BUSINESS,

Kilim shop in Mahdia, Tunisia.

Private enterprise, driven by a nascent middle class, is the key to successful democratic transition in the Middle East

Vali Nasr

IT is no accident that the Arab Spring commenced in Tunisia instead of, say, Syria or Yemen.

It started there because of the promise of prosperity and growth. It started there because of the country's large, literate middle class. It started there because of that middle class's relatively liberal political outlook and thirst for the political freedoms that accompany economic prosperity.

In an environment of political stability and open economic activity, private enterprises flourish and economies grow, supporting the emergence of a middle class. It is that middle class, in turn, that pushes for further political change and bolsters democracy.

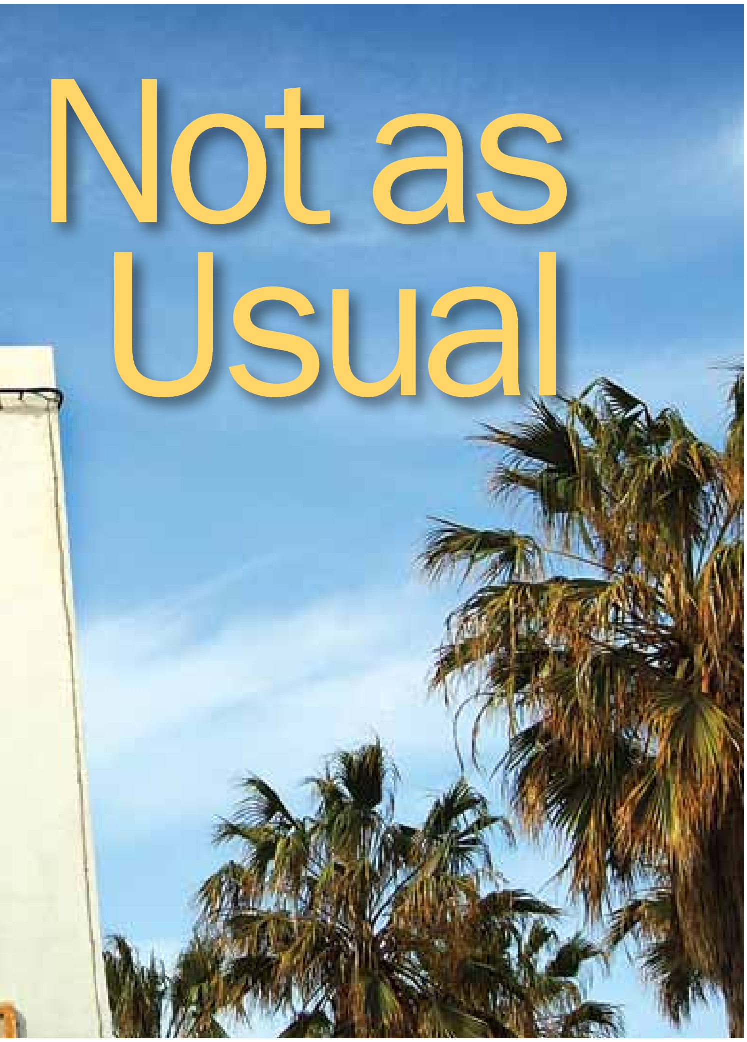
If the Middle East is to realize the democratic promise of the Arab Spring—and if the rest of the world is to enjoy the global benefits it would garner—countries in the region and abroad must foster private enterprise and the emergence of a strong and vocal middle class.

Fertile ground

When protests erupted across Tunisia in January 2011, the economy was open and vibrant. The population was educated and technologically adept—20 percent of the population used Facebook to communicate with family and friends at home and abroad.

During the decade leading up to the Arab Spring, Tunisia was enviously referred to as the "China of the Arab world." Although it was authoritarian and beset with corruption, it was also integrated into the global economy through manufacturing exports and tourism and was growing at a rate comparable to those

Not as Usual



of large emerging economies. This growth produced the middle class that ultimately pushed for political change.

For more than a generation, most of the Arab world has suffered from economic stagnation. State control of economies has produced bloated red-ink-generating public sectors that have crushed innovation and entrepreneurship while shielding inefficiencies behind government protection and high tariff barriers.

As a result, the Arab world has fallen behind other developing regions. It suffers from a sclerosis that has deepened poverty and frustration. And this is only aggravated by the demographic "youth bulge" in the region.

If this picture does not change—if the Arab world fails to follow in the footsteps of successful transition economies in eastern Europe, Latin America, and southeast Asia—the region will not only fail at democracy, but will also grow poorer and more unstable. And that will lead to myriad social and political problems that could threaten global security and economic prosperity around the world.

The most obvious risk is the familiar specter of extremism and terrorism, but fratricidal regional conflict, humanitarian crises, and large-scale labor migration to Europe are also worrisome threats.

Private sector–led growth

The Arab population today numbers 400 million, which will double to 800 million by 2050. Population growth makes aggressive economic growth an urgent imperative. Even to tread water and maintain current living standards, the Arab economies would need to grow at "tiger-economy" rates of 9 to 10 percent for a decade or more. That is a daunting task, one the public sector cannot accomplish alone. Growth must come from the private sector, and that requires reform of the economy: removing regulations, relaxing government control, promoting trade, and bolstering the rule of law.

The region clearly has the potential for private sector growth. In the past decade, the opening up of economies—most prominently in Tunisia, Egypt, and the United Arab Emirates, as well as in Jordan and Morocco—and the influx of new technologies and capital born of high oil prices nurtured the growth of small and medium-sized enterprises. These new enterprises both embraced traditional manufacturing and services and created new industries such as technology start-up ventures. Witness the purchase by Yahoo! of the Jordanian Internet start-up Maktoob for more than $120 million in August 2009.

Thanks to some of this small and medium-sized enterprise activity, we can look past today's gloomy picture and imagine real economic change in the region. Economic reform in Dubai, Malaysia, and Turkey and even the modest loosening of government control in places such as Egypt, Pakistan, and the West Bank have made room—if rarely enough—for local commerce and global trade. Local entrepreneurs and businesspeople have begun to take advantage of these changes.

A growing middle

The result of the escalation in private sector activity has been the birth of a small but growing middle class. In the 1960s, on average less than a third of the populations of large Muslim countries such as Iran, Pakistan, and Turkey lived in cities, and by most estimates, only about 5 percent were middle class. Today, about two-thirds of these countries' populations live in urban areas, with about 10 percent qualifying as middle class.

If the middle class is defined more broadly to include people with formal employment and a steady salary and benefits who can afford to devote a third of their income to discretionary spending, it now includes about 15 percent of Pakistan's population and 30 percent of Turkey's. The numbers are even higher if the definition is extended to include those who have adopted modern family values, such as the desire to have fewer children and to invest in their advancement. One estimate puts as many as 60 percent of Iranians in—or ready to enter—that group.

Signs of this emerging middle class and the capitalist surge it has been driving are found throughout the Middle

East, even in revolution-struck Cairo, war-weary Beirut, and sanctions-worn Tehran. While the overall picture in the Middle East looks grim, signs of promising economic activity in pockets across the region started to emerge in the past decade. That activity did not change the overall economic picture but produced a certain momentum and pointed to the possibility of change. Between 2002 and 2008, real GDP in the Middle East and North Africa grew by 3.7 percent, up from 3 percent in the previous decade.

Middle-class entrepreneurs represent the best hope for betterment of their countries—and the most potent weapon against extremism and for democracy. Until now the Arab world's tiny middle class has relied on state salaries and entitlements, with few ties to free markets. The growth of local entrepreneurship on the back of burgeoning capitalism—and integration with the world economy—could help change that.

These forces are already having an impact. The 2009 Iranian election controversy was a struggle by its rising middle class to protect its economic interests against President Mahmoud Ahmadinejad, who has sought to increase state domination of the economy. And as mentioned, the Arab Spring began as a push by the middle class for political change to match that group's cultural and economic aspirations. Just as Turkey relied on its middle class to transform itself into a successful Muslim democracy fully integrated into the global economy, so too can the Arab world grow with a newly created middle class combined with entrepreneurial zeal.

The promise of the new Arab middle class is compelling: by bringing stability to the Middle East it can boost the global economy too. The Middle East sits at the heart of a larger Muslim world also poised for change. As one and a half billion consumers move up the economic ladder, they will demand the material benefits of liberal capitalism. Some will seek distinctly Islamic goods: not just halal food and head scarves, but also Islamic banking services, education, entertainment, media, and consumer goods.

Boom in Islamic finance

Such consumer demand has already made waves in global markets, as illustrated by the boom in Islamic finance (financial services that abide by Islamic rules forbidding the collection and payment of interest). The growth of such services is integrating the Middle East more closely into the global economy. Although Islamic finance remains a niche market—the Islamic bond market, worth close to $100 billion, represents a mere 0.10 percent of the global bond market, and about 300 Islamic banks and investment firms in more than 75 countries oversee banking services in the hundreds of billions of dollars—some estimate the assets of this sector will grow to as much as $4 trillion by 2015.

Some members of this new middle class are the children of the old bureaucracy, but a far larger percentage come from the provinces and from lower social classes. These sons and daughters of the rural poor have made the jump to the middle class by embracing the regimen of modern economics. Many are devout, but their wealth and aspirations can put them squarely at odds with extremism. After all, with wealth can come conspicuous consumption, liberal social and political values, and a vested interest in engaging the world.

This does not mean there will be no middle-class Muslim terrorists. But much as in Latin America in the 1990s, terrorism will stop resonating with a truly integrated Muslim middle class. Those with a stake in commerce and trade will not subscribe to destructive ideas that endanger their future. The alienation and rage many Muslims now feel toward the West is a product of historical grievances but has been greatly aggravated by their isolation from the global economy. Were that to change, many Muslims would begin looking forward rather than backward. The rise of this "critical middle" is a trend every bit as powerful and important as extremism. And it holds the key to changing the hearts and minds of the Muslim world.

It is too soon to say whether businesspeople in Tunis or Cairo will lead a full-fledged revolution that anchors Arab politics in democracy—a historical transformation akin to the one spearheaded by Protestant burghers in Holland four centuries ago. But history does suggest that a robust embrace of capitalism by entrepreneurs is the way to truly modernize the Middle East.

Western interest

The world has a vested interest in the success of the Arab Spring. If the change does not put the Middle East on the path to prosperity and democracy, increased instability and extremism will wash onto Western shores.

Those who vanquish the Islamic extremism now on the rise across the Arab world will not be enlightened clerics or liberal reformers but entrepreneurs and business leaders. This has obvious implications for Western governments. Values gain currency when they serve the economic and social interests of the people, and when those who hold them gain power, those values shape states' behavior.

The triumph of democracy in Europe followed in the footsteps of capitalist development. Moderate capitalist values have not yet been fully embraced in the Middle East, not because of the fundamental nature of Islam, but because the commercial class leading the process is still too small. Helping that bourgeoisie to grow and dominate its societies is the best way to ensure that democratic values take root.

What can the United States and its allies do? The first solution is to step up trade with the region. The West has committed much in blood and treasure to protecting its interests in the greater Middle East, yet it does very little real business with the region (except with Turkey). Excluding oil and weapons sales, U.S. trade with the whole Arab world amounts to barely a fraction of its trade with Latin America, eastern Europe, or India. The United States now has free-trade deals with Jordan and Morocco, and Europe is considering an economic partnership with the Arab countries of the Mediterranean rim. These are positive steps, but there are still far too few Arab-made goods on Western shelves.

Western governments seem to understand the importance of entrepreneurship, commerce, and open markets to the future of the Arab world, but mechanisms to promote economic change are absent. Bureaucratic rules have prevented financial investments in small and medium-sized enterprises—American dollars have gone only to non-profit-generating ventures—and no concerted effort has pushed governments to embrace reform. Talk of economic change lags behind discussions of politics.

Small and medium-sized businesses remain the region's beacon of hope and the anchor of the international community's economic vision for the region, thanks in part to their

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success over the past decade. But this vision is also based on the belief that there is still ample capital in the region—from local investors who are far more comfortable with political risk than Western investors—that could keep that dynamism alive. There is also hope that the new breed of leaders taking over will be business friendly. Egypt's President Mohamed Morsi fashioned himself "Egypt's Erdogan" (referring to the popular pro-business Turkish prime minister) during the country's recent presidential elections. And it is accepted wisdom that the Muslim Brotherhood's merchant base will encourage the party throughout the Arab world to favor business-led growth.

Stability and reform

There are things that small and medium-sized businesses can do to fulfill their promise—practices that worked in newly democratic countries in Asia and Latin America. But these are contingent on two fundamental factors: political stability and thoroughgoing economic reform.

It is difficult to envisage investors returning to Egypt until the country returns to the rule of law, street agitation ends, and government stability is palpable. But businesses also need assurance that labor strikes will end, that the government will impose and defend labor market rules, and that relations between the government and business will be stable and predictable.

Although there may be plenty of capital in the Arab world, it is less likely to go to businesses in countries where labor strikes disrupt operations, wage hikes cut into profits, and the continuous threat of instability clouds the prospects for business growth. Some political instability is to be expected after the monumental changes that have swept across the region. It will take time for the dust to settle and stability and rule of law return. But some of the political chaos is due to the miserable state of the economy.

Take Egypt. In the first year after President Hosni Mubarak stepped down, Egypt's economy contracted by 0.8 percent (on a calendar basis in 2011), with manufacturing falling by 5.3 percent. Unemployment rose to 12 percent (25 percent for young people). Private domestic investment fell by 10.5 percent, with foreign investment dropping off the table—from \$6.4 billion in 2010 to \$500 million in 2011. The plunge in domestic and foreign investment presented the government with a gaping hole of \$11 billion in its financing in the second half of 2011. International arrivals have decreased about 35 percent—a grave problem for a country whose tourism accounted for 11 percent of GDP. Not surprisingly, the government's budget shortfall ballooned, to \$11 billion (10 percent of GDP, the largest in the Arab world). Combined with capital flight, which continues unabated thanks to persistent political instability, foreign reserves fell sharply, from a high of \$43 billion to \$15 billion. Two out of every five Egyptians live on less than \$2 a day, so the human impact of such jolts has been profound.

No doubt, economic stabilization is needed to address this challenge. That was what Western powers promised at the 2011 meeting of the Group of Eight industrial countries (G8) at Deauville. But stabilization would provide only a short-run gain—not enough to reverse the trends that have dogged the region and precipitated the crisis of governance and economy in the first place.

Clear path ahead

Economic transformation and democratization need private sector growth and business dynamism. Small and medium-sized enterprises have to lead the way with enough growth to turn Arab countries into breakout emerging nations; only then will democracy stand a chance in the region. And that demands structural reforms.

Every recent case of successful democratization has gone hand in hand with economic restructuring. International financial institutions have joined hands with Western governments and private donors to pair thoroughgoing reform with the capital needed to fuel growth.

This partnership reached its apogee in the so-called Washington Consensus. The much-maligned strategy to foster growth and democracy did not always work—or work perfectly—but without it, most democratization efforts would have failed.

The Arab world needs a new Washington Consensus: a clear strategy for implementing reforms and providing needed funds to make them possible. That is the best way to create the right environment and sufficient capital for entrepreneurial growth. ■

Vali Nasr is the Dean of Johns Hopkins University's School of Advanced International Studies and author of the forthcoming book Dispensable Nation: American Foreign Policy in Retreat.

Shyama Kuruvilla and colleagues present findings across 12 country case studies of multisectoral collaboration, showing how diverse sectors intentionally shape new ways of collaborating and learning, using â€œbusiness not as usualâ€ strategies to transform situations and achieve shared goals. The 2030 Agenda for Sustainable Development states that if the â€œinterlinkages and integrated nature of the Sustainable Development Goals (SDGs)â€ are realised, then â€œthe lives of all will be profoundly improved and our world will be transformed for the better.â€