Birdsall and Subramanian, 2004). They could impart a sense of ownership to citizens, increasing their 'buy in' into the political system (Palley, 2003), and create a more level playing field between state and citizens (Gelb and Grasmann, 2010; Gillies, 2010).
- 51 By providing a secure revenue stream to citizens, cash grants could at least on the margin incentivise private investment, entrepreneurship and the development of local markets, including financial markets (Gelb and Grasmann, 2010; Palley, 2003; Sandbu, 2006). Authors of the cash grants literature have adduced considerable evidence that private agents are adept at investing cash windfalls well (Birdsall and Subramanian, 2004; Gelb and Majerowicz, 2012; Sandbu, 2006) and at smoothing their consumption over time (Hsieh, 2003).
- 52 While taxation capacity in the Arab world is low, basic administrative capacity is fairly high in most countries. A cash grant system could be set up quickly, as it only requires basic information about citizenship and age. Individuals without bank accounts could be reached through the use of special cash cards. As we have seen, trust in the state is particularly low in the region, making simple and hard-to-manipulate systems like a universal cash grant particularly attractive politically. The unconditional nature of grants would maximise political buy-in. Options for means testing along the lines of Latin American style conditional cash grants could be considered later on.

4.3. Consequences for Labour Markets

- 53 A cash grant system could help to reorient citizens towards gainful private employment in at least two ways. First, it should be accompanied by public sector employment reform that would make government hiring a more remote prospect. Citizens would hence not be incentivised to wait for easy, often unrewarding government jobs in order to secure their share of the country's wealth, but would be

free to pursue their own preferences, including on the private labour market. Citizens would also be more likely to seek education relevant to the private sector, helping them to contribute to the creation of economic value. Fewer human resources would be 'parked' in unproductive, surplus government positions, and the public sector itself could reorient its staffing and HR policies away from politically determined patronage and towards needs-based, productivity-oriented strategies.

- 54 This effect would be less powerful in poorer Arab countries where public sector employment is already a fairly unlikely scenario for most new labour market entrants (although their preferences and educational behaviour indicate a continued orientation towards the public sector). There is, however, a second potential design feature through which giving cash grants could provide a universally strong incentive for private employment: excluding incumbent public servants above certain income levels—who, after all, already receive an implicit subsidy as they typically earn more than equivalent private sector employees—from receiving the grants.⁶ In this way, the effective earnings gap between private and public employment would be narrowed or closed—without any net loss to existing government employees.
- 55 This citizens' income would then function in a manner somewhat analogous to an unconditional wage subsidy for private employment:⁷ citizens could achieve acceptable total income levels even if they held less-well-paid private jobs, as their citizen's income would top up their wages without penalty.
- 56 An unconditional cash grant would have an 'income effect' that would potentially disincentivise work effort on the margin. Any negative effect however would be less strong than under conventional means-tested support mechanisms: unconditional grants would avoid the substitution (or 'tax') effects of unemployment assistance or insurance and other forms of conditional income support, where benefits are lost as work is found and/or wages increase (Widerquist and Lewis, 2009).⁸
- 57 A cash grant scheme could help politically justify the gradual re-engineering of the Arab world's bloated public sectors. It is quite likely that future generations would prefer a safe cash grant over the highly uncertain prospect of gaining a surplus government job at some point. This quid pro quo would allow governments to recruit on the basis of administrative needs rather than imperatives of patronage. The resulting improvements in administrative efficiency could contribute significantly to citizens' quality of life, and to the local business climate.

4.4. Consequences for Income Distribution

- 58 Given the regressive nature of current distribution arrangements, the cash grant alternative would reduce economic inequality. The impact could be substantial: Iranian energy price reforms of recent years were coupled with the introduction of a universal household cash grant. As a result, the country's Gini coefficient is estimated to have dropped to 0.37 in 2011 from 0.41 in 2010 (Sdrlevich et al., 2014, 52). This is about two-thirds of a standard deviation in the international distribution of country Gini values. Similarly, World Bank simulations have estimated that poverty in Egypt would be cut by one-third if energy subsidies were reduced by 50 per cent and the savings used to finance a universal cash grant (Sdrlevich et al., 2014, 57). The more even income distribution achieved through cash grants would probably also boost domestic demand,

as poorer households, who would disproportionately benefit, have a higher propensity to consume.

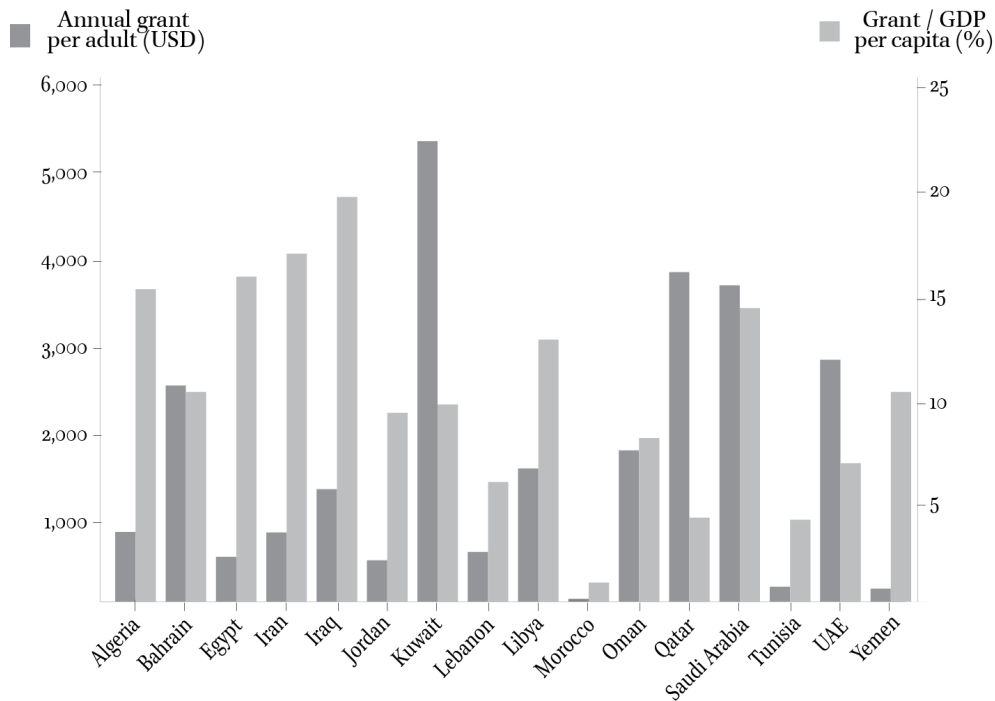
4.5. Consequences for Energy Consumption

- 59 If grants were financed through energy reforms, this would positively impact domestic energy markets: higher energy prices would help reduce energy consumption both through immediate price effects and by providing longer-term incentives to choose more energy-efficient technology and lifestyles. Drawing on panel data from 66 countries, Charap, Ribeiro da Silva, and Rodriguez (2013) estimate a long-term price elasticity of energy consumption of 0.3 to 0.5. This indicates a considerable potential for energy savings: assuming that a typical Arab country's energy prices could be doubled, consumption would decrease by between 19 and 29 per cent given these elasticities. More realistic energy prices would also reduce the energy dependence of industry, end the often politicised rationing of cheap industrial energy, and provide incentives for investing in more modern production processes.
- 60 Despite maldistribution, levels of inequality in the Arab world are moderate compared to most other developing regions; basic infrastructure, state capacity and public services could be improved but again compare reasonably well to the bulk of the Global South. The region would hence have much development potential if economic distortions were reduced and distributional spending leveraged so as to empower rather than segment and immobilise populations.

4.6. Potential Magnitudes

- 61 How much spare cash would there be for a universal cash grant? I provide below some upper-boundary estimates based on 2011 IMF energy subsidy estimates—the last year for which we have data that is consistent across countries.
- 62 Figure 5.10 shows the size of annual cash grants that could be provided to all nationals above 15 years of age if subsidies were eliminated (i.e. energy prices increased to international levels).

Figure 5.10. Size of per capita annual cash grants that could be financed through energy subsidy reforms.



Note: GCC cases here include non-nationals. For more detailed estimates for high-rent countries see Hertog (2014b).

Source: Author, based on World Development Indicators (World Bank) and IMF data.

- 63 Actual cash grants would in all likelihood have to be lower: the current energy subsidy regime has become fiscally unsustainable and at least some of the savings made thanks to its reform would likely have to be used to reduce government deficits. Lower current energy prices mean, moreover, that the subsidies themselves have somewhat declined since 2011. Finally, any cash grant scheme would incur some administrative costs.
- 64 But even if only half of the above amounts could be realised, this would make a substantial difference to the livelihoods of poorer households in most Arab countries—especially Egypt and Yemen, where the grants amount to 10 per cent or more of GDP per capita.

4.7. Political Feasibility of a Transition

- 65 The political economy rationale for moving from the current distributional regime to cash grants is straightforward: Due to the stark inequality of the current system, the net winners from a more equitable system are quite likely to be a majority—certainly compared to a business-as-usual scenario, which will lead to deeper fiscal deficits and either unilateral subsidy reductions without compensation or further deteriorations in public services.
- 66 Recent World Bank research into MENA social security systems adds to our confidence in the feasibility of a cash grant system: respondents in Egypt, Jordan, Lebanon, and Tunisia all reported—in 2012—a strong preference for cash support over in-kind social benefits, and for unconditional over conditional support schemes (Levin, Silva, and Morgandi, 2012, 35f.). Low confidence in public institutions in the Arab world arguably

makes citizens warier of targeted, more complex programmes, hence putting a premium on simple, inclusive distribution policies. Finally, the IMF reports that energy pricing reforms involving compensatory measures have been successful in 100 per cent of cases, while only 17 per cent of subsidy reforms without compensatory transfers succeeded (Sdrlevich et al., 2014, 42).

4.8. Political Economy Implications

- 67 The abovementioned distributional reforms could go a long way towards increasing social security, making private employment more attractive, and weaning private industry off costly state support. The existing system of distribution is regressive (in terms of energy subsidies) and has created a rigid and unfair insider–outsider system (in terms of access to public employment). Replacing this regime with a cash grant system would provide a foundation for a new social contract based on shared access to universal channels of government support and to an integrated, more dynamic labour market.
- 68 To the extent that cash grants would boost formal private employment, the new system could also improve trust and organic linkages between citizen and business—elements that have been tenuous under the old regime. In the long run, this could contribute to the emergence of a real bourgeoisie that enjoys substantial autonomy from the state, pulls its weight in the national economy, and enjoys social legitimacy.
- 69 Distributional reform would only be one major step towards a new social contract and should be accompanied by further reforms of labour markets—for example, making formal private employment rules more flexible to reduce the size of the informal sector—and, in the medium term, by the introduction of more advanced social safety mechanisms. Labour market liberalisation itself would, however, be easier to justify politically if accompanied by a basic income guarantee, an ingredient of compensation that was lacking in many past reform efforts. The first order challenge is hence to re-engineer the distortionary and unfair distributional regime of the old Arab order, and to do so soon.

5. Conclusion

- 70 This contribution has provided an overview of the distributional regime on which the political economy of much of the Arab world has been based since the age of Arab nationalism. Even if in most countries this system ‘peaked’ decades ago, the legacies of subsidisation, public sector over-employment, and labour market segmentation remain strong and are likely to characterise Arab political economies for many years to come—if only in circumscribing the reform options available to Arab governments. Understanding them is hence a prerequisite for any meaningful debate on the subject of reform.
- 71 In its second half, this contribution has developed a proposal for comprehensive distributional reform: converting existing mechanisms of uneven patronage into a universal system of unconditional cash grants. The discussion has been very preliminary and there is need for much further thinking and research, including on implementation strategies, the precise mechanism for setting the amount of grants, whether and how underage dependents should be accommodated in the system, the

way in which savings from public sector reform can be accounted for in this process, and how universal cash grants can be combined with or converted into a differentiated modern social security system etc.

- 72 If nothing else, I hope that the contribution will help to generate a broader debate about comprehensive reform of distributional systems in the Arab world, the various parts of which are interlocked yet seldom discussed together. Any wider-ranging solution will have to take into account political feasibility and the need for immediate compensation.
- 73 The old social pact is decaying. The region needs to move fast to replace it with a more sustainable system before existing distributional structures are whittled away entirely and governments lose their room to manoeuvre in creating anything new. Maldistribution creates social inequality and distorts economies, but it also provides an opportunity for reallocating resources in a fairer, less distortionary way. This opportunity will not last forever.

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NOTES

1. The peripheral cases—Djibouti, Mauritania and Sudan—are not included systematically as their distributional regimes and histories of state-building differ from those of more central Arab countries. Similarly, Lebanon, although located in the middle of the Arab world, is included mostly as a contrast case that has not seen the ambitious state-building of other core Arab regimes.
2. In Egypt, the relatively low numbers might also be explained by the lack of accounting for employment costs in state-owned enterprises and potentially in the large military sector. In GCC countries, the low shares in GDP are an artefact of the large share of the oil sector in GDP (where few are employed); their share in non-oil GDP is much higher.
3. Another piece of evidence comes from the 2010-14 wave of the World Values Survey, which included 12 Arab countries, and which asked respondents both about their income and their employment status. While government employment appears to be on average better paid all over the world, WVS data shows that the average gap in the Arab world is twice as large as elsewhere.
4. 'The average nonsubsidy SSN program in the region distributes only 23 percent of its total benefits to the bottom quintile, while the corresponding figure for the average comparator programs in Latin America and the Caribbean and in Eastern Europe and Central Asia is 59 percent.' (Levin, Silva, and Morgandi, 2012, xxiv).
5. For a global policy initiative on basic incomes, see the Basic Income Earth Network website: <http://www.basicincome.org/about-bien/>.
6. Public sector salary schemes could be adjusted to make sure that the lower earners in the government sector would not be disadvantaged vis-à-vis private employees.
7. Not strictly analogous, as wage subsidies are only paid when an individual is in paid employment.
8. Targeted subsidies for low-wage workers (like the Earned Income Tax Credit in the US) would have similar, if weaker, disincentive effects relative to the citizen's income, reducing work effort and incentives to upgrade one's skills.

ABSTRACTS

The majority of Arab political economies are characterised by a peculiar distributional system built on excess public employment and wide-ranging energy subsidies—features that exist in other developing countries but are more pronounced in the Arab world. This chapter provides an overview of this distribution regime, develops hypotheses regarding its historical origin, and analyses the political and economic distortions it creates. It builds on a wide range of literature on energy subsidies and on recent publications on (the weakness of) conventional social safety regimes. In its comparative analysis of public employment, it mostly relies on primary data. The chapter proposes that the current distribution regime not only benefits insiders and creates multiple segmentation of labour markets, it also weakens links between business and citizens. There follows a discussion of the outlines of an alternative social contract based on less distortionary welfare systems, notably direct cash grants for citizens. In this, the text again draws on a well-developed literature on energy subsidy reform and on potential strategies for compensating for energy price increases. The chapter's main contribution to the literature lies in its analysis of public employment reform and its labour market implications and of the wider

political economy implications of distributional reform. It spells out the potential impact of a more inclusive and less distortionary distribution and welfare regime on social stratification and on relations between state, business and citizens.

L'économie politique de la distribution au Moyen-Orient : un nouveau contrat social est-il possible ?

La majorité des économies politiques arabes se caractérisent par un système de distribution particulier fondé sur un emploi public surnuméraire et un large éventail de subventions en matière d'énergie – des caractéristiques qui existent dans d'autres pays en développement, mais qui sont plus prononcées au sein du monde arabe. Cet article présente un aperçu de ce régime de distribution, il propose des hypothèses quant à son origine historique, et analyse les distorsions de marché que cela engendre. Le texte s'appuie sur une littérature abondante sur les subventions en matière d'énergie et sur des publications récentes à propos de (la faiblesse) des régimes de protection sociale conventionnels. Fondée essentiellement sur des données primaires, cette recherche montre comment le système de redistribution actuel profite non seulement aux « insiders » tout en créant une segmentation multiple des marchés du travail, et affaiblit par ailleurs les liens entre les entreprises et les citoyens. L'article discute ensuite les grandes lignes d'un contrat social alternatif fondé sur des systèmes de protection sociale moins inéquitables, notamment des subventions directes en espèces versées aux citoyens. L'article s'appuie également sur une littérature importante sur la réforme des subventions en matière d'énergie et sur les stratégies potentielles de compensation d'une hausse des prix de l'énergie. La principale contribution de cet article est son analyse de la réforme de l'emploi public et de ses conséquences en matière de marché du travail, et les implications plus larges de la réforme de la répartition sur l'économie politique. Enfin, il expose les incidences potentielles d'un régime de distribution et de protection sociale plus inclusif et moins discriminatoire sur la stratification sociale et sur les relations entre l'État, les entreprises et les citoyens.

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