



DIRECTORATE-GENERAL FOR EXTERNAL POLICIES
POLICY DEPARTMENT



**SMALL AND MEDIUM
SIZED ENTERPRISES
(SMES)
IN THE SOUTHERN
MEDITERRANEAN**

INTA



DIRECTORATE-GENERAL FOR EXTERNAL POLICIES OF THE UNION

DIRECTORATE B

POLICY DEPARTMENT

STUDY

SMALL AND MEDIUM SIZED ENTERPRISES (SMES) IN THE SOUTHERN MEDITERRANEAN

Abstract

In the Southern Mediterranean, micro, small and medium sized enterprises (MSMEs) represent a substantial share of registered companies and employ 25% of the labour force. In Egypt, Jordan, Morocco and Tunisia, MSMEs are concentrated in trade, light manufacturing and textiles. Widespread informality, corruption, insufficiently skilled labour force and difficulties in access to finance stand as the major obstacles faced by the region's small businesses. EU's and Member States development assistance flows have addressed these concerns only partially: between 1995 and 2009, aid flows for MSMEs accounted for 10% of total development assistance and was split among a high number of initiatives, lacking a coherent strategy.

The challenge of job creation has been highlighted by the 2011 upheavals and puts MSMEs at the centre of future economic strategies. In the context of the renewed European Neighbourhood Policy, this note focuses on Egypt, Jordan, Morocco and Tunisia and has four objectives. First, it seeks to provide with a description of MSMEs in these countries, their contribution to employment, the sectors in which they are active as well as the constraints they face. Second, it moves on to assess both EU's and Member States' development assistance commitments for MSME support. Third, it provides with a picture of foreign direct investments (FDI) and partnerships concluded between European and Egyptian, Jordanian, Moroccan and Tunisian SMEs. Fourth, it reviews the visa policies applying for business persons in the region. Finally, it provides with recommendations to support the development of MSMEs within the framework of the Euro-Mediterranean Partnership.

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EXECUTIVE SUMMARY

Egypt, Jordan, Morocco and Tunisia account for more than 4 million formally registered micro, small, and medium sized enterprises (MSMEs) employing 25% of these countries' labour force. Taking into account widespread informality yields even higher figures. Available figures show that a significant share of formally registered businesses is micro in terms of size and that MSMEs are mostly active in trade, tourism, services and light manufacturing.

The constraints faced by MSMEs in these countries are in line with those of bigger companies: competition from the informal sector, corruption, lack of skills and access to finance rank are the four major obstacles hampering their development. Regarding informality and corruption, policies based on penalization cast doubts on their efficiency and call rather for an approached based? on providing incentives for small companies to register their activities. A better quality of education should gradually soften companies' skills' obstacles. Durable alleviation of constraints in access to finance requires both better macroeconomic and regulatory frameworks as well as a stronger financial infrastructure.

EU's and Member States' development assistance commitments for MSME support and development have amounted to € 2.4 billion between 1995 and 2009. In line with the goals set by the Euro-Mediterranean Charter of Enterprise and the Mediterranean Business Development Initiative, they are spread among a wide range of initiatives ranging from support to industrial modernization programmes to funding of business support institutions, provisions of credit lines to banks and microfinance institutions and financing of export promotion activities. Despite commitments for MSME, development assistance represents 10% of total commitments to the countries under study, Member States and EU institutions do not seem to follow a clear and legible strategy for MSME development in the region.

Foreign Direct Investment (FDI) by European small companies into their Egyptian, Jordanian, Moroccan and Tunisian counterparts has been on a steady rise since 2000 and has proven to be more resilient to the financial crisis. Yet, figures remain very low with less than 5% of total EU's FDI to the countries under study. In contrast, as a way to enter Southern Mediterranean markets, European small companies are keener on concluding partnerships such as licensing and franchise agreements.

If business persons travelling from the EU to the Southern Mediterranean are subject to soft visa conditions, their Egyptian, Jordanian, Moroccan and Tunisian counterparts are subject to stringent conditions that potentially hamper the development of commercial and financial links. While Member States do not disclose precise data on the number and purpose of visa applications to the European Commission, it is possible to infer from available sources that business persons suffer from the securitisation of European migration policies.

Recognizing the importance of small and medium sized companies in the Southern Mediterranean, EU's new neighbourhood policy pledges to support them more. Measures should target the alleviation of financing constraints through the provision of counter-guarantees; easier visa conditions for small companies trading with the EU; support for clusters being established by local governments; and, assistance for the creation of statistical information concerning formal and informal MSMEs in the Southern Mediterranean.

1. CHARACTERISTICS AND CONSTRAINTS TO GROWTH OF MSMEs IN THE SOUTHERN MEDITERRANEAN

1.1 Descriptive analysis of MSMEs in Egypt, Jordan, Morocco and Tunisia

1.1.1 Data sources

Micro, small and medium sized enterprises (MSMEs, alternatively referred to as small companies or businesses), are widely recognized as playing a vital role in both developed and developing economies. For example, in the EU these enterprises represent approximately 99% of total registered companies. Likewise, in the Southern Mediterranean countries under study, MSMEs have by far the largest contribution to overall economic activity and job creation, employing approximately 25% of the total labour force.

Despite the central roles of MSMEs, cross-country data on these opaque entities is scarce, due to a number of reasons. For one thing, there are severe discrepancies in the MSME definitions across countries, which introduce comparability issues. Moreover, as many countries at best conduct sporadic statistical surveys or censuses, consistent time-series information is hard to come by. Lastly, institutional weaknesses and widespread informality undermine the reliability of existing data.

In an attempt to overcome some of these obstacles, the International Finance Corporation (IFC) compiled an aggregate database on MSMEs covering a cross-section of 132 countries. Although a good source, the IFC data relies entirely on national surveys and uses the local MSME definitions. Table 1 shows that the variation in the definitions and the coverage.

Table 1. Data availability on MSMEs and employment thresholds used in definitions

	Year of latest survey	Sector distribution	Micro	Small	Medium
Egypt	2006	No	1-5	6-10	11-100
Jordan	2007	Yes	1-4	5-19	20-99
Morocco	2002	Yes	1-9	10-49	50-199
Tunisia	2009	Yes*	1-9	10-49	50-249

Source: MSME Country Indicators 2010 (IFC). * Available data cover only MSMEs active in the manufacturing sector

Another data source is the World Bank's Enterprise Surveys data. The database covers 125 000 small medium and large businesses in 132 countries operating in the manufacturing and services sectors. Initiated in 2002, the Enterprise Surveys are firm-level surveys of a representative sample of an economy's private sector, conducted as face-to-face interviews with the firm's owners and top managers. Since data on employment levels are provided in almost all surveys, micro-data allows researchers to use their own MSME definitions. The Enterprise Surveys suffer from

a potential sample selection biases. Indeed, depending on the countries, they have a tendency to overweight either medium sized companies (Egypt), or small companies (Morocco). Moreover, the surveys are likely to be biased towards companies where the manager-owners have a threshold level of skills and more likely to include formal enterprises thus likely neglecting an important proportion of the MSMEs.

Keeping in mind the shortcomings in each data source, this study relies on the two data sources identified above, namely the IFC's aggregate database and World Bank's Enterprise Surveys. Whenever applicable, the potential limitations regarding the data are highlighted. Moreover, consistency checks are also performed to ensure that the reported figures are the most accurate ones.

1.1.2 Main characteristics of MSMEs in Southern Mediterranean

In an attempt to understand the role that MSMEs play across the Southern Mediterranean countries, it may be useful to look at their relative importance in each country. In each case, the relevant measures are also compared to the world-wide averages for developing and developed countries to provide a better understanding of where the Southern Mediterranean MSMEs stand.

According to latest IFC figures, there are a total of 125 million formally registered MSMEs worldwide of which 71% (89 million) operate in developing economies. The average MSME density per 1 000 inhabitants is of 31; and, broadly speaking, countries with higher GDP per capita tend to have more formally registered small companies (Table 2). While for most of the countries in the database data on unregistered small businesses are not available, the negative correlation between income and business registering suggests developing countries share a common set of characteristics which might be acting as drivers pushing small companies' owners not to register their activities (see below). (Kushinir et al., 2010).

Table 2. MSME number, density and contribution to total employment

Country	Number registered (million)	of MSMEs	MSME density per 1000 inhabitants	MSME employment (% total)
Egypt	2.45		31.2	31.2
Jordan	0.74		25.6	25.6
Morocco	0.75		25.4	25.4
Tunisia*	0.005		0.6	0.6
High income OECD members	36.87		45	45
Developing economies	89		..	33

Source: MSME country indicators Kushinir et al., 2010 Note: *Data on Tunisian MSMEs cover the manufacturing sector only

Globally, MSME densities grew at a rate of 6% between 2000 and 2009, with developing countries witnessing higher growth rates possibly due to an income catch up effect. In terms of employment, micro and small companies located in high income countries represent approximately 45% of the work force compared to approximately 33% in developing economies, thus highlighting their major role as job providers (Kushinir et al., op.cit).

In Egypt, Jordan, and Morocco the MSME density is smaller than world figures with an average of 27 micro, small and medium sized businesses for 1000 people. Egypt has the highest density, with 31 small companies per thousand people, whereas Jordanian and Moroccan proportions are at 25 per thousand. In these two countries, the number of MSMEs between 2000 and 2009 grew at a faster pace than the rest of the world, with an average growth rate estimated at approximately 10%.

In terms of the size patterns of small companies in the countries under study, data show that the distribution between MSMEs is heavily skewed towards micro enterprises: they represent approximately 90% of all registered MSMEs (Table 3).

Table 3. MSMEs share in total in total registered companies (% of total)

	Micro	Small	Medium
Egypt, Arab Rep.	98.1	1.7	0.1
Jordan	89.1	9.2	1.6
Morocco	97.8	1.9	0.3
Tunisia	9.2	59.0	31.8

Source: IFC, op.cit

From a historical perspective, the preponderance of micro companies in the region is explained by the lack of big private sector enterprises due to limited entrepreneurial traditions in Southern Mediterranean upper middle classes (Gallina, 2001). Other potential explanations might exist such as a preference towards not registering properly businesses in order to avoid paying taxes. As a consequence, most companies are small, family-owned, with low ratios of capital investment and overwhelmingly focused on serving local markets. Furthermore, small companies in the region are not only productive economic units, but they also represent social structures where demand and supply are highly interconnected. For example, an important number of micro and small companies operating in traditional market structures such as “souks” form cartels to demand lower prices for some of their inputs while being market competitors. In this regard, southern Mediterranean MSMEs are radically different from their European counterparts (Gallina, op.cit).

1.1.3 Sector distribution and MSMEs characteristics

According to IFC figures, in the Southern Mediterranean countries under study, MSMEs are mostly active in three areas: retail trade, services to other enterprises, and manufacturing. Differences

exist with respect to the size of companies operating in these sectors, as well as within the different activities they undertake. While available sources do not allow for cross country comparisons due to the absence of reliable data, some broad patterns can be distinguished.

In Jordan and Morocco, countries in which disaggregated data on the sector-size distribution of MSMEs exists, micro companies are essentially active in retail trade and repairing of household items. 60% of the micro companies registered in Jordan in 2006 are active in this branch. In Morocco, approximately half of the micro enterprises registered under the latest economic census in 2002 report to conduct such activities. In both countries, the remaining micro companies are split between manufacture of metal products and furniture, hotels and restaurants. The latter two categories are driven by the importance of the tourism industry in the region: estimates report that 95% of tourism enterprises in the Mediterranean are MSMEs (Lanqar, 2011). While disaggregated data on the activities of Egyptian MSMEs is not available, evidence reported in the literature show the same trends (El Mahdy, 2007).

If in the above cited countries the distribution of micro companies is concentrated in the manufacture of metal products and furniture, hotels and restaurants, the activities of small and medium sized companies are more evenly distributed between consultancy, transportation, wholesale trade, hotels and restaurants.

In spite of these marginal differences regarding the activities of micro and small companies, previous research has shown both categories are highly similar (Gallina, op.cit). Most of the smaller enterprises operate in small workshops, many of them set inside the owners' houses. They employ family members, waged employees as well as apprentices. They use rather old equipment and many rely on informal finance rather than banking or microcredit institutions. A very small proportion of these enterprises engage in exporting activities, and develop inter-firm linkages with foreign-owned firms translating into the bulk of small companies serving highly localized markets. On the demand side, structural adjustment programmes and the focus on export led growth translated into low wages, which combined with insufficient job creation resulted into a decline in households' purchasing power that affected negatively SMEs. (Gallina, op.cit; Mejjati-Alami, 2008)

1.1.4 Textiles: a high growth potential sector

Within the manufacturing sector of Morocco and Tunisia, textiles show the highest concentration of small and medium sized companies. In the two countries, between 14 and 35% of all MSMEs operate in the textiles industry. In contrast, the Jordanian MSMEs exhibit only a marginal concentration in textiles, due to a less focus on this sector by Jordanian policymakers and to the dominance of larger companies in textiles' production and exports.¹

Besides the traditional importance of the textiles industries in Egypt, Morocco and Tunisia, the end of the multi-fiber agreement (MFA) in 2005 as well as EU's enlargement help explain these trends (World Bank, 2006). While Egypt, Morocco and Tunisia have long been traditional suppliers to the

¹ Disaggregated data are not available for Egypt.

EU market, EU's enlargement and trade liberalisation with the East Asian countries raised competition. The increased competition faced by Southern Mediterranean countries forced them to upgrade production processes in a bid to keep exporting to the EU. Indeed, Southern Mediterranean countries altogether² are important exporters to the EU: between 1988 and 2002 the share of textiles and clothing in the region's total exports has amounted to 20%.

Proactive policies designed since the end of the 1990s have resulted in a number of measures aimed at fostering the development of the MSMEs active in the textile sectors in the three countries. In Egypt, textiles were included in the EU-funded industrial modernization programme, which introduced assistance measures to engage in innovation and facilitate access to foreign markets. Since 2005, Morocco developed a regulatory framework to develop co-contracting along the textiles value chain, mostly with EU based companies. While sub-contracting entails the outsourcing of a production process, co-contracting implies a partnership between two companies in which they both engage in developing jointly a product. Co-contracting allows moving up the value chain by specialising along various stages of product development. Meanwhile, Tunisia embarked in a pro-innovation strategy with the creation of textiles' research centres, schools and industrial clusters.

1.2 Key obstacles faced by MSMEs

The growth and productivity of Southern Mediterranean MSMEs is hampered by a number of obstacles, ranging from difficulties stemming from deficient infrastructure, difficult access to bank lending, unsuitable business and regulatory climate etc. The World Bank Enterprise Surveys are an attempt to gain deeper insights on the constraints affecting businesses worldwide. The Surveys use standardised definitions of MSMEs. They have been conducted in 2006 in Jordan, 2007 in Morocco and during 2006 and 2008 in Egypt. No Survey has yet been undertaken in Tunisia.

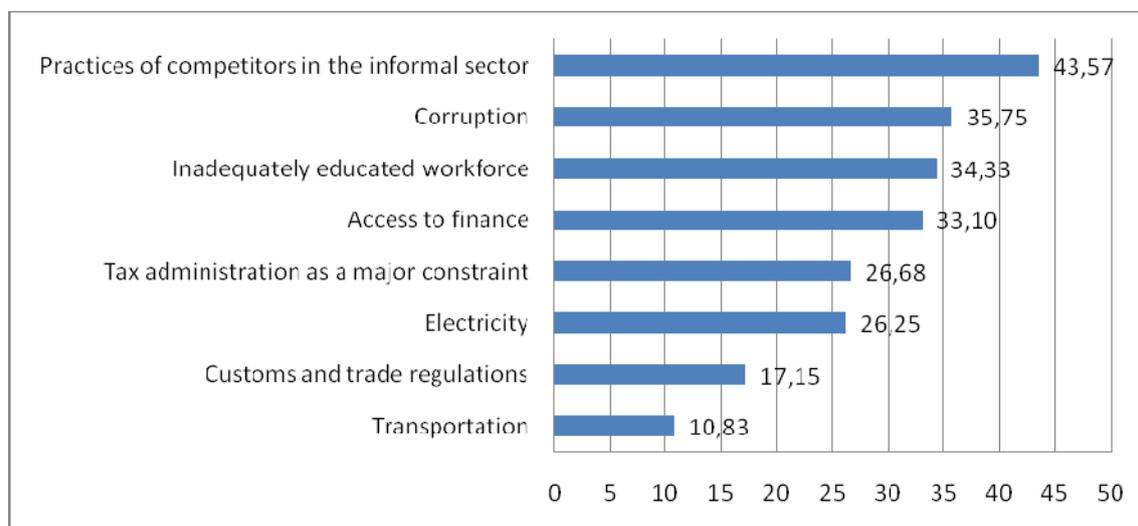
Table 4. Enterprise Survey's definitions of SMEs

Size of company	Employment threshold
Small	<19
Medium	<99
Large	>100

The results show that, on average, small and medium sized firms are subject to the same constraints as larger companies. Informality, corruption, skills, and access to finance are reported to be the most significant obstacles faced by Egyptian, Jordanian, and Moroccan businesses (Figure 1). In a number of studies, these variables are grouped under the notion of "investment climate"³ yet to allow identifying as much as possible their specificities in the Southern Mediterranean context and treated separately in what follows.

² Algeria, Egypt, Jordan, Lebanon, Morocco, Palestine, Syria, Tunisia and Turkey

³ See for example Escribano, Guasch (2005)

Figure 1. Constraints faced by Egyptian, Jordanian, and Moroccan small and medium sized companies (Major constraints identified by SMES in percentage)

Source: World Bank Enterprise Surveys Database

1.2.1 Informality and corruption

According to the International Labour Office, seven criteria can be used to distinguish formal and informal activities. The latter are characterized by the relative ease in setting a business, unregulated competition, family proprietorship, small scale and labour intensive activities, recourse to local labour, and skills acquired outside formal schooling (Mejjati-Alami, op.cit). In Southern Mediterranean economies, despite the lack of recent studies addressing the question, informal activities are estimated to account for a substantial share of national incomes (Table 4) and employ a significant pool of workers.

Table 5. Estimates on the size of the informal economy

Country	Size of the informal economy (% of GNP, 1999-2000 averages)
Egypt	35.1
Jordan	19.4
Morocco	36.4
Tunisia	38.4
China	13.1
Poland	27.6
Germany	16.3

Source: Schneider (2002)

The numerical importance of informal activities is driven by a set of common factors in the countries under study dating to the 1960s, where policymakers, sought to develop autarchic economies based on import substitution and capital intensive industrialization (Mejjati-Alami, op.cit) Such development models failed to deliver jobs to a growing population who was left to develop unregistered subsistence activities. Later, the implementation of structural adjustment plans and the focus on export promotion as well as on external competitiveness prevented wages from rising and a robust wage system from emerging, which induced people to stay in the informal sector to complement income. Finally, the growing rural exodus and the urbanization mismanagement strengthened previous trends, leading to the emergence of a number of small scale activities in the manufacturing and services sectors that compete both with formal activities as well as with informal ones (Mejjati-Alami, op.cit)⁴. Obviously, the high unemployment registered in these economies are also an important driver of informality.

In addition to unsuited development models, uncontrolled urbanization, and lack of formal employment prospects, informal activities are also driven by a weak institutional framework characterized by cumbersome bureaucracies and corruption. For example, research in the context of developing economies has shown that more flexible labour regulations in terms of hiring and layoffs led to decreases in informal employment as well as increases in the number of formally registered companies (Sharma, 2009). High corporate tax rates act as an incentive for entrepreneurs not to register their activities (Djankov et al., 2010). The perception that corruption is high most probably also spurs informality. The registration of previously informal activities can be interpreted as a signal given by entrepreneurs to rent seeking officials who might turn to them for bribes (Safavian, Wimpey; 2007).

From a policy making perspective, informality is a daunting challenge not only in Egypt, Jordan, Morocco and Tunisia, but in the entire Southern Mediterranean. Competition from informal enterprises and corruption exert pressure on formally registered SMEs, hampering their performance and contribution to the economy. In addition, while cumbersome regulations and taxes drive informality, the informal sector has emerged as a partial response to the states' disengagement (Mejjati-Alami, op.cit). Hence, when dealing with the informal sector, rather than going for approaches based on deregulation or penalization, policies addressing the links between the formal and informal sectors and the incentives for formalisation could be more productive.

1.2.2 Skills

For obvious reasons, skills and human capital have a critical effect on both large and small firms' performance (Lucas, 1993; Tan, Batra 1995; Tan, Batra 1996). In developing countries, studies have shown that productive and unproductive small companies could be distinguished by the level of skills of their workforce (Tan, Batra, 1995, op.cit). While the more skilled and better educated workers are likely to prefer working for larger firms, MSMEs are further constrained as regards the skills base of their workforce since they are less likely to provide formal training to their employees, relying instead on less formal, "on-the-job" training.

⁴ Mejjati-Alami notes that informal sector entrepreneurs cite competition pressures arising from informal competitors as one of the main obstacles they face.

While Egyptian, Jordanian and Moroccan MSMEs are providers of informal training, their initiatives are mostly focused on the very specific skills that the jobs entail, i.e. operating machinery, manipulating materials, and so forth. There are SMEs who provide formal training to their workforce, but their number is scarce, especially among smaller companies. Around 10% of the latter offer their workforce formal training, against a 30% average of medium and large companies.

Although informal training is valuable for the enterprise, it does not lead to higher levels of productivity. Instead, studies show that productivity tends to increase with the average years of schooling in the larger and more capital-intensive firms, especially in foreign invested companies, (Fleischer et al.; 2011). Moreover, formal training components incorporating basic numerical communication skills as well as broader trainings focused on the skills required in the industry in which the company operates also tend to enhance productivity (Ribeiro-Soriano, Castrogiovanni; 2010).

As regards basic skills and literacy, contrary to Jordan and Tunisia, where adult literacy reaches 92 and 74%, Egypt and Morocco fare poorly, with more than 50% of the total adult population being registered as illiterate in 2004-5⁵. Although improving education has been at the centre of the two countries' development strategies by, among others, enacting compulsory schooling laws, these initiatives have been weakly enforced. For example 2010 estimates on educational attainment show that 37% and 47% of Egyptian and Moroccan adults respectively have not completed primary school, despite the fact that primary education is obligatory in both countries, (Arbak, 2011, forthcoming).

High illiteracy rates are not the only reason behind low skills. Quality of education has also been very low. In Egypt for example, government efforts have focused on tertiary education at the expense of primary and secondary education, hence neglecting the provision of basic skills and resulting into high dropout rates. Between 2001 and 2008 pre-university education concentrated more than 90% of total enrolment rate, but received less than 70% of total education expenditure, while university enrolment stood at 10% and received between 25 and 35% of education public expenditure during the period. Furthermore, while vocational training exists in Egypt, curricula seem in-adapted since a high proportion of vocational school graduates finish employed in public sector jobs, (El Mahdy, 2011).

1.2.3 Access to finance

Starting a new business or expanding an existing one often requires funding and new investments. The MSMEs, owing to their smaller size, limited collateral, inherent opaqueness, and limited history, tend to face severe obstacles in obtaining external financing, (Berger, Udell, 1998). Not surprisingly, these limitations severely hamper the growth potentials of MSMEs in many

⁵ The aggregate figures mask an important discrepancy. Both in Egypt and Morocco, women and rural youths are substantially less likely to receive any schooling. Hence, considering these two categories, the illiteracy rates are likely to be substantially above 50%.

developing countries, pushing them to rely either on internal funds, i.e. generated through retaining profits, or by informal sources of financing, i.e. money-lenders, family or friends, (Beck, Demirguc-Kunt, 2006). Additionally, financial constraints may also severely undermine productivity gains by disallowing firms to make value-enhancing investments, (Aghion et al.; 2009; Musso, Schiavo; 2008 ; Kinda et al; 2008).

For the Southern Mediterranean countries under study, the situation is not different. According to the Enterprise Surveys, nearly one-third of all small companies in Egypt, Jordan and Morocco have identified access to finance as a major constraint. The Southern Mediterranean small businesses appear to face harsher conditions than their counterparts in other regions. Regional comparisons reveal that only 20% of the Southern Mediterranean MSMEs manage to secure a credit line with financial institutions, which is substantially lower than the 30-40% of MSMEs in developing countries that are covered by the surveys. In 2009 SMEs represented only 13% of total bank lending in the region and only 10% of them financed their long term expenses with a loan (Rocha et al., 2010).

In addition, poor macroeconomic conditions, a deficient financial infrastructure and general governance problems (i.e. corruption) further exacerbate the obstacles to finance for MSMEs. In many countries, the financial sectors merely act as intermediaries between the domestic savers and the public treasury. High interests on government bonds and direct state involvement in the banking sector translate into lower levels of credit directed to the private sector (Djankov et al., 2008). For example, while market shares of public banks range between 25% of total assets of the banking sector in Morocco, they are above 60% in Egypt, a country where public debt and loans to state-owned companies amount to one third of banks' balance sheets (Ayadi et al., 2011). In most countries, the existence of implicit government guarantees within the frameworks of deposit insurances does not give banks incentives to extend lending to profitable borrowers, translating into high levels of nonperforming loans (Diamond, Dybvig, 1986, Ayadi et al., op.cit).

Second, the financial infrastructure in the Southern Mediterranean countries is poor. For one thing, the lack of effective credit information sharing mechanisms between financial institutions the weak enforcement of creditor rights, and, inappropriate collateral regimes in the region further exacerbate difficulties in small companies' access to finance (Maddedu, 2010; Ayadi et el., op cit.; De La Campa, 2010). A good financial infrastructure is instrumental in supporting small companies' access to debt capital since it allows lenders to evaluate borrowers based on their riskiness while providing them with some degree of certainty on a loan's recovery prospects in case of a default by the borrower. Deficiencies in financial infrastructure partly explain why banks demand high levels of collateral to secure a loan (on average 150% of a loan's value compared to 130% in OECD countries) and also their preference for immovable property to secure a loan; a set of conditions excluding SMEs from the credit market.

2. EU AND MEMBER STATES DEVELOPMENT ASSISTANCE COMMITMENTS FOR MSMEs

MSMEs have been a focus of Euro-Mediterranean relations starting with the 1990 Renovated Mediterranean Policy (RMP) which sought to support the implementation of structural adjustment programmes while emphasizing the need to develop small sized businesses. Within the 1995 Barcelona Process (BP), support for economic development was seen as key to favor stability in the

region, the main goal behind the partnership being the creation of a Euro-Mediterranean Free Trade Area (FTA). In this context, development assistance took mainly the form of support

programmes aimed at upgrading the Southern Mediterranean business environment. The creation of the FEMIP (*Facilité Euro-Méditerranéenne d'Investissement et de Partenariat*) under the European Investment Bank (EIB) sought to complement development assistance efforts by providing loans to the region's private sector and SMEs.

In 2004, the Euro-Mediterranean Charter for Enterprise was created under the European Neighborhood Policy (ENP). The charter, adopted in 2004 by industry ministers originating in countries part to the Euro-Mediterranean Partnership outlines 10 areas of action for SME policy: simple procedures for companies, education and training for entrepreneurs, skills improvement, easier access to finance and investment friendly taxation, better market access, support to innovative companies, strengthening of business associations, better quality of business support services, strengthening of Euro-Mediterranean networks and partnerships, and provision of clearer information for entrepreneurs⁶.

The creation of the Union for the Mediterranean (UfM) in 2008 added an additional instrument to the Euro-Mediterranean Charter for Enterprise, the Mediterranean Business Development Initiative (MBDI)⁷. As a part of the six "concrete projects" of the UfM, the MBDI seeks to assess the needs of small companies in the Southern Mediterranean through technical assistance and easier access to finance.

Egypt, Jordan, Morocco and Tunisia have received a total of € 2 billion for development assistance initiatives targeting MSMEs, a share of 10% of their total commitments from EU Institutions and most important Member States donors. In line with the objectives set by the Euro-Mediterranean Charter for Enterprise and the MBDI, commitments for MSME support have been split across a number of initiatives and target sectors, rendering difficult a straight forwarded analysis of their initiatives

2.1 Methodology and data sources

EU and Member States support to the MSMEs in the Southern Mediterranean countries under study falls under the official development assistance (ODA) data recorded by the OECD Creditor Reporting System (CRS) database. The OECD's CRS database gives yearly assistance flows at the project level, classified under the Development Assistance Committee (DAC) sector nomenclature of aid activity. The DAC classification consists of 26 sectors and 150 subsectors.

Projects targeting MSMEs are factored under the *Industry* sector under *SME Development* subsector. However, for various reasons, the category is far from being exhaustive for overall

⁶*Euro-Mediterranean Charter for Enterprise*. Available at: http://ec.europa.eu/enterprise/policies/international/files/euomedcharterf1949_en.pdf last accessed, November 30th 2011

⁷ *Joint Declaration of the Paris Summit for the Mediterranean Paris*, 13 July 2008. Available at: http://www.ue2008.fr/webdav/site/PFUE/shared/import/07/0713_declaration_de_paris/Joint_declaration_of_the_Paris_summit_for_the_Mediterranean-EN.pdf last accessed November 30th 2011

MSME assistance. First, development projects having several purposes, such as the provision of business services or direct finance to MSMEs might rather fall under “*Business services and institutions*” or “*Formal sector financial intermediaries*”. Second, a potential bias between ex-ante purposes and ex-post realizations might exist. For example, in the case of Egypt, the 1998 Industrial Modernization Programme (IMP) funded the Industrial Modernization Centre, an organisation providing assistance to Egyptian companies in their production processes, expansion and internationalization strategies. Within the CRS, the project was factored under the *Industrial Development* subsector, even though the centre’s initiatives appeared to benefit mostly SMEs. Third, commitments for MSMEs in the agricultural sector are not captured under the initial DAC classification, while some cooperation programmes for agriculture and rural development contain a layer on MSME development (mostly through the provision of microfinance loans).

To overcome these biases and provide with a complete representation of EU’s commitments for MSME, a simple four step methodology has been designed.

1. Based on the DAC sector classification, a number of sectors irrelevant for the analysis of MSMEs have been eliminated. Table 5 gives the sectors considered relevant for the analysis of aid related to small companies.

Table 6. DAC relevant sectors for the estimation of MSME related aid

DAC Sector name
II.1. Transport & Storage
II.2. Communications
II.3. Energy
II.4. Banking & Financial Services
II.5. Business & Other Services
III.1.a. Agriculture
III.1.b. Forestry
III.1.c. Fishing
III.2.a. Industry
III.3.a. Trade Policies & Regulations
III.3.b. Tourism
IV.1. General Environment Protection
IV.2. Other Multisector
VI.1. General Budget Support
VIII.1. Emergency Response
VIII.2. Reconstruction Relief & Rehabilitation
XII. Unallocated / Unspecified

Source: OECD CRS database

2. To avoid overloading the analysis of EU commitments with unnecessary data, only commitments exceeding a € 1 million threshold were retained. All projects with commitments below the threshold were eliminated. Such threshold was not adopted to assess Member States' commitments since it would have translated into the elimination of a significant number of projects.
3. Projects descriptions that were clearly not concerned with MSME development were removed (ex. water and sanitation, infrastructure development etc.)
4. To assess the relevance of MSME development and support within the remaining projects, a series of internet searches were conducted. A project was considered MSME-relevant if one of the following criteria were satisfied:
 - Provision of direct/indirect support/finance to MSMEs. Projects for industrial modernisation and rural development fall under this category.
 - Provision of direct/indirect support to an organisation/entity dealing with MSMEs. Projects supporting established business centres or aiming at their creation fall under this category.
 - Provision of direct/indirect support and or finance to financial intermediaries with MSME mandates.

While being important, projects dealing exclusively with MSME policy through the provision of support to government agencies with a view to improve regulations for MSMEs were not included since it was not possible to state whether MSMEs were the direct beneficiaries of these initiatives. Projects pursuing several objectives such as the provision of technical assistance and the microfinance were also included. Dissemination materials (websites, leaflets etc.), project evaluations (when available) and other official documents were the primary sources of information to perform the classification.

2.2 EU's ODA commitments for MSMEs

Based on the selection criteria detailed above, the EU institutions' MSME related ODA has amounted to a total of € 1 billion for the years 1995 and 2009. This amount represented roughly 17% of the total commitments geared to the countries under study (Table 6). To that effect,

- Egypt and Morocco, two key recipient countries both under the Barcelona Process (BP) and the European Neighbourhood Policy (ENP) appear to be the most important beneficiaries of ODA for MSME development.
- Tunisia, although having been widely cited as exemplary in conducting reforms and is one of the most advanced countries in its relations with the EU, receives less (in aggregate amounts) than Morocco and Egypt for MSME related aid. However, the per capita figures put the country ahead of its Southern Mediterranean neighbours, except Jordan.
- Possibly in a bid to modernise the Jordanian MSMEs production base, the country has been by far the main (per capita) recipient of MSME-related ODA from the EU.

Table 7. Country-wise distribution of EU institutions' MSME related ODA, 1995-2009

Country	ODA commitments (€ million)	Per capita (€)
Egypt	495.05	5.96
Jordan	139.41	23.43
Morocco	250.76	7.84
Tunisia	135.69	13.01
TOTAL	1020.91	12.8
As a share of total commitments	17.86%	..

Source: OECD CRS database, World Development Indicators

The countries under study have all benefited from the EU's Industrial Modernization Programmes (IMP). Committed between 1998 and 2002, the programmes were aimed at backing privatization reforms while providing support to industrial and liberalization reforms to back the creation of a Euro Mediterranean free trade area (FTA). The IMPs share the same set of objectives, conduct similar actions between countries and can be analyzed as acting at the policy and company level through actions targeting directly MSMEs. Table 7 gives the objectives pursued and the actions implemented by the IMPs at each level.

Table 8. Objectives and instruments of the IMPs, 1998-2002

	Objectives	Instruments
Policy Level	Enhance regulatory framework	Conclusion of Agreements on Conformity Assessment and Accreditation (ACAAs), Mutual Recognition Agreements (MRAs), domestic measures
MSME Level	Competitiveness increase	Technical assistance
	Industry development	Encouraging MSME creation through support mechanisms
	Enhance access to finance by MSMEs	Technical assistance for financial reporting, business plan drafting, guidance on financing sources

Source: Own compilation

For Egypt, Jordan, and Tunisia IMPs were the most important instrument of MSME related ODA, since their share ranged between 44 and 59% of total commitments for small companies' support (Table 8). In Egypt and Jordan, IMPs funded large business support organisation, the Egyptian Industrial Modernization Center (IMC) and the Jordan Enterprise Development Corporation (JEDCO). The Tunisian *Ministère de la Industrie, de l'Energie et des PME* was responsible for the implementation of the programme.

Table 9. Share of IMPs in total ODA commitments for MSMEs, 1998-2002

Country	Commitments for IMPs (€ million)	Share of IMPs in total commitments for MSMEs
Egypt	249.41	50.38%
Jordan	44.98	32.26%
Morocco*
Tunisia	49.83	36.72%
Total	344.22	33.71%

Source: own compilation based on OECD CRS database.

Note: *According to Ben Naceur et al. (2007), Morocco benefited from an Industrial Modernization Programme in 1997 to which € 15 Million were committed under MEDA II. Using the methodology described above, it was not possible to trace the programme in OECD CRS data for Morocco, while it yielded correct results for the other countries under study.

2.2.1 Evaluation of Industrial Modernization Programmes (IMPs)

In spite of being important components of EU's strategy towards MSME support in the region, IMPs did not deliver the results in line with original expectations. Several reasons can be put forward to explain this outcome (Ben Naceur et al.; op.cit).

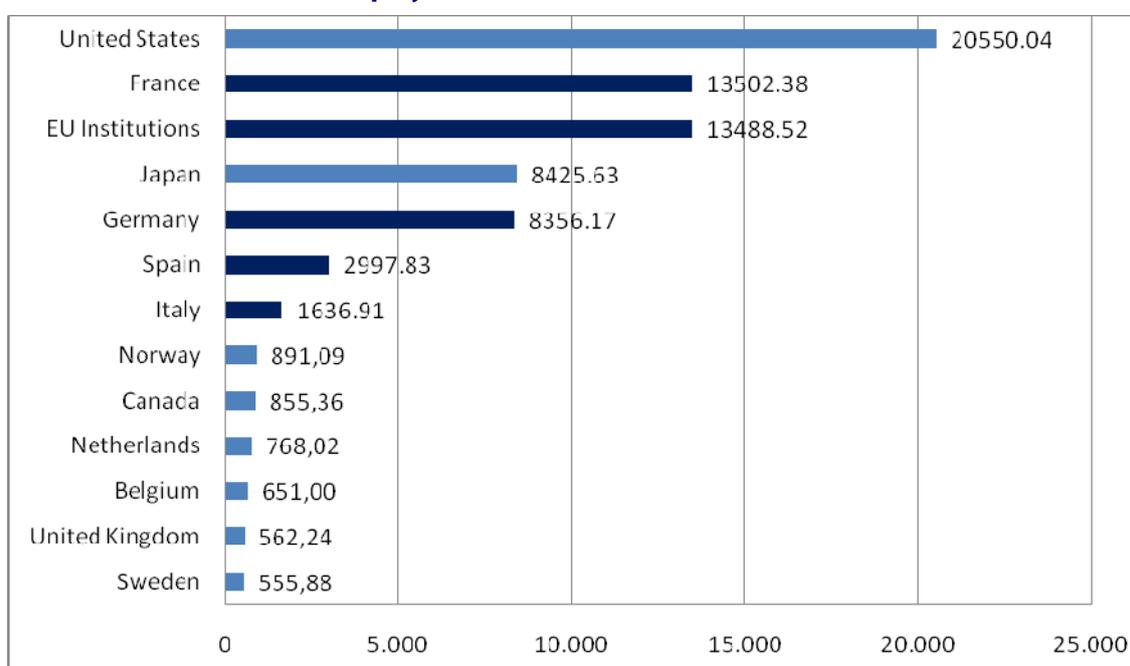
First, IMPs were not implemented according to a long term strategy of corporate restructuring. Creating in a climate of illegibility among targeted small and medium sized companies. Second, a lack of reliable statistical information led to lengthy and costly process of trial and error, hindering the development of clear objectives and milestones. Third, depending on beneficiary countries, either too many or too few institutions were involved in the administration of the IMPs. This contributed to a weak monitoring and/or ownership of the programmes while considerably increasing transactions costs faced by companies and hindering the outreach of the programmes. Fourth, eligibility criteria were too restrictive and neglected the characteristics of the countries' MSMEs. Most of the times, only medium to large companies, employing at least 50 people and three graduated managers, were targeted. In addition, the level of financial assistance was low, varying between 0.5 to 5% of the candidate company's sales. Fifth, while small companies across the region deplore the difficulties in accessing finance as an important obstacle, the IMPs failed to address the link between companies and the banking sector.

The key shortcomings in the IMPs resulted in participating companies to use the programmes not to upgrade their production bases but rather to consolidate their positions in their respective markets. Meanwhile, the creation of the Euro-Mediterranean FTA remains unachieved up until this day, which undermined the impact of the programmes in the participants' exports performance. Hence, at the macroeconomic level, the IMPs have failed to influence these countries' patterns of international specialization.

2.3 Member states' ODA commitments for MSMEs

Analysis of ODA commitments from Member States to the Southern Mediterranean⁸ shows that after the US, France, the EU institutions, Japan, and Germany are the region's main donors (Figure 2). The figures clearly show that a high variation exists between these countries' allocations to the entire region. In particular, many European donors have committed only minor amounts of ODA to the entire Southern Mediterranean. For this reason, the analysis of MSME-related aid has been restricted to the EU institutions, France, Germany, Italy and Spain⁹.

Figure 2. Total commitments for the Southern Mediterranean, from main DAC donors, 1995-2009 (€ million, donors with commitments lower than 500 € million not displayed)



Source: OECD CRS database

Member States' commitments for MSME development present high discrepancies and highlight different interests behind the provision of ODA. For example total ODA commitments from France are greater than the EU-based aid for the period 1995-2009; however, when funds channelled to support to MSMEs are considered, the amounts allocated by France are roughly one-third the EU commitments (Table 9). On the other hand, while Italy is the smallest donor among the EU

⁸ Here, Turkey is not included in the figures due to its pre accession status.

⁹ For comparative purposes, it would have been useful to include the United States in the analysis. However, this was not possible due to the different management of ODA. Whereas the EU and Member States fund specific programmes, the US endows multipurpose funds tasked with identifying and funding development assistance programmes. OECD CRS data does not report the initiatives funded by American funds, rendering void the method outlined above.

countries analyzed here, it commits the highest amount of development assistance for small companies relative to its total assistance (nearly 27% of Italy's total commitment of € 882 million).

Table 10. Main European donors of MSME related aid to Egypt, Jordan, Morocco and Tunisia, 1995-2009 (€ million)

Donor	MSME ODA	Total ODA	Share of MSME related aid (%)
EU Institutions	1 020.91	5 715.29	17.8
France	318.75	9 331.99	3.4
Germany	294.78	5 032.44	5.84
Italy	237.07	882.38	26.87
Spain	57.29	1 683.96	3.40
TOTAL	2 409.81	22 646.06	10.64

Source: OECD CRS database, own estimations

From the recipients' perspective, ODA patterns from Member States differ only slightly from EU's commitments (Table 10). Tunisia ranks as the main beneficiary of MSME related aid in both absolute, per capita, and share in total commitments from Member States. Other important beneficiaries of MSME related aid are Jordan and Morocco, Egypt remaining, on per capita terms the lowest recipient.

Table 11. Country-wise distribution of MSME related aid, 1995-2009 (€ million)

Recipient	Total ODA (EU and MS)	Per capita ODA	MS ODA	MS MSME ODA	Share of MSME commitments in total commitments (%)
Egypt	6 780.01	81.68	5 002.57	91.27	1.34
Jordan	2 076.94	348.9	1 434.24	23.82	1.14
Morocco	8 783.51	274.57	6 659.22	101.95	1.16
Tunisia	2 005.59	192.25	3 834.73	690.85	34.44

Source: ibid

2.3.1 Instruments in MSME related ODA

Member States differ from the EU not only in their amounts, direction but also in the instruments they use to channel ODA. While EU's assistance is mostly delivered through grants, Member States' development finance for MSME support comes mostly in the form of loans. Out of the € 907 million provided for MSME aid, € 800 million came in the form of loans. For example, besides

commitments for Egypt, French ODA is almost exclusively composed of loans. The same can be said for Spain and for Italy.

On the recipient's side, it appears that almost all commitments for MSME development received by Tunisia were in the form of loans, irrespective of the donor (Table 11). These loans are provided as support to IMPs, credit lines for public and private financial institutions and to a lesser extent to microfinance institutions.

Table 12. Share of loans in total MSME ODA by donor and recipient (% of total MSME related ODA)

Country	Egypt	Jordan	Morocco	Tunisia
France	0	100	99.62	97.75
Germany	55.33	0	0	89.01
Italy	83.79	0	85.16	98.74
Spain	0	94.78	78.26	87.51
Total	36.37	72.51	18.54	95.46

Source: *ibid.*

2.3.2 Tied MSME related ODA

In some cases, the assistance provided by the donors mandates that the money be spent on a pre-specified set of goods and services, in many cases from the donor countries. The so-called "tied aid" is also another characteristic of Member States ODA. While the OECD's CRS database does not report the tying status of aid for all projects, available data shows that a third of bilateral commitments carry the condition of sourcing goods and services from the donor country.

The available information on the presence of tying conditions in MSME-related ODA show, once again, substantial variation (Table 12). For example, while tied aid is less prevalent for Egypt, it is substantially more commonplace in bilateral commitments to Tunisian MSMEs, representing more than two-thirds of the total MSME commitments. Among the four EU members considered in the Italy appears to be the country that practices tied aid the most.

Table 13. Share of tied aid in MSME related ODA by Member States, 1995-2009 (% MSME ODA)

Country	Egypt	Jordan	Morocco	Tunisia
France	..	0	0	100
Germany	4.52	63.54	11.82	51.88
Italy	99.58	65.05	100	51.54
Spain	0	0	43.21	82.54
Total	7.05	9.47	30.16	76.73

Source: *ibid.*

2.3.3 Sector distribution of Member States MSME related ODA

In spite of being disseminated across many DAC categories, Member States' commitments for MSME related aid are concentrated in three sectors, *Industry; Banking and Financial Services; and, Business Support Services and Institutions* (Table 13).

Table 14. Distribution of Member States' MSME commitments per DAC sector 1995-2009 (€ million)

DAC Sector	Commitments
Industry (as reported by DAC)	495.34
<i>Of which:</i> commitments for SME Development	437.81
Banking & Financial Services	259.89
Business support services & institutions	95.15
Other	57.5
TOTAL	907.88

Source: ibid

Within the *Industry* category, projects under the subcategory *SME development* are the most important; representing a share of 48% of total MSME related commitments. Projects falling under this category include a wide range of initiatives such as credit guarantees, trainings for officials responsible for the design/implementation of MSME policies, creation of industrial zones, financing of technical assistance missions and studies targeting specific companies and environmental upgrading of businesses among many others. It is noteworthy that within this category almost 50% of total commitments were channelled as tied-aid to Tunisia.

Commitments are scattered among many initiatives, without clear patterns from both the donor and the recipient perspective. One exception could be the French FASEP instrument (*Fonds d'Aide au Secteur Privé*) which aims at providing with credit guarantees French SMEs setting up productive facilities in Tunisia. The only distinguishable common behaviour of Member States in MSME related ODA lies in the support to IMPs.

Commitments under *Banking and Financial services* are mostly split between support to formal and informal sector financial intermediaries, each subcategory concentrating respectively 69% and 29% of total MSME related aid (resp. € 181.38 and € 77 million for 1995-2009). By far, loans were the main instrument used for support under this category, amounting to € 245.16 million, a share of 94% of total commitments under this category. Contrary to the previous category, data show clear patterns in the country distribution of commitments and the share of tied aid is negligible:

- All loans received by Tunisia were provided by Germany through the KfW as support to the IMP. German loans amounted to € 158.6 million
- Jordan and Morocco received a total of € 53.62 million loans to support micro-finance institutions.

- Egypt received € 11.4 million loans from Germany's KfW to refinance the Principal Bank for Development and Credit development bank and to support a rural finance institution.

Similarly to commitments under the category *SME development*, MSME related aid falling under *Business & Other Services* covers a number of initiatives without allowing distinguishing any pattern in donors' behaviour. Most initiatives are reported to target export promotion of SMEs without further precisions. However, contrary to the other categories where commitments are concentrated in a few recipients all South Mediterranean countries benefit from MSME related ODA labelled under the subcategory *business support services and intuitions*. Among many other activities such as initiatives aimed at enhancing the export capabilities of South Mediterranean MSMEs.

3. FOREIGN DIRECT INVESTMENT AND MSMES

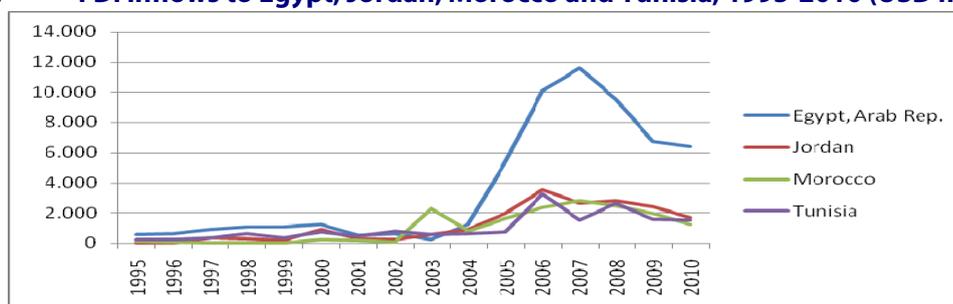
3.1 Stylised facts about foreign direct investment in the Southern Mediterranean

Overall, the performance of Southern Mediterranean countries in attracting foreign direct investment (FDI) has been poor, often disappointing. For example, between 1995 and 2004 Southern Mediterranean countries attracted a total of 8 USD billion of foreign capital flows compared to 17 USD billion received by new EU Member States (Chan, Gemayel; 2004 ; Daniele, Marani; 2006).

Within the region, Egypt, Jordan, Morocco and Tunisia are the top destination countries of international direct investments: between 1995 and 2010 they attracted a total of 9 USD billion, a share of 41% of all FDI inflows of the Southern Mediterranean. Important differences are observed between the countries: while Jordan, Morocco and Tunisia have attracted increasing amounts of foreign investment, since 2005 Egypt emerged as the top recipient, outperforming other countries in growth of inflows, (Figure 3).

The explosion of inward FDI in Egypt has been driven by two factors. First, large investments in infrastructure projects from the United Arab Emirates which between 2005 and 2010, amounted to 5 USD billion¹⁰, and second the pursuance of policy reforms aimed at enhancing the country's FDI performance (ESCWA, 2008)

Figure 3. FDI inflows to Egypt, Jordan, Morocco and Tunisia, 1995-2010 (USD million)



Source: World Bank World Development Indicators (WDI)

¹⁰ Reuters Africa: *Egypt expects \$10bln FDI 2010-11 fiscal year: minister.*

<http://af.reuters.com/article/topNews/idAFJOE6A20GC20101103?pageNumber=2&virtualBrandChannel=0> Last accessed 17th November 2011

Aside from Egypt, the reasons behind the region's poor performance in attracting FDI are to be found in a series of deterrent factors. First, skilled labour lacks and infrastructure is deficient, thus preventing foreign investors to locate in the Southern Mediterranean due to difficulties to obstacles in the functioning of global supply chains (Rezgui, 2005). Similarly, the lack of regional integration and the numerous obstacles to trade also exert a negative influence on foreign investors' decisions to locate in the region (Onyeiwu, Shrestha, 2005 ; Onyeiwu, 2003). Second, poor governance and policy uncertainties complicate transnational companies' decision taking, resulting into lower investments in the region. Moreover, policy uncertainty can be more detrimental to smaller companies, since bigger ones usually have better management capabilities (Suliman, 2005). Considering together a decrease in policy uncertainty and constraints to trade, research has shown FDI inflows could rise substantially in the region (Sekkat, Véganzonés-Varoudakis; 2004 & 2007).

3.2 FDI in Southern Mediterranean MSMEs

3.2.1 Data sources

According to the Balance of Payments Manual 6th Edition, published by the International Monetary Fund (IMF): "Direct Investment is the category of international investment that reflects the objective of a resident entity in one economy in obtaining a lasting interest in a company located in another country". More specifically, direct investment comprises flows of capital related to the initial transaction and all subsequent transactions between the affiliated companies both incorporated and unincorporated. According to the recipient country's legislation and the preferences' of the investing company, the investment in the host country can result in a joint venture, a wholly owned subsidiary, a branch etc. Besides, the foreign investor has the choice to enter the host country either via the establishment of production facilities or via the acquisition of existing structures. Generally, the former is referred to as "Greenfield investment" the latter as "Brownfield investment". The IMF definition, used by international institutions (World Bank, United Nations Conference on Trade and Development), adopts for defining FDI the sole criterion of having a management stake in the targeted company. Hence, researchers cannot distinguish the country of origin of the direct investor or its target company or sectors.

In order to overcome the absence of bilateral data on FDI flows, data released by the ANIMA-MIPO Observatory is used¹¹. The ANIMA-MIPO database is different from international institutions' for several reasons. First, they are based on announcements released in the media each year, without taking into account when the investment materializes. Second, the data allows for distinguishing between investments and partnerships only from 2008 onwards. In ANIMA-MIPO's typology, an investment is defined as a "tangible project dated and realized at least partially by a foreign operator" (ANIMA-MIPO, 2011, p.79). Partnerships are defined as "projects allowing a foreign

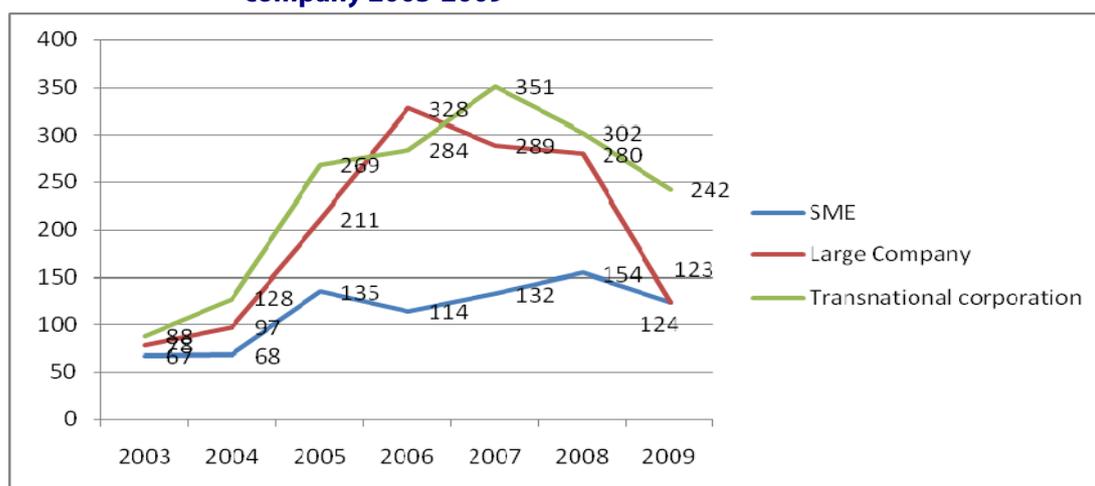
¹¹ For more information about ANIMA-MIPO activities, please visit: http://www.animaweb.org/activite_anima-investment-network.php

company to approach Southern Mediterranean markets by developing relations with an identified partner, opening a local representation, or concluding a franchise agreement” (ANIMA-MIPO, op.cit)¹². As recognized by ANIMA itself, its reliance on press releases to track investments in the region is biased towards big companies since they are more likely to devote resources for communication purposes, while smaller companies’ investments are likely to be unnoticed.

3.2.2 Direct investments and partnerships

An assessment of ANIMA-MIPO’s database confirms the slow but steady rise of SME-related FDIs to the region (Figure 3). Between 2003 and 2009, SMEs represented 20% of the total projects announced in the region, with the EU based companies accounting for the majority of the investment projects announced (60%). However, the invested amounts have been very small, since EU SMES have accounted for a mere 5% of FDI inflows and partnerships during the period with an average size of investments amounting to € 14.7 million (ANIMA-MIPO, 2010).

Figure 4. Number of FDI projects to the Southern Mediterranean by size of company 2003-2009



Source: (ANIMA-MIPO, op.cit)

Small European companies investing in the Southern Mediterranean originate mostly from France and Spain and tend to locate in Morocco and Tunisia. In turn, in Egypt and Jordan, big Gulf companies appear to dominate the foreign investment landscape. For example, in 2005, Jordanian inward investment from the United Arab Emirates, Qatar, Kuwait, and Bahrain amounted to € 900 million, while total EU FDI in the country stood at less than € 100 million, largely dominated by transnational corporations with a marginal presence of European small companies (ANIMA, 2006).

The data published by ANIMA-MIPO for EU SMEs does not distinguish between target sectors or country of origin and destination. Available 2010 data only give sectoral breakdowns of small companies’ investments irrespective of their country of origin. It appears that small companies are

important investors in the fields of engineering (€ 126.4 million), electrical machinery (27.8), transport (243.3) and tourism (134.55) (ANIMA-MIPO, 2010). Considering the share of European small companies in total investment, SMEs investment has equaled 5% in 2010 across all sectors, their total investment in these sectors can be estimated respectively to 7; 2.7; 37.9 and € 34.5 million.

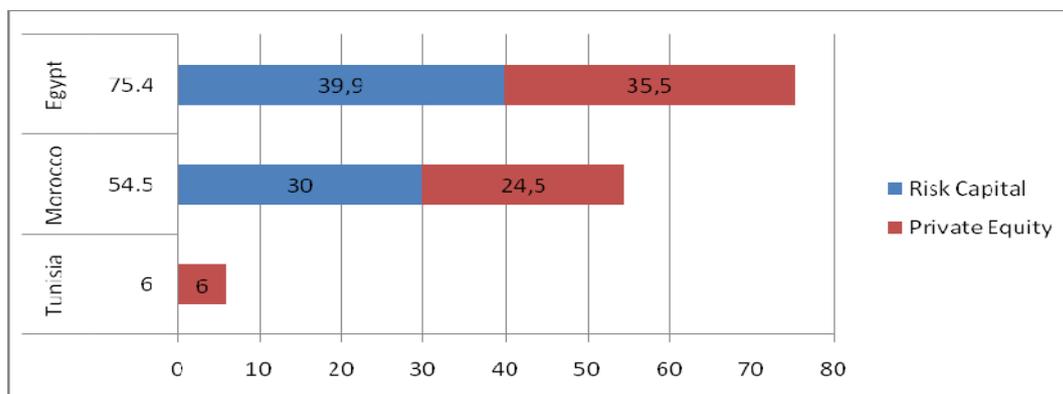
The small magnitude of direct investments from small companies' contrasts with the number of partnerships they conclude with the region's SMEs. The conclusion of licensing agreements, franchises and opening representation offices is a way for companies to minimize the risks associated with internationalization (ANIMA, 2006, op.cit.). Partnerships are also more privileged by companies operating in sectors where the risk of "reverse engineering" is higher as well as by EU businesses. This is illustrated by their importance for SMEs operating in information technology and software, as well as textiles: SMEs, have accounted respectively for 80, 46 and 22% of all partnerships concluded in these sectors.

3.2.3 European Investment Bank (EIB) operations targeting SMEs

An indirect way to assess European FDI into SMEs consists in looking at the European Investment Bank's (EIB's) risk capital and private equity operations under the FEMIP (*Facilité Euro-Méditerranéenne d'Investissement et de Partenariat*). Active since 2002, FEMIP's risk capital and private equity operations endow funds tasked with investing into SMEs in the region, in accordance with its mandate to improve private sector's and small companies' access to finance. Between 2002 and 2009, FEMIP has provided a total of € 135.9 million private equity and risk capital investors in Egypt, Morocco and Tunisia (Figure 5). FEMIP's risk capital and technical assistance envelope, which aims to encourage the funding sources of SMEs in the Mediterranean partner countries, benefits from an annual allocation from the EU budget amounting to € 32 million for the period 2007-2013. In addition, the FEMIP manages an additional financial instrument, the FEMIP Trust Fund (FTF), tasked with financing technical assistance and venture capital projects in the southern Mediterranean thanks to contributions from the E.C. and 15 Member States. While these operations can be loosely assimilated to foreign investments into the Southern Mediterranean SMEs, they represent only a part of all instruments made available by the EIB to SMEs (Box 1).

¹² Additional criteria apply. For more details, refer to ANIMA-MIPO, op.cit.

Figure 5 FEMIP's risk capital and private equity operations in Egypt, Morocco, Jordan and Tunisia, 2002-2009, € million



Source: FEMIP annual reports 2004-2009

Box 1. FEMIPs instruments for SMEs

In addition to endowing risk capital and private equity funds in the Southern Mediterranean FEMIP can provide loans directly to SMEs as well as to financial institutions which then extend lending to the region's private sector in general and SMEs in particular. Currently, FEMIP's budget amounts to 11.7Eur. billion for operations targeting both SMEs and infrastructure. Furthermore, EU support to SMEs may grow as FEMIP is currently envisaging guaranteeing senior and subordinated debt issued by local banks to Southern Mediterranean countries. By guaranteeing loans to SMEs issued by local financial institutions, the EIB can further alleviate constraints on access to finance.

Sources: FEMIP, 2011; <http://www.eib.org/projects/regions/med/instruments/index.htm>

4. EU VISA REQUIREMENTS FOR EGYPTIAN, JORDANIAN, MOROCCAN AND TUNISIAN MSME MANAGERS

4.1 A securitisation of migration in the Euro-Mediterranean Partnership

Migration is a hot topic in Euro-Mediterranean relations since the establishment of the Barcelona Process. With the objective of creating a common area of peace security and prosperity, on EU's side the emphasis has been put on the need to ease migratory pressures through job creation, fighting against illegal migratory flows and securing the rights of legal migrants. Interests are different on the side of Southern Mediterranean countries, who stress the need for co-development and free movement of people as a building ground of the EMP (Aubarrel, Aragall; 2005).

During the 1990s, the rapid pace of globalization and resulting socioeconomic changes such as rising poverty, deterioration of living conditions, the rise of multiculturalism and the revival of right wing extremist ideas and movements in European political landscapes led Member States to picture migration as a phenomenon threatening the survival of Western states. The perception of migration as a threat has resulted in treating migratory flows as a wide security issue, resulting –

among many others - in the enactment of restrictive legislations targeting migration source countries (Hobolth, 2010). Furthermore, the 9/11 terrorist attacks and the perception of a so-called "Islamist threat" led to a securitisation of the migration issue in Euro-Mediterranean relations (Eylemer, Semsit; 2007).

The linkage between migration and security in the EMP bears important contradictions between the objectives of Euro-Mediterranean policies. While illegal migration and border crossing issues related to human, drugs, and arms trafficking are a legitimate security concern, the restrictive nature of visa policies towards the region impedes advancement towards the completion of the Euro-Mediterranean FTA (Ayadi, Gadi; 2011). In addition, Member States' demographic and labour market characteristics require on the longer term free movement of persons, as recognized by the Wider Europe Communication (2003), while restrictive visa policies hinder the management of migratory flows on the short term.

4.2 Visa requirements for business people

Member States' procedures for the issuance of visas up to three months are harmonized by the 2009 regulation establishing a Community Code on Visas - the Visa Code. Short term stay in the EU¹³ is regulated by three types of visas:

- Type A, which authorizes citizens originating from certain third countries¹⁴ to enter the territory of a Member State as part of their journey to another Member State. These are airport transit visas and restrain the holders' circulation to the airport area¹⁵.
- Type C: regulate the entry into the Schengen area for citizens originating in third countries for touristic journeys, family visits, participation in cultural events, business related events and medical reasons among others. They are assorted either with single or multiple entry conditions. Single entry type C visas allow third country nationals to enter the Schengen area one time and stay for 90 consecutive days. On the other hand, multiple entry type C visas allow the citizen to quit and re enter the Schengen area several times within 90 months.
- Type D: manage the entry and stay of third country nationals willing to stay for a period longer than six months. They are issued by Member States for foreign students, workers and investors as well as for family grouping purposes.

Third country citizens applying for any of these visas are subject to a set of common conditions and must pay a 60 € fee to the consulate authorities of the country they are willing to enter¹⁶.

¹³ UK and Ireland have their own visa systems.

¹⁴ Citizens originating from the following countries are subject to Type A visas: Afghanistan, Ethiopia, Eritrea, Ghana, Irak, Iran, Nigeria, Somalia, Sri Lanka, Democratic Republic of the Congo (ex-Zaire)

¹⁵ Type B visas are also issued for non airport transit purposes as long as the transit period does not exceed 5 calendar days.

They must be in possession of a valid passport, provide a photo and 10 fingerprints in addition to documents indicating the purpose of the journey, the applicants' accommodation or proving he/she has sufficient resources to cover the related expenses; proofs of the applicants' sufficient means to cover the expenses associated with the stay; as well as relevant information allowing consular authorities to assess the national's willingness to leave the Schengen area before the visa's expiry date.

Business people have the option to apply for multiple entry long term visas with a validity period comprised between 6 months and five years (Type D visas), yet the E.C notes a "traditional reluctance of [Member States'] consulates" to issue them (E.C., 2009). Candidates to this kind of visa must fulfill supplementary conditions and are liable to provide additional documents proving the existence of trade and/or work relations; entry tickets for fairs, congresses and business related events; documents proving the existence of the company its business activities, and the applicants' employment status within it. In addition to this lengthy and cumbersome procedure, consular authorities enjoy an important discretionary power since the person willing to benefit from such visa must prove its "integrity" and "reliability" (Faure-Atger, Guild; 2011).

The 2004 Visa Information System (VIS)¹⁷ should partially address the visa applicants' "integrity" and "reliability". The VIS is a database containing information related to visa applications for third country nationals most notably biometric markers (face and fingerprints), documentation related to the applicants' journey purposes, financial resources, and history of visa applications¹⁸. Hence, "reliable" applicants willing to obtain a visa for business purposes after a previous successful application will very likely benefit from faster examination periods as well as lower rejection rates. However, while valuable, the introduction of VIS will not address the potential bias existing for first time applicants. Since end 2009, Member States' consulates in North Africa, use the VIS. It is planned to be progressively extended to the Eastern Neighborhood and Gulf Cooperation Council countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates)¹⁹.

Data disseminated by Member States to the Council do not allow identifying the magnitude of business persons' short stay visa applications. Statistics on the number of applications, issuances and rates of rejection of applications to Type C visas could provide with an idea on the situation faced by Southern Mediterranean countries business people willing to develop commercial ties with European partners. However, figures show a high number of applications that rather reflect individuals' willingness to enter the EU to visit friends and families (Table 14). An alternative would

¹⁶ Some Member States do not have representations in some third countries. In this case consular authorities of another Member State process applications. The Visa Code also outlines the principles of cooperation between Member States' consular authorities.

¹⁷ Council Decision of 8 June 2004 establishing the Visa Information System (VIS) (2004/512/EC), Official Journal of the European Union L 213/5, 15.6.2004

¹⁸ Regulation EC N° 767/2008 of the European Parliament and of the Council (EC) No of 9 July 2008 concerning the Visa Information System (VIS) and the exchange of data between Member States on short-stay visas (VIS Regulation), Official Journal of the European Union L 218/60, 13.8.2008

¹⁹ Commission Decision 2010/49/EC of 30 November 2009 determining the first regions for the start of operations of the Visa Information System (VIS), Official Journal of the European Union L 23/62, 27.1.2010

be to rely on data of Type D visas issued, but again they might rather reflect family grouping and issuance of temporary visas prior to the issuance of resident permits than business oriented purposes. Moreover, Southern Mediterranean SME employees are not likely to fit in this category since larger companies are more likely to develop stable partnerships justifying in the eyes of consular authorities the issuance of long term multi entry visas.

Table 15. Applications to Type C visas, number of visas issued and rejection rates for Egypt, Jordan, Morocco and Tunisia by selected Member States, 2007-2009

	Egypt			Jordan			Morocco			Tunisia		
	<i>A</i>	<i>I</i>	<i>D (%)</i>	<i>A</i>	<i>I</i>	<i>D (%)</i>	<i>A</i>	<i>I</i>	<i>D (%)</i>	<i>A</i>	<i>I</i>	<i>D (%)</i>
Belgium	9 113	7 096	22.1	4 403	3 839	12.81	39 977	21 524	46.16	7 083	5 232	26.13
France	75 965	68 764	9.48	16 283	14 080	13.53	35 5337	297 317	16.33	219 611	193 278	11.99
Germany	77 992	67 734	13.15	20 900	17 109	18.14	37 228	26 786	28.05	27 184	21 613	20.49
Italy	30 784	27 481	10.73	11 237	10 669	5.05	27 374	22 892	16.37	21 973	19 124	12.97
Spain	23 137	18 399	20.48	15 583	11 526	26.03	340 365	283 871	16.60	13 076	11 719	10.38
Netherlands	15 557	12 653	18.67	4 725	3 780	20.00	22 544	16 608	26.33	2 884	2 198	23.79
Total	232 548	202 127	13.08	73 131	61 003	16.58	822 825	668 998	18.69	291 811	253 164	13.24

Source: Notes from the Council to the Visa Working Party on the exchange of statistical information on uniform visas issued by Member States' diplomatic missions and consular posts (2008, 2009, 2010). A= number of visa applications, I= number of visas issued, D= percentage of rejected visa applications

The lack of clear figures notwithstanding, evidence exists on the negative effect on international trade and investment of restrictive regulations. Based on a perceptions survey of US based firms engaging in commercial relations with partner companies abroad, visa regulations were found to translate into several billion USD in revenue losses. Among the surveyed companies, medium sized businesses were the most hurt, followed by large and small ones. The latter's resilience can be explained by a smaller exposure to international markets as well as by their size itself, since smaller companies are likely to be able to adapt faster to changing market conditions due to lower internal organisational costs (Santangelo group, 2004).

From the developed countries' businesses perspective, the revenue losses companies are likely to incur due to visa regulations can be explained by the need for personal contact in international trade and investment relations; since they can help in mitigating information asymmetries. For companies operating in developing countries and willing to develop partnerships with businesses based in developed countries' a set of relatively easy visa conditions can alleviate costs associated with trade, while allowing them to bring into their countries new products, processes, hence creating the grounds for positive spillover effects. In this regard, quantitative evidence on the effect of visas on bilateral investment flows has shown that unilateral visa obligations lowered bilateral trade and FDI stock by 19 and 25% (Neumayer, 2011). While the figure needs to be taken with caution since trade and investment are subject to more fundamental economic variables, they are nevertheless enlightening as regards the negative influence of restrictions to free movement of persons.

In the EU context research on whether visa policies towards third countries were determined by business or security interests, found that while companies had an interest in a less restrictive visa policy, policymaking was more influenced by a set of security related variables such as GDP per capita and religious beliefs. Quantitative evidence shows that the lower the per capita income in a third country and the higher its Muslim population, the higher its nationals will incur visa rejections (Hobolth, op.cit).

5. POLICY RECOMMENDATIONS

The uprisings in Egypt and Tunisia, the important demonstrations calling for reform and better living conditions and prospects in Jordan and Morocco have highlighted the urgent need to support job creation and economic reform in the Southern. In response to these unprecedented events, the EU put forward a renewed Neighborhood Policy which among many other proposals seeks to support economic development and MSMEs.

Within this renewed approach to the Southern Neighborhood, EU institutions can contribute to alleviate some of the obstacles faced by small companies while supporting the reinforcement of trade and investment links with the region as well as national authorities in their industrial upgrade policies.

In the area of access to finance, well aware of the difficulties faced by small companies in accessing debt capital, governments in Egypt, Jordan, Morocco, Tunisia and the Southern Mediterranean have put in place credit guarantee schemes. Credit guarantee schemes are mechanisms under which a guarantor ensures the lender against the losses incurred from extending credit to a borrower. However, in spite of being active for a number of years, these schemes have failed to meaningfully facilitate access to debt capital owing to risk aversion and very conservative lending policies. While in the longer run addressing macroeconomic, prudential, and financial infrastructure conditions is of utmost importance to foster both non guaranteed and guaranteed SME lending, in the short to medium run, moving to less conservative lending practices can be done through the provision of counter guarantees. Counter guarantees would ensure the guarantor against the potential losses incurred, hence increasing the leverage of the guarantee scheme and ultimately loans banks can allocate. Due to its long presence in the Southern Mediterranean, EIB's FEMIP could be instrumental in providing counter guarantees after consultation with active Southern Mediterranean guarantee schemes.

If the above cited conditions are indeed an obstacle to SMEs access to finance, bank's reluctance to extend loans to small companies may also be caused by low levels of financial literacy among small companies. For SMEs, financial literacy entails basic knowledge on accounting and financial management procedures. Most EU and Member States' cooperation programs have focused on supply side measures such as support to guarantee schemes and microfinance institutions with a view to ease constraints in accessing finance and demand side initiatives have been rather missing. Future programs for MSME support in the region could comprise financial literacy support for small companies. Should such measures be implemented, they should seek synergies with the activities already undertaken by local SME support agencies.

As regards the movement of peoples across the two shores of the Mediterranean for commercial and financial reasons, the reality is that while EU business persons do not face visa requirements at the Southern borders, Egyptian, Jordanian, Moroccan and Tunisian ones are subject to a set of cumbersome procedures. If to some extent the current procedures distinguish between business persons and conventional voyagers they still put too heavy an emphasis on the applicant's "integrity" and "reliability" for granting short stay-single entry visas. To avoid the negative cost in terms of doing business of such stringent requirements, Member States could envisage shifting from the current criteria assessing a business person "reliability" and "integrity". Since many companies exporting their goods to the Single Market have to comply with safety, quality, and sanitary regulations, the certificates or documents certifying compliance of their products could be considered as an automatic proof of their "reliability" and "integrity".

In the area of SMEs industrial development, governments in Egypt, Jordan, Morocco and Tunisia have developed policies aimed at fostering SME development and innovation. Policymakers have set up industrial clusters, sometimes in cooperation with Member States' development assistance agencies. The emphasis put on SMEs in the new neighborhood policy could support their development through both budget support and technical assistance targeting the organisations managing the clusters. Furthermore, EU's initiatives that could be envisaged include raising awareness on FEMIP's financing possibilities among companies active in these clusters and, fostering partnerships between Northern and Southern Mediterranean academic institutions, as well as partnerships between Chambers of Commerce in both regions that should also be

considered. In addition, given the importance of informal enterprises, policies creating incentives for companies to register their activities within these clusters could be designed in cooperation with the EU. Among these policies, financial support for compliance with EU safety, quality and sanitary and export facilitation initiatives could be envisaged in the framework of the new neighborhood policy.

Besides being the most important obstacle for companies' development in the region, widespread corruption has driven thousands of protesters in the Egypt, Jordan, Morocco, and Tunisia on the streets to call either for regime change and deep political reforms. As general sentiment against corruption grows in these countries, a means to indirectly support MSMEs stands in pushing governments towards the implementation of multi-annual anti corruption strategies and supporting civil society organizations active in this field. Instruments such as the new Civil Society Facility (CSF) outlined in the Commission's Communication "A new Partnership for a New Neighborhood" could be used to fund awareness raising activities implemented by local organizations and technical assistance in designing anti corruption strategies could be delivered to governments in the region. Furthermore, a share of development assistance commitments could be made conditional on the adoption of anti corruption strategies.

Finally, the absence of reliable information on small companies should be addressed, since it hampers the conduct of evidence based policymaking. In the past, the lack of reliable statistical information resulted in costly trial and error process at the moment the industrial modernization programmes were implemented. The production of reliable statistics on formal and informal small companies and their characteristics in Egypt, Jordan, Morocco, Tunisia and across the region could be addressed via the creation of a working group gathering senior officials from both shores within the framework of the Union for the Mediterranean and the Mediterranean Business Development Initiative.

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