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# **MICRO, SMALL AND MEDIUM SIZED ENTERPRISES IN THE MEDITERRANEAN: A POLICY ROADMAP TO UNTAP THE POTENTIAL FOR JOB CREATION**

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A background photograph of four business professionals in an office setting. A woman on the left is shaking hands with a man on the right. In the background, a man in a suit and a woman are looking towards the camera.

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## ABSTRACT

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The objective of this policy brief is to formulate a policy roadmap to untap the potential for employment creation by MSMEs in SEMCs, with a particular focus on Egypt, Jordan, Morocco and Tunisia – building on the findings of four years of research on MSME development carried out under EMNES. MSMEs have an important role to play in creating much needed employment opportunities, but their development is currently hindered by a number of obstacles related to both the structural features of private sectors that remain underdeveloped in most SEMCs and specific issues, such as lack of access to finance, the high incidence of informality and low integration into global value chains.

The proposed policy road map provides a comprehensive framework to formulate, implement and monitor a fully-fledged MSME policy and to mainstream a 'Think Small First' principle in all policy areas relevant to the development of MSMEs. The policy road map is designed to complement the assessments of SME policies within SEMCs conducted by the OECD, EU and ETF (2008; 2014; 2018) and includes a discussion on the role that the EU can play to support its implementation.



## INTRODUCTION

Micro, small and medium enterprises (MSMEs) are the backbone of the economy. In countries with a pro-active business environment, MSMEs contribute substantially to employment creation and inclusive economic growth, whilst also fostering competition and innovation in all economic sectors. In Southern and Eastern Mediterranean countries (SEMCs), MSMEs represent the overwhelming majority of firms and account for between half to three quarters of total employment. That said, a number of obstacles continue to hinder the development of MSMEs and more broadly private sectors in SEMCs, suggesting that part of their potential for employment creation remains untapped.

The objective of this policy brief<sup>1</sup> is to formulate a policy roadmap for unhindered growth of and enhanced employment creation by MSMEs in SEMCs - with a focus on Egypt, Jordan, Morocco and Tunisia – building on the findings of four years of research on MSME development carried out under EMNES.<sup>2</sup> The policy brief is organised as follows: first, it highlights the main characteristics of the MSME sector in the selected SEMCs; secondly, it discusses the obstacles hampering the development of MSMEs in the region and, hence, the potential for creating jobs; the third section presents the policy framework and recommendations.

## COMMON FEATURES OF MSME SECTORS IN THE MEDITERRANEAN

In this section, common features of MSME sectors in SEMCs are identified by building on the findings of country and regional analyses carried out under EMNES. This sets the scene for the discussion about the main obstacles hindering growth of and employment creation by MSMEs in the four countries considered in the analysis and the formulation of the policy roadmap.

Egypt, Jordan, Morocco and Tunisia are all characterised by the so-called “missing middle”, that is, the polarisation of these countries’ private sectors between an overwhelming majority of weakly

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<sup>1</sup> This paper is a result of a participatory process in which EMNES researchers worked together in groups at two policy workshops, held in Brussels in July 2018 and in Piran in October 2018 to bridge the findings of research formulated into policy options and recommendations.

<sup>2</sup> The findings of the following EMNES working and policy papers were used in preparing the brief: Ayadi et al, 2017; Ayadi, Giovannetti and Zaki, 2019; Ayadi and Mouelhi, 2019; Mouelhi and Ghazali, 2018; Sammoud and Dhaoui, 2019; Sandri and Alshyab, 2018; Sandri, Alshyab and Azzoui, 2019; Zaki and Zeini, 2019.



performing micro firms and a few large firms that dominate the market. Ghazali and Mouelhi (2018) affirm that micro firms are the least productive and innovative firms in the market, lacking the human and, most importantly, the financial resources to grow, explaining both the incidence of low survival rates among micro firms and the limited number of small and medium firms in the four countries under consideration. In the latter, roughly nine firms out of ten were classed as micro firms in 2009 and remained micro in 2012, according to data used from the World Bank's Enterprise Survey (Ghazali and Mouelhi, 2018: 5).

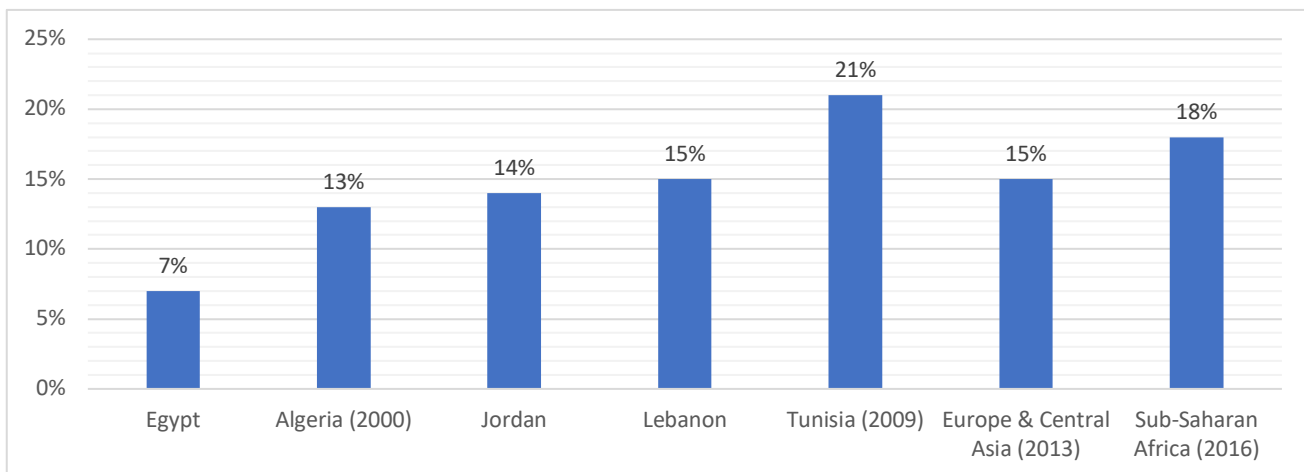
For the most part, micro firms are subsistence firms established with the aim of meeting basic needs and lacking ambition to grow. This explains a second salient feature of the private sectors in Egypt, Jordan, Morocco and Tunisia - widespread informality. The informal sector accounted for 21% of Morocco's GDP in 2014, 30% in Egypt and 42% in Tunisia in 2012 (see Ayadi, Charmes and Ramadan, 2019). Although formalisation does not bring substantial benefits for informal firms that are unlikely to expand, it does imply costs that might suffice to put firms, with very limited financial resources and low productivity, out of business. Against this backdrop, it does not come as a surprise that a substantial share of subsistence firms choose to remain informal. This, in turn, undermines their growth prospects and their contribution to innovation and decent employment. Informal MSMEs might face fewer constraints when it comes to hiring and paradoxically creating more jobs than they would do in the formal sector, but the quality of the jobs created in the informal sector is a matter of concern (see for example ILO, 2018).

To tackle informality, social businesses might have an important role to play, especially when it comes to creating decent employment opportunities in low growth sectors and for vulnerable groups, such as women and the youth. Indeed, social businesses are firms that aim at fulfilling social and environmental needs whilst remaining relatively economically viable, as opposed to firms looking to maximise profits. Social businesses might offer more formalization oriented incentives, as this would enable them to pursue other goals more successfully than just maximising profit. That said, the number of social businesses in Egypt, Jordan, Morocco and Tunisia remains very limited and their impact on the economy is negligible. Ayadi, Charmes and Ramadan (2019) revealed evidence that the contribution of social businesses to value added and employment creation in the four countries is sensibly lower than in France, where the social and solidarity economy is formally recognised and regulated with a dedicated policy framework. Social business has large potential that demands to be better examined. Therefore, further research is needed to understand the mechanisms by which social businesses can thrive in the current economic system, insofar as the duality of characterising objectives is challenging when put into practice.

Last but not least, internationalisation far too often remains the prerogative of few large firms in the four countries considered. Instead, micro firms which are created for subsistence purposes, do not grow or are not in the position to do so and this is particularly true for expansion into international markets. The situation is more worrying when it comes to small and medium firms, only a limited proportion of which engage in exports. For example, Ayadi et al (2017) showed evidence that the overwhelming majority of Egyptian SMEs do not have any exporting activity, whilst roughly half of them depend on inputs of foreign origin. This very fact raises a number of questions about the implications of trade liberalisation in SEMCs. Indeed, a disproportionate increase in imports, compared to exports, could suggest that the asymmetric nature of trade agreements signed with the EU and the implementation of complementary support programmes for SMEs was not sufficient in helping domestic firms face the increased competition (and seize the opportunities) brought about by further trade openness. There are several obstacles facing MSMEs in their development and, necessarily, also in their internationalisation, as we shall see later on.

Ayadi, Giovannetti, Marvasi and Zaki (2019) showed that the integration of SMEs into global value chains (GVCs) remains very limited in the region. In the case of Tunisia, Sammoud and Dhaoui (2019) showed that integration into GVCs is low and often limited to assembly work in the manufacturing sector.

**Figure 1: Gross fixed capital formation by the private sector in % of GDP**



**Source:** World Bank Development Indicators. The data refers to 2018 unless stated otherwise. High-income countries are excluded from the computation of the average for Sub-Saharan Africa and Europe and Central Asia.





More broadly, MSMEs in the countries studied for the most part remained focused on low value added activities requiring the intensive use of an unskilled workforce (Morocco and Tunisia) or were associated with resource extraction (Egypt). This very fact is both cause and consequence of relatively low levels of private sector investment in most SEMCs. Figure 1 above shows that in those countries for which data is available, gross fixed capital formation expressed in percentage of the GDP is lower than the average for benchmark regions. Tunisia is an exception, although this should be checked against more recent data, the latest available dating back to 2009.

## OBSTACLES TO MSME GROWTH IN THE MEDITERRANEAN

Decades of research into the obstacles hampering the development of MSMEs and, more broadly, the private sector in countries such as Egypt, Jordan, Morocco or Tunisia have led to a certain consensus on where the main issues lie: lacking access to finance, a non-conducive business environment and limited entrepreneurial ambition. In their latest joint assessment of SME reforms in the SEMCs, the OECD, EU and ETF (2018) focused on the progress made in tackling these three issues - further evidence of their relevance for policy makers involved in support for MSMEs. In a previous study focused on the obstacles rather than the reforms implemented to tackle them, Ayadi and De Groen (2013) identified and ranked key factors preventing high-growth potential MSMEs from fulfilling their potential.<sup>3</sup> Their findings attested that limited access to finance and several issues related to the business environment – cumbersome administrative procedures, widespread informality, endemic corruption and lacking infrastructure – were the main obstacles to the development of MSMEs in Algeria, Egypt, Morocco and Tunisia.

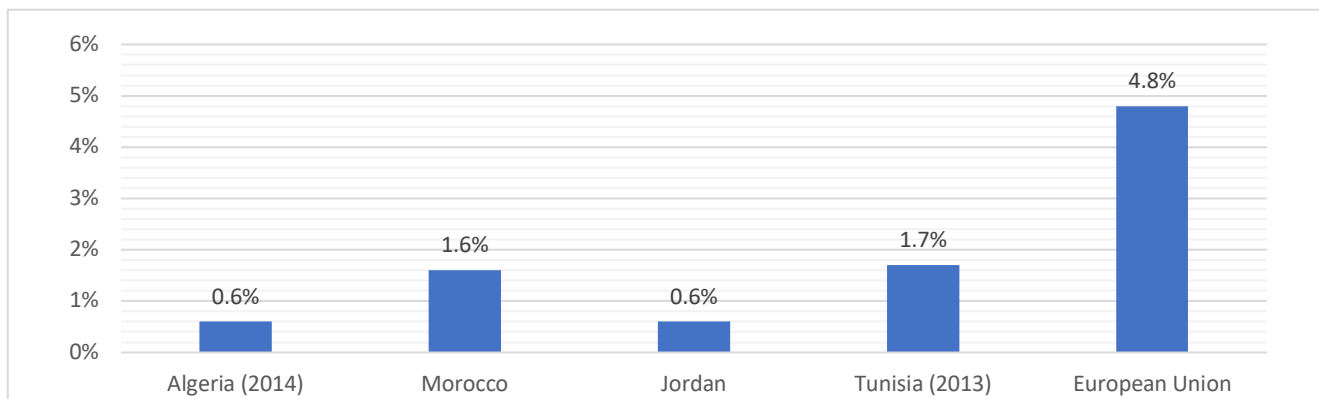
There is growing evidence that entrepreneurship is underdeveloped in the SEMCs. In Egypt and Morocco, the share of the population engaged in entrepreneurial activities, 13% and 9% respectively, was well below the global average in 2017, according to data published in the latest report of the Global Entrepreneurship Monitor (GEM). The situation is actually problematic when the data is disaggregated by gender. The share of the male population engaged in entrepreneurial activities was twice as high as the share of the female population doing so in Morocco and three times higher in Egypt. This is particularly worrying considering that in benchmark regions around the world (e.g. in the OECD), women often play an important role when it comes to creating businesses (for a discussion see Ayadi and Mouelhi, 2018). Figure 2 shows that business creation in the SEMCs for

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<sup>3</sup> The study provided the starting point for EMNES research on the obstacles facing the development of MSMEs.

which data is available is well below the EU average. The low level of entrepreneurship is a symptom of a poorly conducive business environment and persistent obstacles that hamper new business creation.

**Figure 2: New businesses registered per 1000 people in 2016**



**Source:** World Bank Development Indicators

Access to finance for MSMEs and new business remains a challenge. Ayadi et al (2017) showed evidence that in 2013, only 6% of MSMEs in Egypt received bank loans compared to 18% of large firms, according to data from the World Bank Enterprise Survey. In Jordan, only 8.5% of MSMEs were granted a loan, despite being responsible for three out of every four applications for credit. This is particularly worrisome considering that the lack of financing is one of the main factors pushing firms out of business in early development stages (GEM, 2018). In a survey conducted on the young and innovative start-ups, Sandri, Alshyab and Azzoui (2019) highlighted that most start-ups rely heavily on their personal resources in the early stages of their development and rarely consider turning to the financial sector as a realistic option for accessing finance (see also Ayadi et al, 2019). Despite the availability of finance, access to it for MSMEs and new businesses continues to be challenging due to several factors that are explored in Ayadi, Challita and De Groen (2019), such as the lack of financial data on MSMEs on the one hand and high lending rates on the other.

Political instability is another major factor that hinders MSMEs from innovation and growth. Starting from the assumption that innovative firms are more likely to grow, Mouelhi and Ghazali (2018) show that whilst large firms are by far the most innovative in the SEMCs, explaining partly why they are also the best performing in terms of productivity gains, their export contribution and employment creation, political instability is a major obstacle, however, to innovation and upgrading, insofar as it forces business owners to adopt a “wait and see” attitude. In 2014, 41% of the Tunisian firms



covered by the World Bank Enterprise Survey did not invest and identified the political situation as being the main factor behind their decision. Drawing on this assessment, Sandri and Alshyab (2018) confirmed that institutional uncertainty has a negative impact on growth and, thus, employment creation by firms in Jordan.

## POLICY AGENDA FOR MSME GROWTH AND JOB CREATION IN THE MEDITERRANEAN

Emerging trends are likely to shape the future development of MSMEs and, more broadly, the private sector in SEMCs, particularly in Egypt, Jordan, Morocco and Tunisia.

- Technology, digitalisation and automation. On the one hand, digitalisation is expected to offer new opportunities for MSMEs to adapt their business models, to facilitate access to finance and to new markets, whilst automation might enable them to reduce production costs and achieve productivity gains. Digitalisation may also provide governments with new opportunities and instruments to improve the business environment and mitigate against cumbersome administrative burdens and red tape. On the other hand, digitalisation and automation can have a profound impact on the labour market, entailing the destruction of some types of jobs, especially those involving repetitive low-skilled work, whilst creating new ones that require softer and more technological skills in a context where competition between workers is enhanced with the introduction of remote work and offshoring.
- Fiercer competition between countries, firms and workers as markets become more globalised, not only given propulsion by further trade liberalisation and deeper economic integration, but also in relation to the development of the digital economy. In the coming decades, an increasing number of firms and workers might be in the position to offer their services without having to be physically present in the place of delivery and, with the advent of technologies such as 5G and 3D printing, the same would apply to products. At the same time, these technological developments might result in renewed importance of market proximity, insofar as it would be possible to produce products at low cost close to the end consumer. This is also an opportunity for small and medium-sized domestic firms to engage in strategic partnerships with foreign groups.
- The progressive downsizing of public sector employment and the corresponding pressure on the private sector to contribute significantly to employment creation. In the coming decades, in a



context of increasing labour force participation in SEMCs, the public sector alone cannot create enough jobs to absorb increasing numbers of new entrants, or at least not without undermining productivity and putting at risk the sustainability of public finances. The gap in attractiveness between public sector and private sector employment is expected to reduce in terms of job security and, to a minor extent, income might either widen or shrink, depending on whether efforts to incentivise formalisation would succeed in tackling informality. Also, the role of public-private partnerships in the economy is expected to increase, most particularly in the case of large infrastructure projects, which puts pressure on governments to benefit from digitalisation trends which are moving towards enhanced transparency with the aim of tackling endemic corruption.

- The increasing social and environmental responsibility trends of the private sector. Consumers are increasingly socially and environmentally aware, pushing firms to adopt responsible behaviour or risk suffering reputational damages. Governments have a role to play in incentivising responsible behaviour, since inclusive and sustainable growth cannot be achieved without the contribution of the private sector, whose role in the economy is currently underdeveloped but is bound to increase in the coming years in SEMCs.

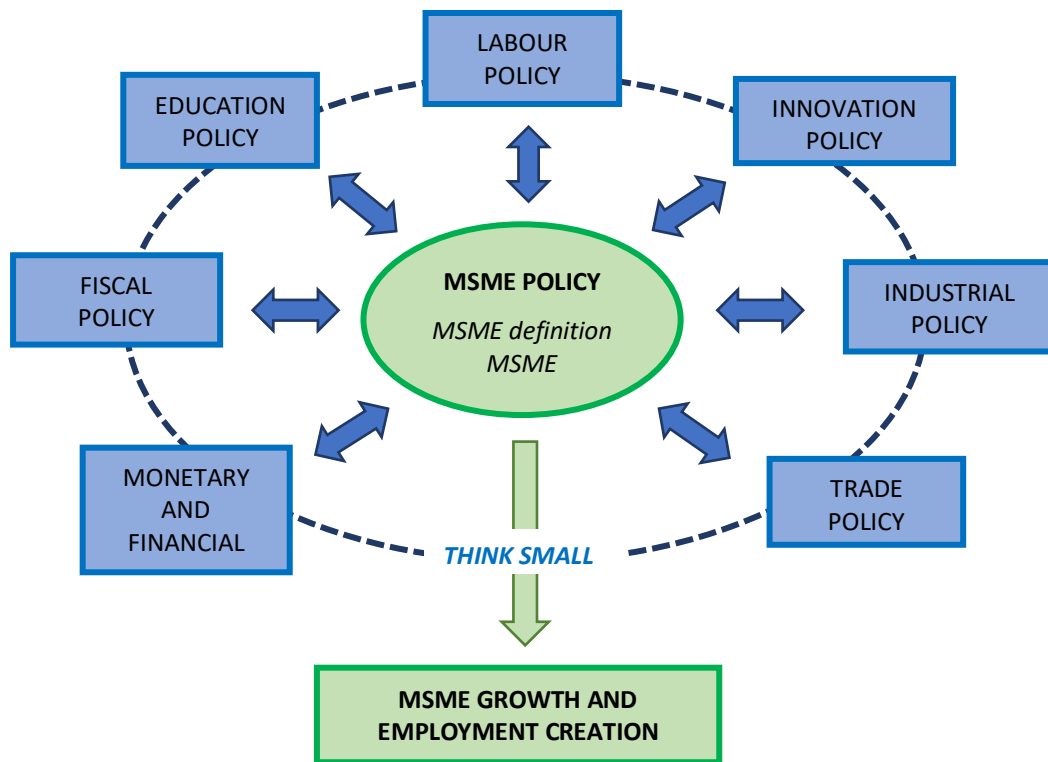
In the envisioned desirable future scenario, Egypt, Jordan, Morocco and Tunisia must nurture the private sectors to encourage greater innovation, growth potential and a higher employment contribution, as well as more integrated in global value chains. Private sectors must evolve to be resilient to shocks, with a critical mass of SMEs reaping the benefits rather than being victims of the digital economy and the green transition, and being inclusive, so that they generate decent and productive employment for all population groups. The support mechanisms needed for innovative start-ups to develop must be in place, along with the right incentives for social businesses to thrive and successfully contribute to meeting social and environmental needs. This scenario is in line with the Sustainable Development Goals (SDGs) and, most particularly, with the eighth goal, i.e. “to promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.” Finally, the scenario must be understood as a building block of a broader Blue Transition Scenario (BTS), a regional integration scenario enabling the shift to inclusive and sustainable development in the Euro-Med-Africa region (see Ayadi and Sessa, 2019).

After the identification of the main emerging trends and the definition of a desirable future scenario for MSMEs development in SEMCs, we formulate the policy roadmap aimed at achieving the desired scenario.

Figure 3 shows the policy framework that revolves around the formulation and implementation of an

MSME policy, to enhance the growth prospects and innovation capacity of MSMEs and, thereby, to maximise their contribution to employment creation. The framework also recognises the importance of mainstreaming a **Think Small First Principle** in the various policies having an impact on the business environment and the obstacles to the growth of and employment creation by MSMEs in order to achieve the stated aim. This principle was mainstreamed in Europe and the US for several years and has produced tangible results.

**Figure 3: Framework for the formulation for the policy roadmap on MSME development**



*Source: own elaboration*

In SEMCs, much remains to be done to create a workable, conducive business environment for MSMEs to thrive and to realise their potential for embracing innovation and creating jobs. Egypt, Jordan and, to a minor extent, Tunisia have ranked low compared to benchmark countries in the 2018 Doing Business Report of the World Bank, respectively 120<sup>th</sup>, 104<sup>th</sup> and 80<sup>th</sup> worldwide. Morocco is an exception and comes close to a number of EU member states in the rankings, in 60<sup>th</sup> position. The most pressing issues to address vary from country to country. For example, Jordan and



Egypt have scored particularly low in enforcing contracts and resolving insolvency, whilst Tunisia ranked poorly in paying taxes and trading across borders. That said, informality is widespread in the four countries, suggesting that the costs of formalisation remain prohibitive for MSMEs and SEMCs should double their efforts to reduce them, e.g. by establishing one-stop shops or developing e-government solutions to streamline administrative procedures.

Egypt, Jordan, Morocco and Tunisia have all embarked in setting up the building blocks of a fully-fledged MSME policy, although with varying degrees of success. In that sense, the OECD, EU and ETF (2018) have recently published a report providing a detailed assessment of key measures and reforms implemented across eight SEMCs. That said, formulating, implementing and monitoring a fully-fledged SME policy is not sufficient to create a conducive environment in which MSMEs can thrive. SEMCs should also ensure that the perverse effects of policies seemingly unrelated to the development of MSMEs do not undermine their efforts to tackle the obstacles the latter face in their growth and, hence, their capacity to create jobs. The experience accumulated by the EU in streamlining the **Think Small First Principle** at all levels of government is valuable and should be leveraged in SEMCs.

The proposed comprehensive framework to formulate, implement and monitor a fully-fledged MSME policy that complements the assessments carried out by the OECD, EU and ETF. The MSME policy must mainstream a **Think Small First principle** and support growth of and employment creation by MSMEs in the various policy areas relevant to their development.

## MSME policy: Think Small First Principle

SEMCs should continue efforts to build effective coordination and consultation mechanisms, ensuring that the actual needs of MSMEs are appropriately taken into consideration in the formulation, implementation and monitoring of their MSME policy. At government level, inter-ministerial coordination should become the modus operandi in the formulation of the MSME policy – the pre-condition for the effective mainstreaming of a think small first principle in all public policies.

The implementation of the MSME policy should be entrusted to a dedicated agency with a sufficient budget to assume a central role in the MSME ecosystem, coordinating between the different stakeholders. In the four countries considered, MSME agencies are already operational or in the process of becoming so, but their role should be stepped up. To support the formulation of MSME policies, the agencies should centralise the expertise needed to propose policy solutions, informed by



both the latest available data and inputs from stakeholder consultations. To this purpose, agencies should host observatories tasked with the collection of detailed and disaggregated data on MSME dynamics and be given the power to collect data from various administrative sources, also in view of providing the best possible service to MSMEs themselves. Progress has been made in the four countries under study and, in some cases, the agencies established to support MSMEs already host an observatory. However, the inter-operability of administrative sources and cross-country comparability of data remains a major obstacle to the development of these observatories, especially when it comes to supporting the internationalisation of MSMEs. A first step in the right direction would be to adopt a unified definition of MSME between SEMCs, preferably harmonised with the EU definition but with a much lower size. As regards to the stakeholder consultations, all relevant actors should be involved – relevant ministries, financial institutions, professional associations and third parties – making sure that the diversity of the MSME sector is well represented.

The observatories established within MSME agencies should also centralise information about existing support structures and programmes, best practices and technological developments that are relevant to MSMEs. A certain share of their budget should be allocated to communication and dissemination campaigns, to make sure that the information reaches out to a maximum number of MSMEs. MSME agencies should not only provide basic information to MSMEs, but also a whole range of services for their upgrading, including advice on how to deal with administrative matters, access to finance or engaging in exporting activities, training on important issues such as producing a business plan or meeting quality standards, and networking events. Last but not least, MSME agencies should leverage their role as both observatory and service provider to monitor the evolution of the MSME sector and the impact of policies implemented in its support. That said, MSME agencies should be relatively independent from the government performing such a role, although this is seldom the case in the countries being considered.

MSME policies must be developed in conjunction with other government policies relevant to their growth, i.e. monetary and financial policy, fiscal policy, education policy, labour policy, innovation policy, industrial policy and trade policy. In the following sections, specific recommendations concerning the various policies identified are formulated.

## **Monetary and financial policy**

The lack of access to finance is the single most important obstacle to growth and employment creation by MSMEs. Besides, continuing to implement laws to secure financial transactions, to efficiently register lands, to maintain registries of moveable assets, and unique identifier for firms to



make their information easily and readily available, Ayadi, Challita and De Groen (2019) formulated a number of additional recommendations to widen the access to affordable financial services for MSMEs. These include developing credit information registries and guarantee schemes, promoting digital financial services and investing in enhanced financial literacy.

To maximise their positive impact, guarantee schemes could be complemented with technical assistance in the preparation of business plans or in the management of cash flow cycles (see Ayadi et al, 2019). The schemes could also be used to achieve specific objectives such as incentivising youth and women entrepreneurship or supporting the development of the social and solidarity economy by facilitating access to guarantees for specific target populations.

MSMEs have often cash flow problems that hinder their capacity to pay their loans if they are granted one. They are generally excluded de facto from government procurement contacts because of the complex procedures and requirements that are not adapted to the capacity of smaller firms, calling for the application of the Think Small First principle in public tendering procedures. Innovative mechanisms to facilitate the participation of MSMEs could also be explored, e.g. development of e-procurement. That said, public administrations are often directly responsible of substantial delays in payment of public contracts, whereas payment delays are a major determinant of MSME closures because of unstable cash flows. Hence, governments should take action to ensure that public contracts are settled in a timely fashion and more broadly, that dispute resolution laws are enforced.

## Fiscal policy

In the SEMCs, low levels of institutional quality and widespread informality is another important limitation to employment creation by both informal MSMEs facing the risk of closure and formal MSMEs forced to deal with unfair competition and a disproportionate tax burden that, in turn, incentivises further informality. In their paper, Sandri and Alshyab (2018) brought evidence that institutional uncertainty and corruption negatively affect firms' decisions to hire. Their findings underscore the importance of making the fiscal system more predictable and deploy credible and tangible policies to fight corruption and tax evasion.

It is also urgent to embark in the necessary reforms to tilt the incentive balance towards formalisation and curtail free-riding behavior in the private sector. This is by no means an easy task. Badawi (2019) recalled that most institutional development interventions do not produce the desired outcomes because they are not implemented in a vacuum, but in a context of institutional failure.





The author identified in the collaboration of strong, reform-minded leaders within bureaucratic units requiring reform a key factor of success. The appointment of SME envoys responsible to ensure that the Think Small First principle is integrated into all government bodies by national governments in EU countries could provide a model for the SEMCs. It must be noted, however, that it remains largely unclear how effective SME envoys have been in achieving their objective.

To support entrepreneurship, tax reductions and exemptions in the fiscal years immediately following the establishment of a job-creating new business should be applied, with particular emphasis on certain categories, such as young and female entrepreneurs. The same principle could be applied to the immediate fiscal years following bankruptcy, to support rather than penalise risk-taking attitudes that are value enhancing.

## Education and labour policies

The creation of new businesses and the growth of existing ones are hindered by the high incidence of mismatches between the skills acquired in educational systems and the jobs available on the labour market characterising most SEMCs. In their paper, Alcidi and Laurensyeva (2019) identified two priority areas for structural reforms. First, provide incentives to firms to affiliate workers into social security, to reduce the divide in protection between public and private sector employment and enhance the capacity of MSMEs among other firms to attract talent of private firms. Second, investing in entrepreneurship education and nurture entrepreneurial attitudes at all levels of education, to boost the creation of new MSMEs driven by business opportunity.

In particular, quality investments in vocational education and training should be prioritised. The latter currently lacks prestige, partly because of limited involvement of the private sector in existing programmes, whereas the participation of experienced business owners and investors is a crucial quality criterion. The growth prospects of micro and small firms are tightly linked to the management skills of business owners, which should be enhanced with training programmes covering areas such as drafting business/investment plans, adopting quality/risk management procedures, following accurate accounting/financial/regulatory standards, expanding network of contacts or engaging in exporting activities.

Besides more structural reforms, active labour market policies have an important role to play in mitigating the incidence of skills mismatches and enhancing access to skills by MSMEs. In their paper, Ayadi and Sessa (2019) identified in the limited availability of labour market data and the resulting



lack of efficient information systems a major factor hindering the effectiveness of policies implemented in the SEMCs. The development of labour market information systems should be made a priority.

## Trade and industrial policies

In the SEMCs, MSMEs are seldom involved in exporting activities and their integration into global value chains is very low. Zaki (2019) identified a number of priority areas to boost export performance and ultimately employment contribution of MSMEs through greater value chain integration. These include attracting foreign investments in the SEMCs' manufacturing sectors, incentivizing technology transfers across the Mediterranean and facilitating "domestic integration" that is, strengthening the connection between highly productive global firms, potential local suppliers and domestic labor force, e.g. through cluster development. To attract foreign investment, measures to improve the business environment and increase industrial capacity should be taken, with a focus on the development of digital infrastructure, which is needed to prepare MSMEs for participation in increasingly digitalised value chains.

In the Euro-Mediterranean region, the potential of regional value chains remains largely untapped, this notwithstanding geographic proximity, trade liberalisation and complementary differentials in terms of know-how, labor costs and resource endowment should have facilitated their emergence, at least in principle. The lack of political stability in recent years has decisively influenced this outcome, but the current situation does nonetheless underscore the potential benefits of devising an industrial policy for the region. The latter should aim at facilitating the emergence of regional value chains and to a certain extent the reindustrialisation of the SEMCs, while being explicitly oriented towards the inclusion of MSMEs. In particular, MSMEs that have a high growth potential in strategic sectors of the economy should be supported with dedicated instruments, in line with country comparative advantages identified at the regional level.

## Innovation policy

The development of digital infrastructure is also a means through which governments in the SEMCs can support innovation, which is important insofar as innovative MSMEs are those more likely to grow, but often the more fragile especially in the early, crucial phases of their development. Badawi and El Zoheiry (2019) formulated recommendations for the development of enabling innovation



systems in the SEMCs, some of which are relevant for the development of MSMEs. These include reinforcing linkages between research and business, which requires exploiting the full potential of public-private partnerships, and encouraging the development of frugal and inclusive innovation, especially at the local level.

Business incubators have an important role to play in supporting innovative start-ups. Sandri, Alshyab and Azzioui (2019) and Zaki and Zeini (2019) highlighted how existing structures in the SEMCs proved successful in attracting young entrepreneurs by providing them with advice, resources, mentors, contacts and even funding. To leverage their full potential, business incubators should be connected to one another, e.g. through the creation of regional networks and the organization of networking events at the national and regional level.

## Role of the EU

In recent decades, the EU has played an important role in supporting the growth of and employment creation by MSMEs in SEMCs, both by advocating the formulation and implementation of MSME policies and by providing direct support to MSMEs through a number of initiatives. Together with the OECD and ETF, the EU contributed by monitoring the progress achieved by SEMCs in implementing the Euro-Mediterranean Charter for Enterprise adopted in 2004 (see OECD, EU and ETF, 2008; 2014; 2018). Since 2008, the Small Business Act for Europe provided the reference framework for these monitoring exercises and, more broadly, for cooperation on MSME development between EU and SEMCs, suggesting that institutions involved in the formulation and implementation of MSME policies in the latter are already familiar with the Think Small First principle. That said, there is still a long way to go for the principle to become mainstream at all levels of policy. To speed up the process, the Euro-Mediterranean Charter for Enterprise could be replaced by a new document inspired by the Small Business Act for Europe, in which SEMC heads of government would commit explicitly to mainstream the Think Small First principle. The EU, through the ministerial conferences organised under the UfM, should provide the impetus for such development.

In ten years of implementation of the Small Business Act for Europe, the EU accumulated a number of lessons learnt that SEMCs can benefit from. In particular, measures to ensure that the information contained in the EuroMed Database of Good Practice<sup>4</sup> is widely diffused and its potential to spur

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<sup>4</sup> For more information, refer to: <http://ec.europa.eu/growth/tools-databases/sme-best-practices/euromed/index.cfm?fuseaction=welcome.detail> (accessed 27 May 2019).



emulation between SEMCs fully exploited could be taken. The database currently contains information on best practices in improving the business environment and spurring entrepreneurship by public authorities in the Euro-Mediterranean area, collected through various EU sources. To increase its relevance, best practices and success stories in the private sector could be collected, for example via enhanced collaboration with MSME associations and observatories.

The EU has multiplied efforts to enhance access to financing by MSMEs. In 2018, the new External Investment Plan was launched, worth a total €4.1 billion and expected to leverage up to €23 billion in public and private investments through a mix of guarantee and blending facilities.<sup>5</sup> Improving access to finance for MSMEs, including those in the agricultural sector, is a priority area of the investment plan, which also foresees the provision of technical assistance to beneficiaries in order to develop financially attractive and viable projects. This is crucial, insofar as the lack of business plans often hampers access to finance by MSMEs in SEMCs. That said, widespread informality might prevent a majority of MSMEs to benefit from guarantees and investments. The EU should, therefore, step up its role in favouring formalisation. For example, the perspective of accessing the EU single market can be an important incentive for MSMEs to formalise and, in that respect, solutions should be explored. Furthermore, MSMEs are often unaware of the opportunity to access EU finance or they lack the human resources needed to deal with the requirements associated with it. Here, the collaboration SME associations and business incubators at the local level, for example in conducting outreach activities and supporting MSMEs in the application process, could prove valuable.

To support the internationalisation of MSMEs, particular attention to their specific needs should be paid in future trade negotiations for the creation of a Euro-Mediterranean free trade area, which in turn should remain a priority for the region. Several SEMCs have expressed doubts over the feasibility of achieving full legislative alignment with the EU and negotiations based on that premise should be reviewed to better fit the needs of SEMCs. In particular, areas where there is a strong commitment from SEMCs to achieve tangible results could be prioritised in trade negotiations. The potential for South-South integration remains largely unexploited, whereas MSMEs might find it relatively easy to expand and compete in neighbouring markets with similar characteristics, compared to entering the EU single market. The EU has been placing increasing emphasis on the subject in recent years and embarked on several attempts to revive the Agadir Agreement,<sup>6</sup> but

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<sup>5</sup> See [http://europa.eu/rapid/press-release\\_IP-18-4385\\_en.htm](http://europa.eu/rapid/press-release_IP-18-4385_en.htm) (accessed 27 May 2019).

<sup>6</sup> In 2017, the UfM launched the Agadir SME programme, which aims at enhancing the competitiveness of SMEs and expanding their use of the cumulation of origin, in view of increasing intra-trade among the four Agadir Agreement



continues to prioritise bilateral over regional trade negotiations, whilst it could leverage its role as the primary trading partner of virtually all SEMCs in order to foster South-South cooperation and integration.

The development of a Euro-Mediterranean industrial policy, aimed at facilitating the emergence of regional value chains and boosting the participation of MSMEs in these, could provide new impetus to the Euro-Mediterranean partnership. In 2017, the EU adopted a renewed Industrial Policy Strategy on investing in a smart, innovative and sustainable industry, aimed amongst other things at maintaining and reinforcing Europe's leadership in global industry. The strong trade ties linking EU and SEMCs and the progress achieved over the years in Euro-Mediterranean industrial cooperation (PEM convention, UfM ministerial conferences and expert meetings, etc.) provide a vantage point for the EU to step up its leadership role in the development of regional value chains. However, this does not seem to be a strategic priority in current industrial and trade policies, whereas other actors, such as China, are expanding their involvement considerably in the region's industrial sector. To restore the confidence of investors and to facilitate the emergence of regional value chains, efforts in the direction of political and socio-economic stabilisation should be continued.

The development of regional business networks is crucial to support internationalisation and innovation by MSMEs. The number of initiatives in that sense multiplied in recent years. The EU and the UfM promoted the scaling-up of entrepreneurial activities through initiatives such as the Enterprise Europe Network, based in the EU but which is open to the SEMCs, the Mediterranean Entrepreneurship Network or the SIEMed Network, whose originality lies in leveraging know-how from a diaspora of communities. These networks could be leveraged to increase the attractiveness of entrepreneurship in SEMCs, for example by linking entrepreneurship with access to international mobility, something that was already experimented with in the previously mentioned HOMERe project. The EU and the UfM also supported network development aimed at expanding business linkages between MSMEs and business support organisations, e.g. via the EU-funded EBSOMED project<sup>7</sup> or the establishment of the Euro-Mediterranean Development Centre for Micro, Small and Medium Enterprises, conceived as an integrated and widespread network of business development support centres.

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member countries and their exports to the EU. See: <https://ufmsecretariat.org/project/agadir-sme-programme-fostering-sme-competitiveness-and-trade-in-the-agadir-agreement-member-countries/>

<sup>7</sup>See: <http://ebsomed.eu/en/about-ebsomed>





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