1 Introduction: Arab Capitalism

Among Middle East experts, it is a frequently espoused view – if not received wisdom – that pro-market reforms are the root cause of the social discontent that has driven unrest across the Arab world since 2010 (Achcar 2013; Bogaert 2013; Joya 2017; Kaboub 2013). According to this reading, neoliberal policies have exposed increasing numbers of Arab citizens to the inequality and poverty resulting from unfettered capitalism. This narrative sits uneasily with a number of facts: Most Arab countries continue to employ more citizens in their state apparatus than other countries of comparable income; subsidy systems, while shrinking, have continued to be unusually expansive; and Arab governments continue to intervene deeply in private markets through licensing systems, nontariff trade barriers (NTTBs), and allocation of land and credit. By standard measures, all other major regions of the Global South remain more "neoliberal" than the Arab world.

This Element proposes an alternative explanation for both the socioeconomic frustrations of Arab citizens and, critically, the broader economic development failures of the core Arab world: the problem is not exposure to capitalism per se but the *very uneven* exposure of Arab citizens and firms to markets, rooted in their uneven access to the state's resources and protection. The past decades have seen marketization for some parts of the population – especially younger labor market entrants and small firms consigned to the growing informal economy – yet continued protection and insider privileges for others, be they state employees or larger firms with deep connections to the state apparatus. I argue that deep divisions between insiders and outsiders are the defining dynamic of the political economies of core Arab countries, especially the Arab republics with a deeper legacy of state-directed development. I do not deny that private markets have become more important over time or that the region's old, more inclusive "social contract" has eroded, as has been pointed out by a wide range of authors (Achcar 2013; Bogaert 2013; Devarajan and Ianchovichina 2018; Heydemann 2007; Kaboub 2013; Kandil 2012). Yet this erosion has been happening very unevenly, leading to forms of social exclusion and patterns of economic stagnation that a simple marketization story cannot explain.

As a result, different segments of both labor and capital exist in very different spheres: on the labor market there are millions badly paid but still fundamentally secure lower middle-class bureaucrats. They are emblematic figures in Arab public imagination, immortalized in the 1992 Egyptian black comedy "Terror and Kebab," in which the protagonist, played by Adel Imam, accidentally takes the Mugamma bureaucratic complex at Tahrir Square hostage when his frustration with idle and unresponsive government workers leads to a scuffle and mass panic. While often frustrated, Arab state employees remain shielded from the market, enjoy formal social security, and are extremely secure in their tenure. They are insiders.

While Arab bureaucrats are numerous, there are even more workers in the region's informal sector – the most famous of them Mohamed Bouazizi, the unlicensed Tunisian fruit vendor who set himself on fire on December 17, 2010, after repeated harassment by local police forces (themselves state-employed insiders by this Element's account). Far from secure, informal workers in the Arab world fight a daily battle for economic survival and enjoy even less social safety provision than their peers in other parts of the Global South. They operate in a raw, unregulated private market, and their frustrations were a key driver of the revolutionary fervor unfolding in Tunisia after Bouazizi's dramatic act of protest. They are quintessential outsiders and their outsider status tends to be unusually long-lasting.

A similar story of insiders and outsiders can be told about firms: on the one hand, state elites and institutions protect large firms led by cronies like Egyptian steel magnate Ahmed Ezz or Syrian telecoms, retail and real estate baron Rami Makhlouf. Shielded from competition through mechanisms like discretionary regulation, subsidies, and access to credit, insider firms enjoy unusually deep protection from the market. On the other hand, the vast majority of businesses in the Arab world are small, informal enterprises – grocery stores, repair shops, small-scale construction companies – which are struggling to survive on the unregulated market, let alone grow, as state institutions are at best indifferent and at worst openly hostile to them. As I will argue, the forces keeping outsider firms small and precarious are unusually strong in the Arab world.

While belonging to the same social classes from a macro perspective, insiders and outsiders in the labor market and among capitalists in reality represent very different constituencies, with fundamentally different relationships to the state and often opposed interests. Insider–outsider divides account for key sources of socioeconomic frustration among Arab citizens such as declining social mobility and elite-level cronyism, important drivers of recurrent unrest since 2010.

The deep segmentation of insiders and outsiders is consistent with the low growth and dynamism of Arab economies more broadly. The weak performance of Arab economies over the past decades is hard to overstate and difficult to explain just with excessive pro-market reforms: the region boasts the world's highest unemployment rates, the lowest share of hi-tech goods in manufactured exports, the lowest firm entry rates, and the smallest growth in labor productivity (Arezki et al. 2019; Arezki et al. 2021; Benhassine 2009; European Bank for Reconstruction and Development 2013; Gatti et al. 2013).

Most Arab countries have comparatively institutionalized state apparatuses, have made great strides in providing basic public goods in health and education, and lie in close proximity to European markets – yet seem unable to make effective use of these assets. While my main aim is not to explain the region's growth record, the deep structural divisions of labor and capital documented in this Element are bound to hamper economic development. State-sanctioned segmentation of insiders and outsider in labor markets and private business undermines the dynamism of Arab economies, leads to misallocation of resources, weakens incentives for firms to improve productivity and provide training, and reduces workers' incentives to seek skills. The Arab world's core development problem arguably is persistent dualism rather than unrestrained capitalism.

My argument cuts across several spheres of the economy, and I propose that weaknesses in different spheres reinforce each other. I therefore frame my account in terms of the wider "Varieties of Capitalism" debate, which focuses on capturing such system-wide institutional linkages and complementarities.

I specifically argue that core Arab economies outside of the oil-rich Gulf are regulated by stretched, overcommitted, and interventionist states. Uneven regulation and unbalanced distribution of scarce resources by this state creates deep insider–outsider divides in private sectors and labor markets. These divisions themselves reinforce lopsided state intervention through economic and political feedback loops: insider interests are relatively better organized and recognized by political elites, while the politics of outsiders is typically limited to sporadic outbursts of protest. An equilibrium of low skills and low productivity results from and reinforces these static insider–outsider divides: protected insiders feel little competitive pressures to improve skills or productivity; similarly, as outsiders are unable to effectively compete with insiders, their ability and incentives to invest in skills and productivity are also limited.

The region's social divisions, and the resulting divergence of interests, undermine cooperation and trust between state, business, and labor, hence impeding the negotiation of encompassing reforms or skill system upgrades that could overcome economic dualism. Exclusion of outsiders and low productivity of insiders quite likely contribute to weak diversification and growth outcomes in the region.

Some fundamental parts of this story apply to economies in the Global South in general, notably low government capacity and a segmentation of business and labor into formal and informal markets. Others, however, are regionally specific, including the relative importance and historical ambition of the state in the economy and, closely related, the unusual rigidity of insider–outsider divisions. Insiders and outsiders exist everywhere, but the dividing lines are particularly stark, immovable, and consequential in the Arab world, hence the term "segmented market economies" to describe our cases (henceforth SEME).[1]

The formerly "populist" Arab republics Algeria, Egypt, and (pre-civil war) Syria with their deep and ambitious histories of state intervention are closest to this ideal type. Economically somewhat more liberal systems like early republican reformer Tunisia and pro-capitalist monarchies Jordan and Morocco are less perfect fits, as is Yemen, which has been too poor historically to develop the same level of state intervention as its republican peers. Yet in international comparison, even the latter cases stand out more often than not on the interlinked features discussed in this Element.

The ambition of this Element, like in much of the Varieties of Capitalism (VoC) literature, is both conceptual and explanatory: it first aims to identify the main features of capitalism in key Arab cases to then illustrate how they are causally interlinked through mutually reinforcing mechanisms of insider–outsider segmentation. It proposes that these features of Arab capitalism account for the generally low economic dynamism that the region has seen in terms of job creation, firm creation, and skills formation, and that insider–outsider divides have also shaped socioeconomic frustration, political mobilization, and protest over recent decades. Theoretically, the Element extends the political economy of insider–outsider labor markets – much analyzed in the European context – to the developing world, where this socially corrosive phenomenon thus far has mostly been investigated through a purely economic lens.

After an explanation of its case selection and method, the Element outlines the segmented market economies concept in more conceptual detail, followed by an overview of the historical roots of etatism in the Arab world. The subsequent sections investigate the state, labor, firms, and the market for skills. I then discuss whether the harsh economic adjustments that Egypt has undergone since 2016 presage the trajectory of the wider region and discuss a number of theoretical puzzles and gaps in general comparative political economy that emerge from this Element's arguments.

1.1 Case Selection and Method

This Element deals with seven Arab countries that can be considered "core" members of the region: Algeria, Egypt, Jordan, Morocco, pre-2011 Syria, Tunisia, and pre-2015 Yemen.[2] These have been part of a shared regional

[1] I choose SEME to distinguish the concept from Schmidt's "state-influenced market economies" or SMEs, advanced capitalist countries with an interventionist state (Schmidt 2009).

[2] Data on Syria in this Element are from 2010 or just before; data on Yemen are from 2015 or earlier.

space of political competition and ideological diffusion in the post–World War II era in a way that more peripheral members of the Arab League like Djibouti, Mauritania, and Sudan have not been (Choueiri 2000; Kerr 1965; Mufti 1996).

I exclude high-rent countries – the Gulf Cooperation Council (GCC) monarchies and Libya – where hydrocarbons income has created substantially different economic structures.[3] I also do not systematically discuss countries whose economies have been shaped by major, long-term conflicts before the 2010s, like Iraq and Lebanon.[4]

One might criticize the Element for cherry-picking cases. Investigating a limited number of cases that approach a particular ideal type is, however, standard practice in the VoC literature and is difficult to avoid given the relative complexity and limited range of the theories it proposes. Our omission of more peripheral Arab cases is also in line with definitions of the region among international institutions.[5]

Perhaps more important, the case selection in this Element is theoretically motivated by a particular set of historical circumstances that determine the applicability of its model: it only includes countries that engaged in an ambitious state-building project that was directly or indirectly affected by the nationalist and statist ideological competition dominating the region from the 1950s to the 1970s. Aggregate comparative data on the rest of the Middle East and North Africa (MENA) region as well as other world regions as "control groups" are contained in the online appendix (O6).

As we will see, even among our core cases, some fit the model considerably better than others – and it is the ones that pursued the nationalist state-building project the most ardently that show the best fit. Morocco, the most peripheral of my "core" cases in this Element that was least affected by the nationalist and statist wave of the post–World War II era, has the worst fit.

1.2 Existing Literature on MENA Political Economy

Existing literature on the political economy of the Arab region captures some of its development issues, but also fails to describe and explain key features that make the region distinct.

[3] The GCC countries have notably been able to absorb a majority of the national workforce in the public sector and rely on a migrant workforce for most private sector jobs. There is little informal employment of citizens, while there is considerable informal employment of foreigners, including in informal foreign-run businesses. Labor markets and private sectors are therefore also segmented, but in very different ways (Hertog 2014; 2021).

[4] Although excluded, pre-2011 Libya and pre-1979 authoritarian-populist Iraq share many of the features of our model.

[5] https://data.worldbank.org/region/middle-east-and-north-africa; www.unescwa.org/about-escwa.

Most prominently, critiques of "neoliberal" economic adjustment across the region rightly point to growing inequality, state withdrawal, and corruption from (imperfect) marketization and privatization as key features of regional economic development since the 1970s (Achcar 2013; King 2009; Mitchell 1999). Yet in international comparison, the Arab world remains the least neoliberal region apart from a small number of socialist holdover countries. State intervention and protection for select sectors and actors remain pervasive, if substantially less so than during the nationalist phase of the 1960s. Recent literature on crony capitalism in the region has shown in great detail that the elite-level insider cartels that have emerged from partial marketization since the 1970s remain rooted in state intervention in licensing, trade protection, and allocation of credit and subsidies. Literature in labor market economics (and original research in this Element) shows that Arab labor markets are not generally market-driven but instead are deeply divided between protected insiders and precarious outsiders – and the precariousness and lack of social safety mechanisms for these outsiders are explained not least with the fact that large-scale resources are devoted to insider privileges in the shape of state employment, regressive subsidy schemes, and contribution-based, state-supported social security. In Arab economies, some face brutal exposure to (often informal) markets but others benefit from unusually deep protection from the market. More generally, as Adly (2020, 9) has pointed out, Arab development failures are as much a problem of distribution as they are a problem of weak production, which the neoliberal narrative has little to say about. This Element focuses on the many ways in which insider–outsider divides undermine the productive capacity of Arab economies.

The focus of other authors on the (neo-)patrimonial nature of Arab capitalism usefully highlights the informal nature of elite-level insider coalitions (Heydemann 2004; King 2009; Schlumberger 2008). I propose, however, that formal rules and institutions can matter at least as much in organizing economic exclusion in the region. Moreover, insider–outsider dynamics also play out on the lower rungs of the labor market, which contains a large and theoretically neglected insider group of formal state employees. This group can be both fiscally and politically as consequential as elite coalitions.

Literature on the decline of corporatist institutions and the broken promises of social progress among Arab regimes rightly points to the erosion of old social contracts (Ehteshami and Murphy 1996; Guazzone and Pioppi 2009; King 2009). Past social guarantees – perhaps most prominently that of state employment for all university graduates – have indeed eroded, the Arab middle classes are falling behind, and social mobility has been declining across the region (Assaad et al. 2021). This literature does, however, not tell us much about the important areas in which insider privileges continue to be upheld, which extend beyond capitalist elites to a well-protected, rather large minority of formal employees – and which often contribute to the declining social mobility of new labor market entrants and their resulting political frustration.

More broadly, existing literature does not engage systematically with linkages between different spheres of the economy like the private sector, the labor market, and the (seldom discussed) skills system. Most authors also focus primarily on within-region differences rather than situating the region in global comparative context (Ayubi 1995; Cammett et al. 2015; Henry and Springborg 2010). In both these regards, a VoC approach holds particular promise. It can help bring the Arab world region back into comparative perspective and make it a source of broader comparative political economy theorizing, which it has largely ceased to be since the 1980s.

1.3 "Varieties of Capitalism" Approaches and the Arab World

The basic premise of VoC is that capitalism is not uniform. Instead, firms and workers in different advanced economies use different formal and informal ways of coordinating economic transactions. The core spheres of coordination in the original, firm-centered VoC formulation by Hall and Soskice are corporate governance and finance, intercompany networks, industrial relations, and skills systems (Hall and Soskice 2001).

Most variants of VoC assume that different features of a given type of capitalism are complementary and reinforce each other through mutually "increasing returns": patterns of exchange in one sphere increase the payoffs to complementary behavior in related spheres. In European "coordinated market economies," for example, cooperative industrial relations between employers and workers result in high job security, which allows education systems to focus on the acquisition of specialized skills – which conversely empower workers in industrial relations negotiations. The longer-term focus of this equilibrium in turn allows banks to provide firms with long-term, "patient" capital, which itself helps firms to focus on long-, rather than short-term profitability – a focus that is more compatible with employment stability and worker interests (Hall and Soskice 2001). Such complementarities keep a system in an equilibrium that privileges certain types of exchange such as short-term, market-based interactions in the case of Anglo-American liberal market economies or long-term, nonmarket based exchanges in the case of coordinated market economies like Germany.

While the original VoC formulation has been much criticized, it has spawned an ongoing search for different types of capitalism not only among advanced countries but also in less developed areas (Feldmann 2019; Nölke et al. 2015; Nölke and Vliegenthart 2009; Schneider 2013; Walter and Zhang 2012).

Although based on a study of Latin American cases, Schneider's account of "hierarchical market economies" (HMEs) comes closest to a full-fledged model of complementary institutions that could apply to developing countries in general. HMEs are characterized by the dominance of diversified, technologically unsophisticated private conglomerates, a strong presence of transnational companies, atomized labor relations and low skills. He argues that these factors and the interactions between them are characterized by nonmarket, *hierarchical* relationships that undermine horizontal coordination, and that there are "negative complementarities" between them, resulting in a low-skills equilibrium that prevents Latin America from catching up with advanced countries. The groups that have best adjusted to the demands and opportunities of this system tend to be the best politically organized, leading to "political complementarities" that make reform of the system's interlocking components even more difficult.

At least descriptively, Schneider's model fits the Arab world quite well. In the core Arab cases, large firms tend to be similarly diversified and are, if anything, less technologically sophisticated; skills are even less developed; the workforce is even less organized; and levels of cooperation and coordination among firms and between firms and labor are even lower, as formal and informal relationships between market participants remain largely hierarchical (Adly 2020). It is also quite plausible that all these features reinforce each other in a detrimental way. The region differs only with regard to transnational capital, the presence of which in the Arab world is considerably smaller. It remains, by contemporary standards, relatively isolated, with fairly small, often domestically owned manufacturing sectors.

That said, there are critical, mutually reinforcing features that distinguish Arab capitalism which the HME model does not capture. The full set of these is outlined in Figure 1 and empirically illustrated in subsequent sections of the Element. First, a key player structuring Arab capitalism is the state, an actor that Schneider discusses only in passing. The state was not included in the original formulation of VoC, but has been increasingly integrated in more recent contributions (Hancké et al. 2007; Nölke et al. 2015; Schmidt 2009; Schneider 2013; Walter and Zhang 2012). Its deep role as employer, subsidizer, and interventionist regulator in the Arab world is central to the model, adding another level of hierarchy.

Deep intervention by the state is a key cause for the segmentation of both businesses and workers into insiders, who enjoy state support and protection, and outsiders, who do not. Much of Arab business remains dependent on support and protection from the state and vulnerable to state intervention,

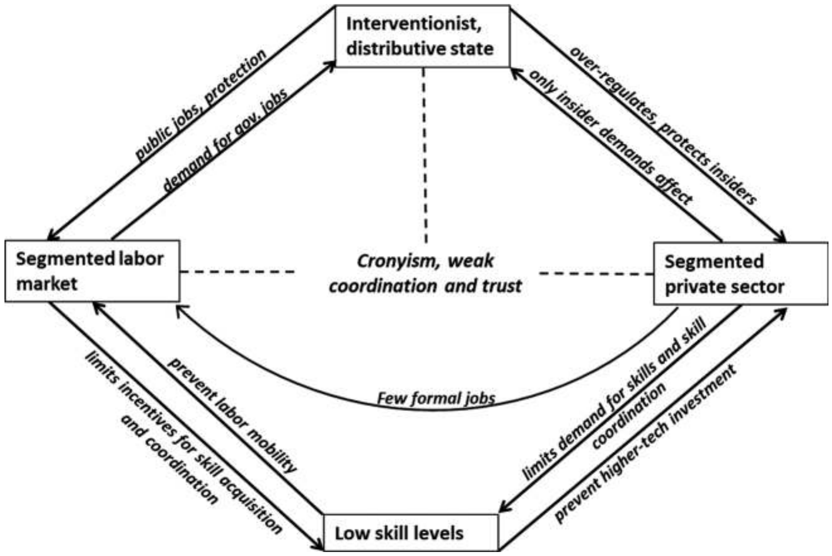

Figure 1 Segmented market economies

even more so than in other regions. The ability to tap state resources and navigate heavy Arab bureaucracies is very unevenly distributed, however. At the top, privileged links to state elites and bureaucracy create a small group of firms with better access to regulation, credit and subsidies, and, as a result, unusually high profits. Most other businesses, particularly smaller firms, remain outsiders whose property rights are uncertain and whose interests are not represented in the policy-making process (Benhassine 2009; Heydemann 2004). These divisions have come to be much better understood in recent years thanks to qualitative case studies and econometric evidence on crony capitalism in the Arab world.

On labor markets, the state also retains a stronger role both as regulator and, crucially, as direct employer. Fairly heavy labor regulations and weak job generation by formal private businesses create a large informal sector, not unlike in other developing countries. But different from most other cases, including in Schneider's Latin America, insiders on the labor market for the most part are formal *public* employees rather than private ones, as formal employment in the weak private sector remains tiny (Gatti et al. 2013). Employment-related ("Bismarckian") social security benefits are unusually generous in the Arab world, yet as they are based on formal work contracts, they increase divisions with outsiders who are excluded from them (Levin et al. 2012). Noncontributory social assistance that would benefit outsiders, while expanding in recent years, remains weak across the region. The divided labor market caters to a relatively large insider group and saps state resources that are diverted from more inclusive and growth-oriented policies.

Segmentation in the Arab world is particularly rigid and hard to overcome in both business and labor market. There is less mobility between segments and barriers to entry are higher – both, again, the result of particularly deep formal and informal state intervention that creates especially pronounced and stable privileges for insiders (Benhassine 2009; Schiffbauer et al. 2015). Despite all "neoliberal" downsizing, Arab capitalism provides more widespread distribution of state resources than in many other developing countries, benefiting a relatively broad middle class. Yet the system remains deeply exclusive for those outside of this coalition.

Rigid insider groups in business and labor market in turn create vested political interests that make economic reforms to reduce segmentation difficult. As we will see, insiders in the Arab world have more to lose than elsewhere, and their insider position is more stable over time, giving particularly strong opportunities and incentives for "opportunity hoarding" (Tilly 1998). As a result, insiders often resist reforms actively, both in authoritarian and democratic systems. Outsiders, for their part, usually demand expansion of insider benefits to them rather than wholesale reform, the benefits of which are less certain and potentially lie only in the distant future. The weakness of the private job market further boosts outsiders' political demands for government jobs (Assaad and Barsoum 2019).

Where and when it exists, interest group politics is centered around better-organized insider interests, not unlike industrial relations in dualistic European labor markets. Encompassing interests that could push for inclusive reforms have weak incentives and opportunities to organize given the complexity of such reforms, their diffuse payoffs, and, in contrast, the immediate threat they can pose to insiders. Political elites are incentivized to privilege insider protection or the occasional expansion of insider privilege to politically salient outsider groups over other policies. This has been most visible in Tunisia, where the region's most powerful union, the Union Générale Tunisienne du Travail (UGTT), mostly represents the large minority of formally employed nationals, leading to periodic tensions with weaker and more dispersed networks trying to rally the majority of unemployed and informally employed.

Like other developing regions, the Arab world is trapped in a low-skills equilibrium in which companies do not invest in technology because the required skills are not available, while students or workers do not invest in skills because they are not in demand (Booth and Snower 1996; World Bank 2008b).