

# FEMISE RESEARCH PROGRAMME

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## *THE EXPORT POTENTIAL OF SMEs IN SOUTHERN MEDITERRANEAN COUNTRIES, a study in the light of the FTA between the SMC and the EU*

*Meine Pieter van Dijk  
Economic Faculty, Erasmus University*

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Meine Pieter van Dijk

Professor of Urban management in emerging economies  
Economic Faculty  
Erasmus University  
POBox 1738 H12-29  
3000 DR Rotterdam  
The Netherlands  
Tel. 31104082429  
Fax 31104089153  
e-mail [mpvandijk@few.eur.nl](mailto:mpvandijk@few.eur.nl)

# **THE EXPORT POTENTIAL OF SMEs IN SOUTHERN MEDITERRANEAN COUNTRIES, a study in the light of the FTA between the SMC and the EU**

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# **THE EXPORT POTENTIAL OF SMEs IN SOUTHERN MEDITERRANEAN COUNTRIES, a study in the light of the FTA between the SMC and the EU**

## **Introduction**

The Barcelona agreement signed between the European Union (EU) and 12 Southern Mediterranean Countries (SMC) envisages the creation of a Free Trade Area (FTA). The agreements will be signed with the individual countries and should be effective before 2010. The Barcelona agreement wants to develop the commercial and political relations between Europe and these Southern Mediterranean countries.

The effects of improved trade relations with Europe for small enterprises in Mediterranean countries are hardly known. The EU has entered an agreement with a number of Southern Mediterranean Countries already to create a Free Trade Area (FTA) by 2010, but 15 EU countries will have to negotiate with 12 SMC.

The Euro-Med Partnership intends to promote economic, trade, political and social contacts with the SMC. The Financial Times (15-12-1997) concluded that the partnership is failing to make progress because the stalled peace negotiations between Israel and the Palestinians. It is hoped that the Third Euro-Mediterranean Conference of Foreign Ministers in Stuttgart (April 15-16, 1999) has given an additional impetus to the Partnership.

The Mediterranean countries are increasingly facing the effects of globalisation and the Uruguay Round (Van Dijk and Sideri, 1996). Enterprises operate in an international context and they have opportunities abroad, but also face competition. As far as the theoretical framework is concerned it can be concluded that a number of themes play a role at each of the different geographical levels distinguished. At different levels the question concerns the role of the government at these levels or more generally: what is the role of different actors? What are the major actors: companies (Porter, 1990), governments (Wade, 1991) or networks (Klapwijk, 1996)?

This research project tries to assess the possible effects of the Barcelona agreement on small and medium enterprises in Southern Mediterranean Countries. The basic question is whether these enterprises can become competitive in a global economy.

In a contribution to the FEMISE publication "Les enjeux du partenariat euro-mediterraneen", the theoretical concepts used in the globalisation debate are reviewed (Van Dijk, 1998). In that article the history of Euro-Mediterranean co-operation is summarised and the new policy of the European Union is discussed. Changes in trade policies, the importance of structural adjustment and the new role for the private sector are discussed separately in more detail. Finally conclusions are drawn concerning the

trends in European development policies and the prospects for future EU-Mediterranean co-operation. This information will not be presented here again.

In chapter 2 of this report the theoretical framework of the study will be presented. Van Dijk (2000) suggests using competitiveness as a measure for performance, which can be used at different geographical levels. For the small and medium enterprises (SMEs) it means that the price, quality and design of their products are more important and that their competitiveness, the competitiveness of the cluster, the city or the region where they are working may have to be developed further.

A positive factor for SMEs in Southern Mediterranean countries is the creation of the single currency in Europe. Chapter 3 explores the consequences of this development for them.

Chapter 4 studies competitiveness at the level of the region. The main factors studied in detail were suggested by Collier and Gunning (1998). They mentioned as the most important characteristics of the environment of firms in Africa: risk, lack of openness, lack of social capital, poor public services and lack of financial depth. A number of other constraints relevant for the Southern Mediterranean countries will also be analysed in this chapter.

In chapter 5 a cluster of enterprises just outside Cairo is studied, using original data collected in 1999 with support of Femise.

Chapter 6 draws the theoretical conclusions of the study, while in chapter 7 practical conclusions are formulated.

## **1 The potential of SMEs in Southern Mediterranean Countries**

South Asia is the largest market for the European Union (EU). North Africa and the Middle East is the second region. in importance for the EU export to developing countries. The major economic issue concerning the Euro-Mediterranean partnership is the extent to which the Mediterranean countries will be able to compete at the world market, on the basis of the opportunities provided by a better access to the European market. They are facing competition from the East Asian countries, but also from the African Caribbean and Pacific (ACP) countries, which usually have easier access to the European market already for some time.

Questions, which should be asked to find out what the effects for small enterprises in the Southern Mediterranean countries will be, are:

1. Which factors determine the competitiveness of the small enterprises in Mediterranean countries and the competitiveness of the cities in which they are located?
2. How can the dynamics of the small enterprises sector be explained?

3. What are the export potential of these small enterprises and which factors currently discourage or constrain export possibilities?
4. What effects can be expected from the introduction of the Euro for SMEs in the Southern Mediterranean?

A research project to answer these questions for at least two cities in two Southern Mediterranean countries has started under the aegis of Euro-Mediterranean Forum of Economic Institutes (FEMISE). In this paper an overview of the issues and some preliminary answers will be presented. Some conclusions will be drawn concerning the possible consequences of the EMU for developing countries.

In this chapter the history of Euro-Mediterranean co-operation is summarised and the new policy of the European Union is discussed. Changes in trade policies, the importance of structural adjustment and the new role for the private sector are discussed separately. Finally conclusions are drawn concerning the trends in European development policies and the prospects for future EU-Mediterranean co-operation.

There are differences between the ACP and the Mediterranean countries. To put the relations between Europe and the Mediterranean countries in their proper perspective we will briefly summarise the characteristics of the Lomé convention and the present discussion on its follow up since the Green paper (European Commission; EC 1996). Interesting experiences with negotiating with the European Union have recently been gained by South Africa and Egypt. We will review those experiences briefly as an example of what other countries may expect in the near future.

Several authors have criticised the Lomé conventions as being selective (only certain countries), in conflict with international trade agreements (there is no reciprocity) and not effective (trade with Europe has not increased significantly). The argument that the ACP countries did not have to adjust their economies because they received support from the European Union is less valid at the moment, since the European Union started financing structural adjustment programmes since the beginning of Lomé IV.

In the framework of the discussion for an eventual Lomé V all kind of proposals are made (EC, 1996, NAR, 1996 and Van Dijk, 1997): to

- Start to differentiate between ACP countries
- Impose reciprocity
- Make trade part of the World Trade Organisation (WTO) instead of the Lomé V convention
- Do away with the illusion of partnership
- Admit that Lomé did not have all the desired effects: trade did not increase and the countries did not grow faster than other developing countries.
- Admit bureaucracy on the European side as well

- Instruments like Stabex (stabilisation of agricultural export revenues) and Sysmin (the same for minerals) are underfunded and benefit a limited number of countries and commodities.
- Do not make it a treaty giving developing countries unconditional rights to the agreed amounts of money, which was implicit in the partnership philosophy of Lomé
- Be clear about economic, environmental and political conditionality
- Stress the importance of themes like poverty eradication, women and the environment
- Add more on private sector development and conditions for investing in each other's economy
- Provide the same benefits to the poorest non ACP countries as to the ACP countries which at present include a number of very wealthy countries, in particular in the Caribbean.

The conclusion must be that the Mediterranean and ACP regions can learn from each other. The ACP had the advantage of negotiating as a group, while the European Union deals with the Mediterranean countries on a case by case basis. However, if the final goal is to reach a FTA by 2010 at a certain moment the negotiations will have to take place with the region as a whole. The European Union will need a waiver for such a FTA from the WTO. It is not clear, however, whether such a waiver will be obtained as easily as it used to be obtained for the Lomé conventions.

## **2 Theoretical framework: different levels of analysis**

### **2.1 Methodology**

In the first part of this chapter the theoretical concepts used in the globalisation debate are reviewed. Subsequently the idea of analysing competitiveness at six different levels will be elaborated. Employment, poverty, industrial development and economic growth can be analysed at different geographical levels, using different empirical material and resulting in different theories and recommendations. The most important levels are the global level, the level of a continent, the level of a country, a region, a cluster, a city or a neighbourhood/industrial estate. The important research questions at the regional and city level, where our research took place, are:

1. Which factors determine why a region or city is attractive to investors?
2. What is the role of a city in a specific region?
3. When can we speak of an industrial district (Van Dijk, 1993)?
4. What is the importance of 'linkages' in and outside the region (Twomey and Tomkins, 1996)?
5. Is there flexible specialisation taking place (Van Dijk, 1995)?

Twomey and Tomkins (1996) rightly stress that "most theories and analyses of regional development intrinsically rely on the concept of linkage as the mechanism via which growth or decline is transferred across product and factor markets.



At the level of the cluster the question is whether they are lagging behind compared with others and if so why?

1. Is clustering of certain enterprises a desirable development?
2. What can be done to give the neighbourhood or industrial estate an impetus?
3. What are the dynamics of the small scale sector over time?

According to Krugman (1995) the competitiveness of companies in the United States is high because of cheap imports thanks to international trade (for example from China). According to Porter (1990) firms compete and we need to go from the macro to the micro-foundations of competitiveness: the enterprise is the agent of growth and dynamism and the state can only provide an enabling environment.

In the 1990s a number of researchers became interested in the dynamics of small enterprises. In the eighties the first small enterprise tracer studies started to appear, allowing statements about the dynamics of small enterprises over time. This new direction was very much influenced by the success of East Asia as analysed in the World Bank East Asian miracle study, which found that small enterprises did make an important contribution. Also many researchers got an opportunity to go back to the place where they collected data years ago, allowing them to make some generalisations over time. This kind of research is rare in the Mediterranean countries, however.

Small enterprises are often still the most important sector for urban employment creation in Mediterranean countries. Its lack of competitiveness, due to high production costs and stifling regulations often hamper the modern industrial sector. Small enterprises do not suffer so much from these constraints and play an important role in creating employment in the urban areas and in the development of an entrepreneurial class. Their innovative capacity is an additional argument to develop the handicraft part of the sector in a specific way.

The research proposal for this study suggested to carry out a survey in selected Mediterranean countries, to assess the potential for export, the present situation and the factors constraining the development of small enterprises in these countries. The study requires a uniform theoretical framework, based on Van Dijk (1995). Local teams would be involved and a seminar would be organised to compare the results and to come to a common publication and common recommendations to the EU and the governments of the countries in the region. The present work has contributed to the launch of four country studies on micro and small enterprises by the Economic Research Forum (ERF; see Van Dijk, 1999).

The project leader has undertaken a number of surveys of small enterprises in Africa and Asia using a questionnaire with a common basic structure (Van Dijk, 1998). This questionnaire has been discussed with potential partners during the FEMISE workshop in Cairo February 1999. It was used again, adapting it for the major research questions at the enterprise level:

1. Which factors determine the competitiveness of the small enterprises in Mediterranean countries and the competitiveness of the cities in which they are located?
2. What is the export potential of these small enterprises and which factors currently discourage or constrain export possibilities?
3. How can the dynamics of the small enterprises sector be explained?

The flexible specialisation concept was used to understand the dynamics of this sector. Van Dijk (1992) defines flexible specialisation as a higher order concept, which points to six important, and often interrelated, characteristics of the dynamic small enterprise sector:

- (1) An innovative mentality on the part of the entrepreneur;
- (2) The technology used by skilled personnel trained on the job, which often has a multi-purpose character
- (3) Interfirm co-operation often in the form of subcontracting
- (4) Clustering of micro and small enterprises (cluster as a geographical grouping)
- (5) Networking of micro and small entrepreneurs (networking defined as the set of relations in which an entrepreneur operates); and
- (6) Specialisation and proven flexibility.

A number of researchers are now trying to understand better the components or the major contributing factors of these concepts. Much emphasis is rightly put on the role of innovation, on the importance of clusters and networks or other forms of interfirm co-operation.

During the February 1999 Cairo ERF workshop it was suggested to undertake similar research in different countries to get a good impression of the micro and small enterprises in the entire Mediterranean region. This concentration on Egypt would be justified, given the ERF study intends to focus on three other countries besides Egypt (Jordan, Lebanon and Morocco) and enterprise studies are available for a number of the major cities in Turkey, although they usually do not focus on the export potential of these enterprises.

The definition of small enterprises depends on the local available definition and the possibility for comparison with existing studies. To assure complementarity with the study undertaken by the Cairo University their definition of informal sector will be used to distinguish this sector from the small enterprise sector with an export potential.

The research design is comparative between countries, with the possibility of comparing this small enterprise study with the informal sector study undertaken by the University of Cairo in different Mediterranean countries. The unit of analysis are the micro and small enterprises in the selected cities. The sample has been stratified to ensure that certain sectors with export potential would be included.

A random sample of some 100 enterprises would be interviewed, but because of problems to obtain permission for this we had to limit ourselves to a smaller number of case studies. The survey is conceived as a one time joint effort, but the analysis will follow an agreed framework based on the theoretical framework and the previous experience with small enterprise surveys.

Complementary information will be collected on small enterprise promotion policies, on schemes providing credit, technology or export facilities. Existing studies will be used to add to the picture. Also a discussion with organisations of small enterprises in the selected city will be organised to obtain their point of view on the present policies and programs and the perspectives for the small enterprise sector to develop and to start exporting.

At the global level we are interested in the factors determining the growth of the global economy and developments in international trade and capital flows. If the world economy grows at 3 percent, this requires an increase of the growth of world trade of 6 percent, but an increase in the flow of capital of roughly twice this percentage (Van Loon and Van Dijk, 1995). In a more and more global economy it is important to know which factors determine the growth of trade and capital flows.

Improved infrastructure, better communication and increased transportation create increased trade, capital and migration flows. Because of the increased liberalisation of the world economy a company can choose a location anywhere in the world. The question is which factors usually determine the choice. The trade and capital flows do follow a spatial pattern, although economic theory has not really incorporated this spatial dimension of doing business (Krugman, 1995). Research issues at this level are:

1. Location decisions at the global level: where should we be present as a global company? (Firm internationalisation is an important issue, whether it concerns the whole firm or some part of it).
2. Logistical issues: how to get something at the right place?
3. Institutional: which international rules apply for investments, trade and services?
4. What linkages are there between world regions?

At the level of a world region the question is what determines the dynamics of such a continent? What is the role of regional trade agreements? How do worldwide agreements such as the Lomé convention or the General System of Preferences (GPS) of the General Agreement on Trade and Tariffs (GATT) affect the continent? Is there such a thing as Fort Europe? Does trade in the region grow more than trade between the bloc and other world regions? What are the advantages of monetary integration? Is the international debt problem a problem of one particular world region?

Research questions at this level are:

1. Location issues at the continental level: in which part of the continent should we have a factory or sales point?
2. Logistical issues: how do we get goods or services in a certain region?

3. Which international rules apply to investment, trade and services and which agreements exist: the North American Free Trade Area (NAFTA), the Asian and Pacific Economic Council (APEC), EU, etc.?
4. How do the capital, goods and services flows move in that region?
5. What is the result of economic integration (Nielsen et al. 1991)?
6. What is the role of the government in the case of regional integration (Wade, 1991 and Jacquemin, ed., 1986)?
7. Can we learn from certain regions (World Bank, 1993)?

What determines the economic development and the development of employment in a certain country? To what extent does the country have a 'competitive advantage' (Porter, 1990)? The national policy is getting less important if a country integrates in a larger regional context, such as the European Union. It limits the country's possibility to formulate its policies independently.

The most important issues at this level are:

1. The choice of location within a country?
2. The importance of clusters of economic activities (Van Dijk and Rabellotti, eds, 1997)?
3. How does the government and the private sector create an 'innovative milieu', 'which balances competition and co-operation' (Castells and Hall, 1994)?
4. Which factors determine 'the competitive advantage of nations'?
5. What is the role of important ports for the national economy (Dasanayaka, 1997 en Van Klink, 1995)?

Which factors determine the economic performance of a region? McLeod (1996) finds that if a "successful national economic management becomes harder, there has been a growing interest in the region as a key site for economic governance". The economic issue at this level is why certain region stay behind in their development, while others grow faster. McLeod (1996) rightly makes the point that "this debate also concerns the institutional re-regulation of 'rust belt' or 'reconversion' regions".

The important research questions at this level are:

1. Which factors determine why a region is attractive to investors?
2. What is the role of a city in a specific region?
3. When can we speak of an industrial district (Van Dijk, 1993)?
4. What is the importance of 'linkages' in and outside the region (Twomey and Tomkins, 1996)?
5. Is there flexible specialisation taking place (Van Dijk, 1995)?

Twomey and Tomkins (1996) rightly stress that "most theories and analyses of regional development intrinsically rely on the concept of linkage as the mechanism via which growth or decline is transferred across product and factor markets.

## **2.2 Researching the informal and micro and small enterprises**

The urban informal sector is often still looked at as an elephant (Mead and Morrisson, 1996), which we may not be able to define precisely, but we know it when we see it. However, urban informal sector research deals with micro and small enterprises outside the official legal framework.<sup>1</sup> By now we can build on 25 years of case studies, sample surveys and research on the topic. What comes out is a change in emphasis. The main issues we are interested in have changed over time, as can be seen in Box 1 (based on Van Dijk, 1997). In that overview the main conclusion is that what counts at the moment is being competitive. In a global economy even the informal sector is confronted with imports of competing products.

Box 1 provides the major issues in the seventies, eighties, and nineties and at the moment in the first three rows under the heading. During these three decades also alternative terms were suggested which are listed in row four to six. Finally, different ideas concerning the kind of policies which would benefit the informal micro and small enterprise sector were developed over time and are summarised in row seven to nine.

The table suggests that competitiveness is the key issue for micro and small enterprises in the informal sector at the moment. A number of new key words characterise our thinking about this sector at present: technological development and innovation, export potential, the importance of business support systems and of local and regional government policies.

In this contribution we propose to explore what it means to take competitiveness as a measure for performance at the national, regional, city, cluster and enterprise level. Secondly, we will indicate what the advantage of this approach are and how research could be undertaken to identify the weight of different factors influencing competitiveness at different levels. Some policy conclusions will be drawn from some research undertaken with this paradigm in the African and Asian region.

<b>Box 1 Issues Seventies</b>	<b>informal Eighties</b>	<b>sector Nineties</b>	<b>research 2000</b>
Definition al issues	Sub-sector studies	Dynamics small enterprises	Competitiveness
Dualism	Specific themes:	Flexible specialisation	Technological capability
Employment potential	- Credit, etc. - women in IS	- innovation - clusters	Business support system
Linkages & constraints	Structural adjustment	- networks - interfirm	Export potential
<b>ALTERNATIVES</b>			
Self-employed	Informality	New competition	Value chain approach
Informal inc. opportunities	Informalization	Private sector development	Exclusion debate
Petite production	Micro-enterprises	Industrial districts	SMEs in transition
<b>POLICIES</b>			
Government should help:	Adjustment policies	Private sector development	Private Business supp.
- Provide credit, etc.	Liberalisation & legalisation	Branch organisations	Regional government
- Provide t.a. technology & training	Deregulate	Use existing organisations	Local Gov.: deregulation, space/infrastr

The discussion about achieving international competitiveness is only starting in the Middle East and North African (MENA) region.<sup>2</sup> Questions asked are: which factors determine the competitiveness at the enterprise level and the dynamics (their rise and decline) of micro and small enterprises? The first advise to an urban manager, wanting to make his/her city more competitive in the global economy would be that there is nothing as practical as a good theory, which would be one about competitiveness in this case (Van Dijk, 2000a).

### **2.3 Competitiveness and informal micro and small enterprises**

Which theory is most relevant for urban and informal sector development? We suggest using a theoretical framework, which can be used to link different levels of analysis in the economy. In the global economy one needs to be competitive. Although the competitiveness measure can be used as well at the national, the regional, city, or cluster as at the enterprise level, competitiveness has a different meaning at these different levels and other factors may contribute to its explanation. Previously the discussion focused on productivity, efficiency and comparative advantage.<sup>3</sup> Productivity is an indicator

of efficiency. Originally the concepts used were labour and capital productivity. More recently the term total factor productivity is used more often (World Bank, 1993).

Comparative advantage is a static indicator, while competitive advantage is dynamic and man-made. Comparative advantage is what you have, while competitive advantage is what you could achieve. The change from comparative to competitive advantage is one from an essential static approach (a certain given level of production factors) to a more dynamic term. The competitive advantage is not inherited but can be acquired through innovation. The source of the competitive advantage is innovation and not just factor endowments. Technological progress becomes important, just like organisational and managerial innovations, which are also considered sources of growth. Competitiveness needs to be stimulated in very different ways at the different levels.<sup>4</sup>

Competitiveness, used to indicate the performance of enterprises, can be defined for clusters of enterprises, cities, regions and even at the level of a world region and at the national level. At the level of the world region (the Middle East or South East Asia) or at the national level competitiveness refers to 'The ability of a part of the world to achieve high rates of economic growth, on the basis of suitable policies, institutions and other economic characteristics' (Van Dijk, 1999c). At the country level we also talk about 'the strategy is to ensure the economy's high growth by improving its competitiveness, expanding its export base and tackling the (remaining) reform agenda' (IMF Survey 27-9-99), or it can be defined at the national level as the ability of a national economy and in particular of its industrial sector to retain its position at the apex of the economic hierarchy of nations.

Porter (1990) suggests abandoning the notion of a competitive nation. The only meaningful concept of competitiveness at the national level is national productivity according to him. His argument is that enterprises go bust, but nations or regions don't have the same bottom line of do we make money, or are we losing money. However, this was exactly the problem in the past. Countries, regions and cities did not look at their performance in such terms. Stagnation and decline at the national, regional and city level are the equivalence of losing money and going bust at the cluster and enterprise level!

Competitive advantage at the enterprise level is 'the capacity of a firm to gain, maintain and expand its share in markets for final products' (Visor, 1996). At the cluster level enterprises in the cluster together do better than those who are not part of the cluster. Examples of this are given in Van Dijk and Rabellotti (eds, 1997). For the European situation the reader is referred to Van den Berg (et al, 1999).

Kresl and Gappert (1996) distinguish at the urban level economic and strategic determinants of competitiveness. Strategic determinants are institutional flexibility, an effective local government and the ability to conclude public-private partnerships. These are important factors explaining competitiveness at this level, besides the better known economic factors such as the available factors of production, infrastructure, economic structure and urban amenities.

Discussing competitiveness at the regional level we talk about 'how well regions perform in terms of applying skills, resources, technology and information to production, distribution and trade' (Van Dijk, 1999c). Competitiveness at the firm level is defined as the capacity of a firm to gain, maintain and expand its share in markets for final products.

Urban micro and small-scale enterprises can compete in a global economy through clustering, networks, interfirm relations and flexible specialisation. New technologies have become available which are profitable at a small scale. Inter-firm relations in the cluster help these firms to meet the challenges of the new international competitive environment. Modern and traditional forms of clustering and networks exist in many countries. Entrepreneurs take advantage of what is beneficial to them. They can export themselves or increase their sales to larger exporting firms.

Which variables can be suggested for the measurement of competitiveness? Some indicators of competitiveness measurable at different levels can be mentioned:

- Percentage growth of the production (at the enterprise, cluster, city, regional or country level)
- Development market shares (idem)
- Growth of exports (idem)
- Firms outside the cluster are lagging behind compared with firms inside the cluster (for the cluster)
- At a lower geographical level competitive advantage could be measured in terms of how well regions and firms perform in terms of applying skills, resources, technology and information to production, distribution and trade.

What are the advantages of this theory? In the first place competitiveness is measurable and provides the urban or regional manager the opportunity to rank his/her city or region. With which cities or regions do we want to compete? Secondly the theory helps to identify the factors explaining competitiveness, measured for example as a higher growth or market share of a region, city, of enterprise. The factors mentioned by Kresl (1996) help for example to explain the competitiveness of a city. Much research concerning location factors can be interpreted as identifying the competitiveness of a region or city.

Factors influencing the competitiveness of a cluster are entrepreneurship, the existence of a business support system and of an innovative environment (Van Dijk, 1999b). At the city level one can add the importance of policies to create the conditions for this kind of economic development. For local governments this can range from providing land and infrastructure to local government developing an innovation policy.

In the third place this theoretical framework has the advantage that different levels of aggregation, which are normally covered by different disciplines are now linked. Urban management is by definition multi-disciplinary, but very little multi-disciplinary research is actually taking place. That is a challenge for the future. Management science and business economics normally study the lowest level



of the enterprise. Geographers, regional and development economists have worked on clusters and urban and regional economists are occupied with the urban and regional level. Finally macro economists and international economists work on the other two levels: the country and world region level.

Finally, this theoretical model helps to emphasise that different actors are active at the different levels and often have different instruments and only partially realise the importance of the higher levels for what they are doing. Linking these interests and policies could be one of the roles of the urban managers or regional development authorities.

This approach has consequences for research to be undertaken in this field, for policies to be formulated at the different analytical levels to promote competitiveness and for the need to co-ordinate these efforts, through a strategic planning exercise at the regional or city level. Decisions are now again taken in the private sector may lead to a more optimal use of the scarce available resources.

## **2.4 The history of Euro-Mediterranean co-operation**

The association process in the European Community started with a few Mediterranean countries. Turkey and Greece were the first associates and later Yugoslavia, Cyprus and Malta followed. The agreements with the first two countries included eventual custom unions with the then European Community (EC), freedom of movement of labour and firm promise of membership. They also included financial protocols. The later Mediterranean association agreements also included customs unions and financial protocols but were not so specific about factor movements or European Union membership (Rollo, 1994).

In 1972 agreements were signed with Morocco and Tunisia and the Community gradually concluded such agreements with all Mediterranean and Middle Eastern countries desiring closer relations with the Community. Contrary to the Lomé countries the co-operation with the Mediterranean countries is one of a series of individual association agreements, instead of an overall agreement with a series of countries.

During the November 1975 Barcelona conference the Barcelona Declaration and the Work Programme were agreed. They bring together the European Union and 12 partners from the Mediterranean region: Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Syria, Tunisia, Turkey and the Palestinian Authority. The Euro-Mediterranean Partnership (EMP) has a political and security dimension, an economic and financial partnership and a partnership in social, cultural and human affairs. Three Euro-Mediterranean association agreements had been signed in 1996, with Tunisia, Israel and Morocco. Four similar agreements are currently being negotiated with Egypt, Jordan and the Palestinian Authority. Negotiations with Algeria should start shortly, and exploratory talks are under way with Syria.

Rollo (1994) adds that the remaining Mediterranean associates, despite lower levels of development and the likely competitive pressures they will face from full integration, are pressing to become members. However, the European Union has not responded enthusiastically to these applications. Arguments used are the human rights situation in Turkey and the cost of the common agricultural policy or of setting up structural and cohesion funds. Fear of increased migration to Europe has also increased during recent years.

The bigger Mediterranean countries in particular face a number of similar problems. Population pressure, high unemployment, slow economic growth and a relatively isolated location with no natural hinterland should be mentioned. On the European side there is a fear for unrest in the region, for large migration and for fundamentalism, which may be the real reasons for the recent surge in interest in the region.

Four Mediterranean countries (Algeria, Egypt, Morocco and Tunisia) would contribute about 60 million inhabitants to the European Union (counting 350 million in 1993), almost as many as the total population of the Czech republic, Hungary, Poland and Slovakia together. The co-operation agreements concluded cover duty-free access to the Community for industrial products, trade concessions on some agricultural products and in most cases development assistance through financial protocols. Half of the aid is loans and this part is actually increasing substantially. During the European Council meeting in Cannes no agreement was reached on the total amount for the next five years, however.

There is a clear deadlock in the negotiations with Egypt, like there is a delay in those with South Africa. The European Union has made its offers, Egypt rejected them, asking much more access for fruit and vegetables, rice, flowers and so forth. According to Ricardi (Bulletin Quotidien Europe 9-1-1997): The fifteen engage in a pathetic battle to shave a few tonnes here a few tonnes there, each country defending its own production and prepared to give in on that of its partners.

## **2.5 European Union aid going to the Mediterranean countries**

For the European Union aid to the Mediterranean region is divided in two parts: Maghreb (Algeria, Morocco and Tunisia) and Mashreq (Egypt, Israel, Jordan, Lebanon, Palestine and Syria). Financial co-operation has been negotiated on a country by country basis. Before 1980 the aid to the major Mediterranean countries (Algeria, Egypt, Morocco and Tunisia) was low (under US\$ 30 million per year, Development Assistance Committee; DAC 1995b). It averaged \$ 90 million per year during the 1980s and constituted fewer than 4 percent of total aid from all sources provided to the major Mediterranean countries in those years. After the renewed Mediterranean policy in 1992 Community assistance to those countries increased substantially, amounting to \$ 526 million in 1993 and to \$ 638 million in 1994. The development co-operation budget represents about 5 percent of the total

Community budget depending on the year (this does not include the funding for Lomé IV and the European Development Fund, EDF, which are outside the budget).

Assistance to North Africa and the Mediterranean increased on average by 25 percent annually in real terms during 1988/89-93/94. This reflects a greater concern for the area. In 1993 and 1994 the region accounted for 16 percent of total allocable bilateral Official Development Aid (ODA), as compared with 7 percent in 1992. The major recipients in 1990-91 were Egypt and Morocco (DAC 1995b).

Contrary to ACP countries about three-quarters of European Investment Bank (EIB) loans extended to Mediterranean countries carry commercial terms. DAC (1995b) notes, however, that some countries may also benefit from an interest subsidy of two percent (Egypt and Jordan in 1994), while projects in the sector of environment or for urban sewerage may benefit from a subsidy of three percent, while loans to Asian and Latin American (ALA) countries and Central and Eastern European Countries (CEECs) are usually extended at market terms.

The first three generations of financial protocols (1978-91) made available 4,230 million European Currency Units (ECUs), including grants and EIB loans. By the end of 1994 96 percent had been committed and 80 percent disbursed. Of the northern Mediterranean countries Malta and Cyprus had almost fully committed the money allocated to them. At the end of 1995 60 percent of the ECU total (grant and EIB loans) had been committed. Decentralised co-operation programmes, co-operation networks between members of civil society in the Community and the Mediterranean, such as universities, local authorities, the media and the business have become more important.

The fact that the European Union is paying more and more attention to the Mediterranean countries is proven by the increasing amounts reserved for that purpose, at the expense for example of the ALA countries. In particular the South European countries pushed for this. Aid is considered necessary to prepare the Mediterranean countries for a Free Trade Area (FTA). For 2010 the creation of one big FTA is envisaged, but there is no clarity yet on the trade concessions that will be given. They will certainly be limited for agricultural products. Such a FTA would hopefully also increase inter-regional trade between the Mediterranean countries.

## **2.6 Strengthened Mediterranean policy**

The Communication of the Commission dated October 19, 1994 indicated that the resources so far made available for co-operation with the Mediterranean partners have been insufficient to meet the challenges posed. DAC (1995b) finds that the prosperity gap between Europe and the Mediterranean countries is widening, migratory pressures are increasing, while the development of the economies of the Mediterranean partners remains obstructed by an excessive and inefficient public sector.

Subsequently the European Commission has embarked on a wide-ranging process of consultation to consider the actions necessary to remedy this situation. Agreement was reached on the need to coordinate European Union activities in the region and on the priority areas of intervention. In its Communication of March 8, 1995 the Commission proposed that the European Community action should be based on support for:

1. Economic transition
2. Socio-economic balance
3. Regional integration

The priorities were largely agreed with the World Bank and the European Council in Cannes in June 1995 allocated 4.700 million ECU from the Commission's budget for grants for the Mediterranean region for the period 1995-99. This budget will allow greater effectiveness of the European Community's interventions in the region. The Commission also suggests replacing the Financial Protocols by a horizontal financial co-operation instrument based on the Mediterranean budget line, which was created in the 1994 budget process at the initiative of the European Parliament.

The new instrument would enable the European Community to increase flexibility in its financial co-operation so that greater account could be taken in the allocation of resources of such factors as efficiency of past operations, progress towards the objectives of the Association Agreements, good governance and human rights (DAC, 1995a). The new system would be implemented through rolling three-year programmes, negotiated with the partners and adapted annually to take account of the factors mentioned.

#### 1. Economic transition

Of the three priorities for Community action, economic transition and socio-economic measures will get the majority of the resources. The Commission realises that the implementation of Euro-Mediterranean free trade will pose major challenges to economic structures in the region, and in particular in the private sector. A major effort will need to be made to attract greater foreign direct investment in the region. To achieve this "modernisation, reconstruction and privatisation will all need to be encouraged in order to attract" those investments (DAC, 1995a).

It is noted that support for transport, energy and telecommunications infrastructure should be financed mainly by EIB loans. However, for specific programmes, necessary for social reasons (for example in the rural areas) a limited amount of funding from the community budget will be necessary.

#### 2. Socio-economic balance

Since the European Commission expects that in certain sectors the modernisation and adjustment of the economies of the Mediterranean partners will undoubtedly produce strains in the social fabric, it is

proposed that a major part of the financial co-operation efforts should be concentrated on support in this area. Problems to be addressed are poverty, rural-urban inequality, demographic problems and degradation of the environment. European Union supported social infrastructure programmes such as water, sanitation and electrification programmes, should be extended.

The European Union also notes the need to halt the exodus of the rural population by undertaking programmes of integrated rural development providing jobs in the rural areas. Finally, the emphasis on environmental programmes needs to be stressed. One suggestion here is that this might be most efficiently implemented by continuing existing arrangements for subsidies on EIB loans. In fact the Lomé convention, the ALA regulation and the proposed Mediterranean regulation emphasise the importance of integrating environmental concerns in the preparation and implementation of development projects.

### 3. Regional integration

Regional integration, although of major importance for the success of economic development in the region can be supported principally, according to the European Commission through the European Investment Bank, which provides loans for regional infrastructure projects.

For the European Community budget expenditures on regional integration will be less of a priority. It is noted that regional co-operation projects funded under the Middle East Peace Process, in which the European Union plays a role, could require significant funding. The Commission proposes finally the extension of decentralised co-operation programmes, which have been particularly successful in bringing together the grass roots of society in Europe, and the Mediterranean partners.

In 1994 the commitments for Mediterranean assistance were 43624 million ECU, while the disbursements were only 29693 million ECU. This represents about 15 percent of the EU's budget for co-operation with developing and non-member countries (total commitments 2.994,47, disbursements 2.182,09).

### **2.7 Changes in trade: the new GSP**

The European Council adopted in 1994 the new revised European Union scheme of generalised preferences (GSP) for the period 1995-98. It takes in particular into account the different level of competitiveness of developing countries. An environmental and social clause will become applicable at a later stage. The new scheme is based on a system of preferential tariffs expressed as a percentage of the normal customs tariff rate, depending on the sensitivity of the products. Previously a system of duty-free ceilings and quotas were operated on an annual basis. The uncertainty it introduced has now been eliminated through the application of preferential tariffs throughout the period of operation of the

new scheme. As noted in DAC (1995a) this gives greater predictability and security to both the beneficiary countries and economic operators and greatly simplifies the operation of the scheme.

It is added that the new scheme introduces gradual elimination of certain sector of products originating in certain beneficiary countries in view of these countries industrial development in these areas. Hence, the real benefits of the GSP will be redirected away from those countries with sectors which no longer require the GSP to compete in the open market, toward those lesser developed beneficiary countries in real need of economic assistance to develop their economic production base.

From January 1, 1998 additional benefits will be provided under the GSP for those countries which can prove that they respect certain international norms laid down by the International Labour Organisation and the International Tropical Timber Organisation. However, there is also a provision for temporary withdrawal of GSP in case of slave labour, prison labour, shortcomings in customs controls regarding the movements of drugs, failure to comply with international conventions on money laundering, fraud or failure to provide administrative co-operation regarding the verification of Certificates of Origin and manifest cases of unfair trading practices by a beneficiary country, including discrimination against the European Union and failure to comply with obligations under the Uruguay Round to meet market-access objectives (Van Dijk and Sideri, eds, 1996).

Fortunately the European Union is more conscious than before that lower tariffs for raw materials is not enough and that developing countries also need lower tariffs for processed raw materials and industrial products. Unfortunately, there is a continuing protection for agricultural products.

However, the European Commission and Council were unable to keep the commitment of presenting to the FTA summit by the end of 1996 a comprehensive report on the EU's preferential schemes (F. Riccardi in Bulletin Quotidien Europe, 8-1-1997). They have asked for six more months to complete their work, which confirms the difficulties in determining a strategy for free trade areas. Riccardi adds that it was "much easier to make promises left and right (to all the Mediterranean countries, the Latin American countries, South Africa and -as far as the Commission intended- Russia, Ukraine and even the United States)".

## **2.8 Structural adjustment and the Mediterranean countries**

The EU's support of structural adjustment is not limited to the ACP countries, but was also introduced for the Mediterranean countries in the 4th Financial Protocols. 300 million ECU together with a limited proportion of protocol budget funds were earmarked for this purpose. Funds have been allocated to individual countries on the basis of eligibility criteria as well as financing needs (DAC, 1995a: 27). Five operations in Algeria, Jordan, Morocco and Tunisia totalling 270 million ECU have been approved between 1991 and 1994.

European Union intervention takes the form of general or sectoral import programmes in order to reduce external financing requirements. Co-ordination with the World Bank has reached the point where the Commission has participated with the World Bank in countries' public expenditure reviews. It is concluded (DAC, 1995a: 28) that the European Union programmes in Mediterranean countries have contributed to the continuation or resumption of reform, the reduction of external financing gaps and the increase in social expenditure for vulnerable groups.

## **2.9 Private sector development**

A number of instruments exist to finance the private sector in the Mediterranean countries. DAC (1995a: 36) mentions:

- Joint ventures and forging business links: the European Community Investment Programme (ECIP) and to a lesser extent the EIB
- The development of information/advisory network known as Med-Invest
- Support of decentralised co-operation (not formal government channels, but programmes have been developed to transfer European know-how to the non-member countries:
  - . Med-Media
  - . Med-Urbs
  - . Med-Campus
  - . Med-invest and
  - . Med-associations

OECD (1995b) makes a number of suggestions how to further develop the private sector and lists donor actions as possible donor's responses to the challenges of private sector development. Actions listed concern the macro, meso and micro level:

- Fostering an efficient and hospitable enabling environment
- Financial sector development and reform
- Private sector assessments
- Privatisation and public sector reform
- (Small) enterprise reform
- Foreign direct investments and technology development
- Institutional development
- New ways of conducting the aid process: aid interventions in a market setting
- Improving donor co-operation and coherence

### **3 The impact of economic integration and the Euro on SME in SMC**

Our research focuses on the effects of improved trade relations with Europe for small enterprises in Mediterranean countries. South Asia is the largest market for the European Union (EU). North Africa and the Middle East are the second region in importance for the EU export to developing countries. The major economic issue concerning the Euro-Mediterranean partnership is the extent to which the Mediterranean countries will be able to compete at the world market (and what the role of small enterprises would be in that competition), on the basis of the opportunities provided by a better access to the European market. They are facing competition from the East Asian countries, but also from the African Caribbean and Pacific (ACP) countries, who usually have easier access to the European market.

It is estimated that SMEs contribute between 30 and 50 percent of GDP and provide between 60 and 80 percent of employment in many countries. The IMF considers further liberalisation a key to growth: the "economic potential of Middle East and North Africa could be freed by reforms and investment" (Financial Times 17-11-1997). Until a few years ago local industries were sheltered behind high import tariffs. The imminent reduction of tariff barriers is forcing enterprises in the SMC to prepare for a level playing field. The question is however, not only whether these companies will be able to compete with imports, but whether they will be able to export.

When the European Economic Monetary Union (EMU) started January 1999 and the Euro became a fact of life, the main argument used was to further the economic integration process in Europe.<sup>5</sup> Six stages can be distinguished in the economic integration process:

1. A free trade area, an area with no visible trade restrictions;
2. A custom union, which is the same plus a common external trade policy;
3. An international commodity market: the same, but also no invisible trade restrictions;
4. Common market: the same plus a free movement of factors of production;
5. Monetary union: the same plus a common currency;
6. Economic union: the same plus a common economic policy.

A monetary union has as its major advantages that there is no longer a currency risk and there are no longer costs involved in exchanges between the member countries. Additional advantages are the greater transparency of the common market, if all prices are expressed in a common currency. Finally, intra trade and investment can be expected to expand (the long-term dynamic effects) at the expense of trade with third countries. It will be very difficult to assess the increase of the efficiency of Europe's economies in the long run. Usually general equilibrium models are used for that purpose, but by definition they leave out the dynamic effects and can only analyse the static long-term effects



Frieden (1998) mentions also the desire for further European integration as an important factor making the Euro attractive. He adds two factors:

1. The quest for anti-inflationary credibility; and
2. Support from powerful business interests.

He also points to some of the threats: the trade-off between inflation and growth and employment, the competition with the dollar (or co-ordination as suggested by the Japanese between the three major currencies) and the weak correction mechanisms: migration and capital flows, which will only work if liberalisation lead to more labour and capital mobility.

In the literature there is very little on the effects of the European EMU for developing countries (except Van Dijk, 1998, Lelieveld, 1999, Haan 1999 and an editorial in the Interdependent in February 1999). The major issues that are mentioned are:

1. If Europe were going to grow faster, that would be good for African countries as it increases returns on exports to that region (the Interdependent, February 1999).
2. Standardised interest rates will make borrowing from the EMU zone cheaper (the Interdependent, February 1999).
3. If investors in Europe want to diversify, they will have to invest outside the region (the Interdependent, February 1999). However, a more successful EMU may also make Europe more attractive to investors and hence reduce funds available for emerging countries.
4. An integrated European capital market may also be more deep and hence make borrowing there more attractive (the Interdependent, February 1999).

It should be mentioned that the new European currency would have different effects for different regions. If the Euro becomes stronger countries which have linked their currency to it (such as the CFA zone for example) may face troubles compared to countries whose currency is not linked to the Euro. A stronger Euro will erode the competitiveness of the CFA countries' exports to Europe. Presently these exports which accounts for more than 60 percent of their trade (the Interdependent, February 1999).

For the success of the Euro, much depends on whether countries will take the Euro as a reserve currency and start using it for trading purposes. In general trade carried out in Euro will be cheaper for most Third world exporters and importers from Europe, since they do not have exchange costs like they had before when they worked in eleven different currencies with each a different currency risk and with at the average a larger spread on the conversion.

Private sector development in the Southern Mediterranean Countries may help these countries to increase their exports and to benefit from the new FTA and single currency. The Third Euro-Mediterranean Conference of Foreign Ministers in Stuttgart (April 15-16, 1999) has given an additional impetus to the Partnership (Euromed Synopsis, 16-4-1999). Industry remains a priority

sector for co-operation and the conference considered the initiatives to support contacts among SMEs a very important activity.

#### **4 Which factors influence competitiveness in the MENA region?**

Enterprise growth in the MENA region depends on macro and micro economic factors. The macro factors are better known through World Bank and IMF reports and were discussed in the previous chapters. Here we look at enterprise competitiveness from the microeconomic perspective, focusing on the incentives and constraints facing entrepreneurs in the Middle East economy. The focus will be on manufacturing firms. Entrepreneurs are considered the major microeconomic agents. Understanding their behaviour is important for the understanding of the growth process in the MENA region.

After the Second World War the majority of the inhabitants in the MENA region still lived and made a living in the rural areas. Major changes over the last fifty years are the impact of the substantial oil price increases in 1972 and 1978, the impact of political developments in the region and a gradual but continuing urbanisation process.

While a number of developing countries, in particular in Southeast Asia and Latin America industrialised, hence absorbing rural labour and reducing poverty, the industrial sector in the MENA region has only increased very slowly if the effects of the oil sector are excluded. The focus in this chapter is on understanding the weaknesses in the enterprise growth process.

To analyse the process of firm development and the determinants of enterprise performance across the MENA region the relevant factors should be linked to policy variables and other region-specific factors that influence the productivity and economic growth of these enterprises. We first analyse the existing situation, focusing on the constraints enterprises are facing. Subsequently we will mention new opportunities and list some key issues, which are specific for enterprise development in the MENA region in the future.

Collier and Gunning (1999) mention five characteristics of the environment facing urban firms: risk, lack of openness, lack of social capital, poor public services and lack of financial depth. We will first consider to what extent these factors are also crucial for enterprise development in the MENA region and then suggest some additional specific factors, which also seem to play a role in this region.

##### **1. Risk: "investors rate Africa as highly risky"**

Investors consider investments as highly risky. This may also be the case in many MENA countries, but these countries are less dependent on foreign investors. In many MENA countries structural adjustment has created increased economic hardship for the most vulnerable segments of the population; however, investments in the informal and micro-enterprise sector have contributed to easing

the pressure through providing employment. Such informal employment has provided sustenance to workers who otherwise would have had no source of earnings and has supplemented falling incomes of salaried classes who take on part-time jobs.

Enterprise development in the MENA region is less dependent on foreign investors because of oil revenues and its induced effects, such as cross-regional investment and labour migration. Until recently capital was invested in the industrial sector mainly through the public sector, but that is changing. Secondly, many workers from MENA countries with little or no oil work in the oil rich countries and send home part of their income to be invested in houses, consumption or enterprise development. Recently the need for private and foreign capital has increased, because governments don't invest as much any more in the industrial sector as they used to do. Finally, it will be argued that new opportunities have been created for foreign investments. Countries like Turkey and Tunisia have already benefited from a combination of new opportunities and a more positive policy environment for private enterprise development.

We conclude that although investment in the micro and small enterprises can be described as risky, risk can also be defined as the essence of entrepreneurship (Schumpeter, 1942). Hence dealing with it would be part and parcel of running one's own enterprise. Many people in the MENA region have started their own business and the most important question for them now is how to become more competitive in a global economy.

## 2. "Lack of openness has depressed investment"

Trade liberalisation and exchange rate depreciation would be mechanisms stimulating investment. Indeed that has been a lack of this kind of openness in many MENA countries. The present more liberal situation should have invited more investments, which is often not the case. This indicates that more may be necessary in the MENA region than just trade liberalisation and exchange rate depreciation. The attitude towards private enterprise development is not always favourable and life is still made difficult for many foreign investors, while the need for foreign investment, to be able to link to the world economy, is now widely recognised.

## 3. "Lack of social capital"

In the MENA region social capital, defined in a broad way as social relations because of similar religious, ethnic or regional backgrounds, exists and is quite important. In some countries Islamic banking for example has helped to supply funds to credit starved new entrepreneurs. In some countries ethnic and regional backgrounds are important determinants of success for small entrepreneurs. The existence of strong business networks of Palestinian entrepreneurs illustrates this point.

## 4. "Weaknesses in public services provision disproportionately impinge on manufacturing"

Collier and Gunning (1999) refer in particular to the lack of infrastructure and high utility prices hindering enterprise development. Although it is dangerous to generalise too much, this point also seems to be a hindering factor in many MENA countries.

##### 5. "Lack of financial depth"

It is often noted that formal financial markets are not as developed in Africa as in most other developing regions. Collier and Gunning (1999) add to this that it does not necessarily follow that this has been an important constraint upon investment in these countries where this is the case, because informal finance may be an important source of investment.

In many MENA countries financial markets are also not well developed, or are not functioning properly. If many banks in Yemen for example had for a long time too much liquidity, this is according to the local bankers because of a lack of good projects. However, there also was no institution to channel credit to micro and small entrepreneurs, until the Industrial Bank of Yemen (IBY) started a Small Enterprise Development Unit (SEDU) specifically for that purpose (Van Dijk, 1994).

In the MENA countries a number of other constraints than the ones mentioned by Gunning and Collier need to be mentioned and will be discussed below:

6. The predominance of oil and oil related industries (with limited relations with the rest of the economy), and of security problems

7. Female participation is extremely low in the region and hence an important resource is not fully used

8. The important role of state-owned enterprises in the economy, while privatisation often only started recently

9. The prevalence of a more urban economy, with little off-farm employment in the rural areas while most enterprises can be found in clusters in, or close to cities

10. The pursuit of import-substitution policies

6. The predominance of oil industries and of security problems

A real oil boom started in the MENA region after the first substantial price increase in 1972. A number of MENA countries benefited directly, while others benefited indirectly through the financial support

they would get from oil producing countries, or through the transfers coming from the increased number of guest labour in these oil rich countries.

The regional economy was characterised by a lot of labour migration and subsequently an increased dependence on the oil industry, which became clear in a very painful way in 1982 when oil prices in real terms declined and remittances to home countries diminished if labour was not just sent back. Another disadvantage of a high dependency on one sector is linked to the nature of the oil industry. It generated only limited up- and downstream effects with other sectors and enterprises of a smaller size.

The issue of security problems in the region will not be discussed, but the tension between Israel and the Arab countries certainly had a negative impact on the development of the economy in the region (FMES, 1997).

#### 7. The importance of female labour participation: decreasing fertility and changing views on the role of women

Labour force participation of women is low in the MENA region as has been illustrated by the situation in Egypt and Jordan. The low female labour force participation in Jordan, where only 11 percent of the women are in the labour force or at maximum 12.5 percent, is particularly surprising. Given the average population growth is declining and women should have more time for paid work. Secondly, the educational system in Jordan and a number of other countries also educates more women, so they should qualify for the better jobs. Finally, it is known that there are labour shortages in Jordan in certain sectors, which would allow women to take up these jobs. Trends in labour force participation have been mentioned, but their potential contribution to the economic development of the MENA region still requires more attention.

What is even more striking is a kind of new divide that was found in the MENA region: low educated women end up in micro-enterprises, while high educated women find a job in the formal sector. Mostly women are looking for a job in the public sector. The sector does make a difference. In Egypt for example women tend to be so well treated in the public sector that there is little incentive for them to go and work in the private sector at the moment.

Increased access to education, a higher average age of marriage and declining fertility are presently trends contributing to increasing the size of the female labour force in the MENA region. The role of the informal and micro-enterprise sector will probably be crucial in absorbing these women. A multi-disciplinary approach to research on this topic is essential to effectively understand the role of women in the informal sector and to understand not only the economic factors in place but also their interaction with demographic as well as traditional and cultural aspects of society.

Women have been more adversely affected than their male counterparts by the receding role of the state and privatisation efforts, as the public sector has long been a major employer of women in the MENA region. This reduced role has been associated with the increasing participation of women in the informal sector, however. The extent of women's involvement in this sector remains anecdotal. There is an urgent need in many MENA countries to quantify these figures through more research. In addition, there is a concentration of women in specific income generating activities such as dairy products, garments and carpet weaving in Egypt, which are not always the most rewarding and dynamic informal sector and micro-enterprise activities.

The gender gaps in labour participation, employment, earning, access to education is presently studied in depth in some research projects funded under ERF's research program. The first figures for Egypt and Jordan show an increased participation, partly due to a more serious effort to actually include all activities in which women are active in the data collection (Assaad, 1998 and Flyn, 1999).

#### 8. Importance of state-owned enterprises and privatisation policies

The important state manufacturing sector is specific for the MENA region. Only gradually some privatisation is taking place. In many MENA countries the state sector absorbed the majority of the funds available for investment in the industrial sector. Privatisation is often a slow process, which is not always given a fair chance (Van Dijk and Schulte Nordholt, eds, 1995). It may give an impetus to enterprise development in two ways. One, more dynamic privatised companies may look for better local integration to bring down their cost of production. Secondly, the fact that investment may come forward in the privatisation process.

#### 9. The prevalence of a more urban economy

In most MENA countries the economy is presently much more an urban phenomenon than 25 years ago. This provides a potential for development, given agglomeration economies, the existence of an important and concentrated market and a more educated labour force. Such an urban economy also means that there is less off-farm employment in the rural areas and more enterprises are grouped in clusters in, or close to cities, with all the economies that can be achieved in cities and clusters (Van Dijk and Rabellotti, eds, 1997).

#### 10. The pursuit of import-substitution policies

In many MENA countries policies to promote import-substitution were wrongly accompanied by protection of the domestic market. It meant local enterprises were not used to international competition. In many MENA countries the degree of competitiveness of the economy is low and increasing exports for example is considered very difficult (Van Dijk, 1999a).

## **5 The competitiveness of Egyptian SMEs<sup>6</sup>**

### **5.1 Introduction**

We interviewed 15 entrepreneurs in depth, using a specially designed questionnaire (annexe 1). They were all located in Tenth of Ramadan, a new city, some 40 kilometres from Cairo, the capital of Egypt. The city was created some twenty years ago and now counts about 1000 enterprises.

Mahdi (1997) and Meyer (2000) have studied the area before. Given the available data, which provided the broader picture, we could limit our study to the factors influencing competitiveness at the different levels distinguished and the factors influencing the export potential of these industries.

The results can be summarised per research question as follows:

1. Which factors determine the competitiveness of the small enterprises in Mediterranean countries and the competitiveness of the cities in which they are located?

For the case of Tenth of Ramadan City, regional competitiveness is clearly promoted through tax incentives. To stimulate regional dispersion of economic activities to alleviate the pressure on Cairo, the new towns policy aims to develop new economic urban growth cores. The fact that in the last 20 years more than 1000 companies have started in Tenth of Ramadan city might lead to the conclusion that the government policy has been effective. However certain drawbacks have to be mentioned.

First of all most companies in the area have not completely relocated or are not only operating in the new city, but instead have some affiliates still working in Cairo. The main reason stated for this is the bureaucratic procedures which need to be fulfilled in the centre of the capital. A second observation is that both employers and employees mostly still live in Cairo and not in Tenth of Ramadan city. Most of the housing projects are still in process or not completely occupied at the moment. The results of these developments are that instead of reducing pressure on Cairo in terms of housing and transport for example, Tenth of Ramadan city is actually increasing the transport flows. The tax incentive can not be considered to be a success. On the other hand a lot of enterprises in the city have been able to successfully expand their activities since their (partial) relocation or new start in this new city.

2. How can the dynamics of the small enterprises sector be explained?

Most of the small and medium size enterprises are family businesses that were successfully able to expand. Most of the companies are focussing on the national market and also rely on government expenditures and orders. Some companies have successfully progressed from micro/informal to become small formal sector enterprises.

3. What are the export potential of these small enterprises and which factors currently discourage or constrain export possibilities?

Most of the companies are not exporting at the moment. The main reasons for this are:

- Bureaucratic hazzles
- Lack of information
- No market potential
- No financial possibilities
- Absence of government stimulation programs

The need for improving the situation for exporting is more related to the above factors and not to any export barriers. Hence not so much is expected from lowering tariffs or from free trade zones. For importing goods and services they do see some improved opportunities.

The entrepreneurs do not expect a lot of new competitors after opening up their markets, although especially in the textile industry problems might be expected, because of higher production costs than for example the NICs in Asia. Even through Europe Asian companies might be able to pose a real threat to the Egyptian industry.

4. What effects can be expected from the introduction of the Euro for SMEs in the Southern Mediterranean?

In relation to the EURO not much information is available at the enterprise level in Tenth of Ramadan city since they are not exporting, but for importing some of the production factors and resources this might improve some of the information and opportunities for reducing the cost.

## **5.2 Competitiveness of Egypt at the national level**

UNCTAD (1999) studied the competitiveness of Egypt at the national level. The conclusions are very positive. The main problems are the:

- Need to review the taxation system and the incentive framework
- Good governance, a more efficient administration and institution building
- Shortage of middle management
- Need to create new networks, which cut across family ties

Strong points of the Egyptian economy are the natural resources wealth, human capital and strong domestic demand and commitment to integrate in the world economy. However, it is expected that Egypt can achieve 8 percent growth in the years to come (Egyptian Gazette, 4-2-1999). The actual achievements according to the World Bank (2000) are substantial.

Other factors, limiting the competitiveness of the Egyptian economy are the wage level, which is relatively high. The most constraining factor is, however, the bureaucracy, which really hinders the



development of the industrial sector. The plethora of rules and regulations stimulates illegal imports and trade, which then competes with products produced locally often at higher cost (Le Progress Egyptien, 30-9-99). Finally exports are hindered by an overvalued currency.

The conclusions of UNCTAD (1999) concerning the competitiveness of Egypt in general, is that there is a need to review the taxation system and the incentive framework. Good governance, a more efficient administration and institution building are necessary and there is a shortage of middle management. Finally, there is a need to create new networks, which cut across family ties. The report mentions as the strong points in the country: natural resources wealth, human capital, strong domestic demand and commitment to integrate in the world economy.

### **5.3 Competitiveness in Egypt at the cluster level**

Tenth of Ramadan can be considered a locational cluster (Van Dijk, 1999b), given the density of enterprises in a relatively small area. Within the cluster a number of networks exist, ranging from rotating savings and credit associations (ROSCAs) to all kind of other associations. ASMINC is an Egyptian NGO with its head office in Tenth of Ramadan. Its objectives are summarised in table 4. The study of El Mahdi (1997) has shown the importance of the association for the SMEs in the city.

Table 4 Objectives of ASMINC

1. Creating job opportunities through assisting in the start-up of new projects
2. Supporting, i.e. extending assistance to small and medium scale projects existing in the new cities
3. Providing better work conditions and livelihood in the new cities.

The research questions at this level are:

1. Which factors determine why a region is attractive to investors?

The main factors stated were:

- Availability and price of land
- Tax incentives
- Clean Environment
- Close to Cairo
- Reasonable infrastructure

Besides these factors high expectations are also contributing to the development of the area. Since the city is completely new and still under development, investors speculate that there will be further improvement of the city. Stagnation in provision of urban facilities, like waste collection, public

transport and leisure activities, lowered their optimism and reduced additional investments. The city does not have a good local market base because of lack of inhabitants and related purchasing power.

## 2. What is the role of a city in a specific region?

The city in the region remains Cairo, Tenth of Ramadan does not have a real local economy and commuting is mostly preferred resulting in congested infrastructure on the main road to Cairo. Housing policy has so far tried to stimulate new people to move to this new town, although this new population is mainly looking for jobs in Cairo, hence increasing transport flows even further.

## 3. Can we speak of an industrial district (Van Dijk, 1993)?

It seems that Tenth of Ramadan is functioning like a spatial cluster. The clustering of activities is mainly the result of creating business parks and of zoning policies. It does not lead to inter-sectoral co-operation.

Although business associations are in place, no real links with for example education and financial institutes are existing, nor do joined marketing strategies or fairs take shape. Also for export possibilities horizontal co-operation is taking place. Hence the cluster aspect in Tenth of Ramadan is mainly physical in terms of the joint location of different small and medium sized enterprises. The real benefits of this being located at the same spot have not yet fully developed.

## 4. What is the importance of 'linkages' in and outside the region?

The case of Tenth of Ramadan city clearly illustrates that linkages with the rest of the region are explaining to a large extent the success of the 'cluster'. In positive sense being close to Cairo in combination to tax incentives have stimulated the development of this satellite town. On the other hand since most of the economic activities as well as movements of the labour force (commuting) are mainly focused on Cairo, have increased pressure on the housing markets in Cairo as well as on its infrastructure. Absence of Public Transport, good urban facilities related to quality of life and local government structure does not provide for a sustainable urban development both in Tenth of Ramadan as well as in Cairo.

## 5. Is there flexible specialisation taking place?

There is no clear example of flexible specialisation in our sample, although the availability of good quality cotton is considered a real opportunity for the Egyptian textile industry.

## 5.4 Competitiveness in Egypt at the enterprise level

Competitiveness in Egypt at the enterprise level leaves a lot to be desired. Productivity is in general very low and the privatisation process has been very slow. However, we found that enterprises in clusters are performing in general better than dispersed firms and find it easier to increase their exports.

To increase exports the European Union has launched a program for the industrial sector, which puts the emphasis on the opportunities for small and medium enterprises in the European market. Egyptian enterprises have to apply to the program. After a free diagnosis the enterprise has to pay ten per cent of the study which will be undertaken by a consultant. The consultant will help to prepare a business plan and a strategic plan. The enterprises need to pay for the implementation of the plan.

Business support systems have been developing and has an impact on these enterprises in a number of MENA countries. An example in the Egyptian situation is given in Box 2. The Private sector development program (PSD program) is considered quite successful and Egyptian entrepreneurs look forward to the follow-up, which will help them to become more competitive when Egypt will participate in the Free Trade Area (FTA) with the EU. Developing clusters of enterprises will be easier for programs like the IMP, because they are located near each other. Also other BSS will find it easier to provide assistance to such clustered enterprises. However, the possibility to develop clusters should not be over estimated, because in practice this tends to be largely a spontaneous process.

### **Box 2 The EU Private sector development program in Egypt**

The formula of the EU Private sector development program (PSD) in Egypt is to provide opportunities to small and medium enterprises. These enterprises have to apply for support from the program. They then get a free diagnosis and have to pay ten percent to a study undertaken by a consultant that draws up a business or strategic plan. To get this plan implemented the entrepreneur has to pay again.

Presently the program provides mainly technical assistance and not so much equipment or credit. The EU has put the emphasis on a consultation process and not on providing financial assistance. The follow-up supported by the EU, the Industrial Modernisation Program (IMP), will stress the hardware side of upgrading and makes a distinction between different industrial sectors, which the current program does not seem to do.

## 6 Theoretical conclusions

Cities and regions are more and more integrated in the global economy and compete with each other. Good urban and regional managers can play an important role in that 'war of cities', or the development of the 'region state' (Ohmae, 1995). A good manager is someone who via an integrated approach, based on a strategic plan, makes his/her city more competitive and in such a way that the social problems are also tackled. This requires to develop a 'pro-poor urban and regional development strategy'. Promoting the urban informal sector and using social development funds would be important just like a different way of supplying urban services.

Some of the concepts discussed can be used on different levels: clustering, flexible specialisation and industrial districts, for example. However, the concepts may have a slightly different meaning at these different geographical levels. Although analytically it may make sense to distinguish the different levels, the relation between them should not be neglected.

Economic liberalisation and privatisation of public enterprises do not mean the end of the government's role in the economy in most MENA countries, but rather a change in that role. Parts of that new role comprise more positive industrial, credit, trade, tax, and labour regulations as well as other economic development policies and programs the results of which should be manifest at the micro and small enterprise level.

To increase competitiveness we need to come up with suggestions to further develop micro and small enterprises through a more positive approach of different levels of government and through a maximum involvement of the private sector and organisations of micro and small enterprises. SME policies do not only concern macro economic policies, but should concern the whole existing and developing business support system (including the role of the NGO and co-operative sector). Sometimes Socio-economic development funds, set-up with or after the structural adjustment programs were launched, contributed to the development of the BSS (Van Dijk, 2000b).<sup>7</sup> In Egypt the Social fund provides credit to small and medium scale enterprises, while in Jordan also support to employment generation activities were envisaged (Van Dijk, 1992).

## **7 Practical conclusions**

The need to find productive employment for the many unemployed people in many MENA countries is very clear. The general issue is the possible contribution of micro and small enterprises to the economic development of these countries and to increase remunerative employment of their male and female workers.

Present policies and projects do not always reach micro and small entrepreneurs in the MENA region. The emphasis is too much on what central government could and should do and too little attention is paid to what for example local governments could do, or on the role of the private sector and of private sector organisations. Finally, too much emphasis goes to credit at the expense of exploring new markets and introducing recent technological developments. Labour laws and regulations, which sometimes inhibit the development of contractual labour relations in micro and small enterprises, may need to be reconsidered in that light.

Three key issues need to be addressed to promote enterprise development in the MENA region:

1. The first issue is how to increase the competitiveness of the enterprise sector and how to increase employment in this sector in the different MENA countries?
2. Secondly a distinction needs to be made between enterprises of different sizes and it will be necessary to define a role for each of them separately.
3. How to increase female labour force participation?

### ***Ad 1. How to increase the competitiveness of the enterprise sector and how to increase employment in MENA countries***

To increase competitiveness different levels of government should admit that often no enabling economic environment exists and no competitive environment has been created. In some of the MENA countries there is no commitment to real reform. The type of enterprises to develop could be determined on the basis of an identification of competition in the country concerned or through an in-depth analysis of the quality and cost of the current imports compared with the cost of similar products presently produced in the local scale enterprise sector.

### ***Ad 2. The need to make a distinction between enterprises of different size and to define a role for them separately, while trying to increase the linkages between enterprises of different sizes***

Often no distinction is made between different types of enterprises, such as formal and informal sector enterprises (depending on for example legal status). Also no distinction is made based on size (micro-enterprises up to 10 employees), between micro, small, medium and large. It is also necessary to

distinguish State manufacturing and private manufacturing sector), which will now be discussed, besides the informal and micro-enterprise sector.

It is well recognised that many new jobs generated in the MENA region are often in the informal and micro-enterprise sector. However, enterprises in this sector are generally characterised by low productivity and poor working conditions (ILO, 1998). For the informal sector to mature into a highly productive and integral component of the national economy, as it has become in Southeast Asia through its dynamic subcontracting links with the large and formal enterprise sector, a policy agenda needs to be developed. The starting point is a clear understanding through research of the complex circumstances and needs of this heterogeneous sector, since there is a lack of comprehensive micro and small enterprise studies in most MENA countries.

Micro and small enterprises tend to have below average productivity, provide poor working conditions and avoid tax and social security payments. This is primarily a function of entrepreneurial behaviour in the face of limited access to markets, to credit and to technologically superior work methods. For small and micro firm examples, simply accessing social service facilities cannot ensure an effective response unless these programs are adapted to the specific needs, unless they address all of the complex factors that impact on entrepreneurial behaviour, and unless they are demand driven by the beneficiaries themselves.

Although this report does not deal with poverty directly, it is known that poor people usually work in micro and small enterprises in the informal sector and hence the development of these enterprises will also help the poor. The development of the private medium and large-scale industrial sector has taken place against the backdrop of a largely public sector, which dominated industrial sector. In general the industrial sector in the MENA region is not very integrated. Understanding of the behaviour of all these entrepreneurs is crucial for understanding the dynamics of the growth process in the MENA countries at the micro level.

### ***Ad 3. How to increase female labour force participation***

Discrimination of women in the formal sector may be imbedded in traditional beliefs regarding the women's role in society or maybe due to economic reasons. Employers may refrain from hiring women because they see them as unwilling to put in long hours of work or because they perceive that investment in them with regards to training may be lost as they move into marriage and raising children (Assaad, 1998).

Cultural and religious factors may limit female participation, immigrant labour may be involved in a number of jobs, which in the above-mentioned example Jordan women could also have taken and finally there may be a lack of child care facilities which constrain women to take up paid labour.

It is important to highlight the role of female workers and entrepreneurs in micro and small enterprises, including women working at home. Under which conditions women are involved in micro and small enterprises in the MENA region?

Existing studies point to the contrast in the participation of women in home-based enterprises where they are well represented and micro-enterprises where they are poorly represented. An explanation to this can be found in the traditional division of labour along gender lines and the socio-cultural norms that sustain such a division of labour. Women's poor representation in the small and micro-enterprises may be due to barriers to employment "either because of discrimination against women or unwillingness to provide support structures to working women" (Moghadam, 1998).

Barriers to the entry of women into the labour force can be addressed by policies that reduce women's domestic burden. The provision of child care centres and better access to public services such as clean water, health care, sanitation, education and family planning are essential in relaxing the constraints facing women and thereby raising their productivity (Assaad, 1998).

Access to credit and technical assistance are important determinants of successful income generating projects in general. More attention needs to be given to conditions and delivery mechanisms of such access that ensure that it reaching women. In this respect, differentiation will be made between delivery of credit for survival type activities and that for micro-enterprises with potential for growth.

Policies for trade liberalisation and private sector development in the Mediterranean countries will continue, but will have to be complemented with programs for the poor sections of the population. Grants will go in particular to the poorer countries, such as Egypt and Palestine and to the poorer sections of the population in these countries.

There has been a lot of discussion about more coherence in European Union policies, but the practice of dealing, for example, with Morocco and Egypt shows that incoherence is usually the rule. If trade concessions cannot be given, the country is offered some more development assistance. This does not seem the way to develop small enterprises in these countries. It also goes against what the NGOs propose and developing countries deserve. It is positive that the role of the NGOs and the private sector (including the small-scale enterprises) will be more prominent in any future co-operation between Europe and the Mediterranean countries. They can contribute to the development of civil society and of the economy in these countries.

On the positive side it should be noted, that the Mediterranean countries can benefit from their location near Europe and the increased interest in their problems. The private sector can be an engine for the desired development and an outward orientation tends to be positive in such case (World Bank, 1993). Macro economic developments in a number of countries have been positive recently, although growth was not as high as in East Asia.

On the positive side we also noted more attention for the Mediterranean region and the willingness to work to one big FTA. DAC (1995a: 20) speaks of plans for a partnership, but given the experiences with the Lomé convention, one has to be prudent in this respect. The relations with Mediterranean countries are a hot issue in Europe at the moment and it may lead to a buffer zone policy, similar to the approach of the United States to Mexico. The Mediterranean countries, in the light of recent negotiations with Egypt, South Africa and for post Lomé IV have to be realistic in what they can expect, however:

1. There is more competition for the favours of Europe.
2. There is an internal crisis with the European Monetary Union (EMU), which seems to be worse than the crisis concerning the creation of the single market (the fort Europe discussion).
3. There is a more business like and pro-business approach at the European side, while trade preferences have been eroded in many cases due to the Uruguay Round.
4. The WTO has become more important and has to approve regional FTAs.
5. The role of small enterprises will be crucial. Policies to support their development need to be developed.

It is recommended to learn more from previous experiences with partnerships and development of small enterprises. The European Union should do more evaluations of projects in Eastern Europe, where it introduced new technologies for SMEs in countries in transition. The European Union (DAC, 1995b: 9) has not always developed country strategies and it is recommended to do so in a more systematic way for the Mediterranean countries.

There are a number of new opportunities in the MENA region. A number of recent developments have created new opportunities for the enterprise sector in the MENA region and deserve attention:

1. Economic integration in a multilateral framework (the World Trade Organisation, or in the context of the Barcelona process)
2. More private enterprise development and a gradual development of a business support system in a number of MENA countries.

#### Ad 1. Economic integration in a multilateral framework

A new situation has come into existence with the globalisation of the world economy. Because of the Uruguay and subsequent Millennium Round of respectively the General Agreement on Trade and Tariffs (GATT) and the World Trade Organisation (WTO) and because of the announced Free Trade Agreement (FTA) with the European Union (EU) it will become easier for enterprises in the MENA



region to export their products and hence export-oriented policies need to increase the competitiveness of the small and medium enterprises in the MENA region.

Ad 2. More private enterprise development and a gradual development of a business support system in a number of MENA countries

A certain dynamics can be found in the MENA region. One can think of:

- The importance of clusters and networks and the resulting graduation among entrepreneurs which this will bring about
- A smaller role for government, a more important role for entrepreneurs and their organisations
- New theoretical approaches to dynamics of small and micro-enterprises stressing the importance of inter-firm relations, for example through subcontracting.

Economic growth can be decomposed into growth due to factor accumulation and growth due to an increase in total factor productivity. An important role in the development of the productivity of micro and small and medium enterprises is the existence, or gradual development of a business support system.

The first recommendation is that it is worth to identify clusters, which are promising and could be fostered. Different levels of government should try to make them more competitive. Secondly the Mediterranean countries should use existing institutions as much as possible. Finally, they can help to create an enabling environment for SMEs by:

1. Deregulation; a fine balance needs to be reached what can be deregulated and what needs to be regulated
2. Engage in a dialogue with the private sector on what the role of the government and the private sector should be
3. After developing a vision, the vision needs to be put in practice through a strategy

The Barcelona process is promising. In fact it is a special opportunity to gain access to a very big market and to enjoy a legal framework which would attract foreign investments.

Development is never only a question of joining a FTA. It is also necessary to undertake efforts in the private sector and to identify local opportunities for enterprise development.

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## Notes

1. It is suggested to use the term micro and small enterprises in the formal or informal sector. Micro and small can be defined by using a size criterion (employment) and informal or not can be based on a legal criterion, such as: 'the enterprise has no legal status', which usually implies that the legal minimum wage is not paid and workers do not enjoy social security.

2. MENA region or Arab countries as defined by the World Bank, including Iran and Turkey.

3. Comparative advantage used to be the basis for evaluating competitiveness between countries until the end of the 1970s. The comparative advantage of a country is based on differences in factor costs of production, such as taxation, labor, energy, land construction or raw materials.

4. Competitiveness can be considered as an important force behind locational choices of enterprises. Location factors at different geographical levels can then be interpreted as factors contributing to the competitiveness of a region, city or company.

5. Nielssen (et al., 1991) distinguishes several stages of integration.

<sup>6</sup> The field work was undertaken jointly with drs. Marco van Hoek from Erasmus University.

7. A Business Support System (BSS) can be defined broadly as all the supporting activities, which are important for micro, small and medium scale entrepreneurs.