

Woodward, Richard; Safavi, Mehdi

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## Private sector development in the South and East Mediterranean region

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# CASE Network Reports

## Private Sector Development in the South and East Mediterranean Region

Richard Woodward  
Mehdi Safavi

No. 110/2012



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al. Jana Pawla II 61, office 212, 01-031 Warsaw, Poland

tel.: (48 22) 206 29 00, fax: (48 22) 206 29 01

e-mail: [case@case-research.eu](mailto:case@case-research.eu)

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## **The author**

**Mehdi Safavi** is currently an early career fellow and PhD candidate in Strategy and International Business at the University of Edinburgh Business School. He holds an MSc in Information Technology Management from the Shahid Beheshti University of Tehran, Iran, and a BSc in Electrical Engineering from the Ferdowsi University of Mashhad, Iran. His current research is concentrated on knowing and capability recreation through mergers in the British Higher Education sector.

**Richard Woodward** is an economist at CASE - the Center for Social and Economic Research - in Warsaw and a lecturer in international business at the University of Edinburgh Business School. He is the author of numerous publications on privatization in post-Communist countries (especially management-employee buyouts) as well as local development and SME support in Poland, and is currently researching the innovation networks of European enterprises. Some of his recent publications include: "Knowledge-intensive entrepreneurship in Central and Eastern Europe: results of a firm-level survey" (with Slavo Radosevic and Maja Savic) in F. Malerba (ed.), *Knowledge-Intensive Entrepreneurship and Innovation Systems: Evidence from Europe*, London: Routledge, 2010; "Networking and Competitiveness" (with Piotr Wójcik), in I. Hoshi, P.J.J. Welfens, and A. Wziątek-Kubiak (eds.), *Industrial Competitiveness and Restructuring in Enlarged Europe: How Accession Countries Catch Up and Integrate in the European Union*, New York and Basingstoke: Palgrave Macmillan, 2007, and "The Reform Process in Post-Communist Transition: Understanding Reform in Eastern and Central Europe and the Commonwealth of Independent States" (with Piotr Kozarzewski), in J.M. Fanelli and G. McMahon (eds.), *Understanding Market Reforms, Vol. 2: Motivation, Implementation and Sustainability*, New York and Basingstoke: Palgrave Macmillan, 2006.

## **Abstract**

This report is concerned with the analysis of privatization and private sector development for the eastern and southern Mediterranean countries partnered with the European Union and collectively known as MED-11. Noting that the analysis applies to the situation prior to the dislocations of the Arab Spring, we review the shift in the relative shares of the public and private sectors in these countries, as well as the business climate affecting the development of the private sector, examine a number of cultural factors that may influence the development of the private sector, and discuss some alternative scenarios for future developments. In the last 20 years, efforts have been made in all countries of the MED-11 to encourage private sector development and, to a greater or lesser extent, privatization of state-owned assets. However, there is a great deal of differentiation among the countries in the group. In the MED-11, Israel has not only the most business-friendly policy environment but also the most developed private sector, accounting for almost 80% of employment. The other countries of the region can be divided into two groups: one, including Algeria, Libya, and Syria, where reforms promoting privatization and private sector development have been very limited, and the rest, in which they have been much more extensive (the Palestine Authority is, for obvious reasons, a rather special case). A generally poor business environment makes for a large informal sector in almost every country in the region; however, generally speaking, we do not find the cultural factors we examine to be hostile to private sector development. Optimistic, reference and pessimistic scenarios are discussed; which of these is realized in any particular MED-11 country will depend greatly on the direction of change following the events of 2011's Arab Spring.



# 1. Introduction

This report<sup>1</sup> is concerned with the analysis of privatization and private sector development for the countries collectively known as MED-11. Specifically, these include nine Mediterranean partner countries of the EU (Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, the Palestinian Authority, Syria, Tunisia), Libya (an observer), and Turkey (an EU accession candidate).

This report is divided into sections. The first deals with the larger issues of private sector development in the MED-11 countries, and starts with a look at the business climate affecting the development of the private sector (with special attention devoted to the question of finance). It then examines a number of cultural factors that may influence the development of the private sector. The second section focuses on privatization of the state sector, beginning with an overview of the shift in the relative shares of the public and private sectors in the economies of the countries examined, and then moving on to a closer look at the relevant policy framework in each country. In each of these sections each country is profiled individually. The report concludes with a discussion of some alternative scenarios for future developments.

The following reports have been used in preparing this report:

- Omaima M. Hatem, *Privatization in Egypt* (2011);
- ITCEQ - Tunisian Institute of Competitiveness and Quantitative Studies, *Report on Privatization and Private Sector Development in Tunisia and Libya* (2011);
- Moroccan Institute for International Relations (IMRI) – *Report on private sector development in Morocco* (2011a);
- Moroccan Institute for International Relations (IMRI) – *Report on private sector development in Algeria* (2011b);
- Moroccan Institute for International Relations (IMRI) – *Report on private sector development in Turkey* (2011c);
- Palestine Economic Policy Research Institute (MAS), *Report on Privatization for MEDPRO: Palestine* (2011a);

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- Palestine Economic Policy Research Institute (MAS), Report on Privatization for MEDPRO: Israel (2011b);
- Palestine Economic Policy Research Institute (MAS), Report on Privatization for MEDPRO: Jordan (2011c);
- Palestine Economic Policy Research Institute (MAS), Report on Privatization for MEDPRO: Syria (2011d);
- Palestine Economic Policy Research Institute (MAS), Report on Privatization for MEDPRO: Lebanon (2011e).

The reader should note that this report, as well as the aforementioned reports on which it is based, all consist of desk research. The authors of this report have had to rely on the aforementioned reports and the accuracy of the findings contained therein.

## **2. Private sector development**

In all MED-11 governments have passed rules and regulations to ease and accelerate the processes of private sector development in recent years, although there have been differences with regard to the pace of privatization and the volume of governmental support. In addition, popular uprisings in the area started in December 2010 in Tunisia, subsequently affecting Egypt, Libya, and Syria, and have changed the countries' priorities, which have shifted to establishing a new political order or stabilizing the current one, with economic reform having to take a back seat at least in a short term horizon.

Among the countries of MED-11, Israel has not only the most business-friendly policy environment but also the most developed (in terms of private sector GDP per capita) private sector, accounting for almost 80% of employment, while the least developed one is also found under Israeli administration, in the Occupied Palestinian Territory (OPT) where, although the share of the private sector is above 60% of GDP, that share has actually been falling since 2000 (moreover, the fragility and dependency on outside forces – both the Israeli occupation and foreign aid – of its economy raise doubts about how meaningful the discussion about that share is). Israel's private sector has attained such a high level of development despite the fact that, like several other countries in the region (including Algeria, Egypt, Libya and Syria), Israel followed a socialist, state-led development path for several decades.

Indeed, countries in which private sector development is lagging, such as Algeria, Libya and Syria, continue to do so; in the case of Algeria and Libya, this is due largely to the extreme degree in which the state-owned gas and oil industry dominates these countries' economies, and although all three of these countries have introduced certain reform and liberalization measures, they remain very modest in scope. The Syrian government has made some market-friendly reforms in recent years, and although the country's business environment remains a very unfriendly one for private sector development, the private sector share in the economy has shown impressive growth in the last decade. The environment for private sector development in Algeria and Libya is not at all favourable. In Algeria private sector development has lagged behind that observed in almost all of the other countries considered here, and in Libya, the other major oil country in the region, some degree of liberalization (accompanied by a privatization program of limited extent)

only began in 2003. However, just as in the case of Algeria, the dominance of the state-owned oil sector ensures that the private sector share of the economy remains small.

Developments have been more positive in Tunisia, Lebanon, and Turkey. Tunisia has experienced rapid economic growth in the last decade and a half; however, the private sector investment has slowed since the 1990s, with development in that period being largely state-led. In Morocco, while the post-colonial period beginning in 1956 saw the creation of a large number of state-owned corporations in many sectors of the economy, since the introduction in 1990 of a policy of economic liberalization and privatization, the public sector share of GDP has been reduced significantly. The private sector dominates the economy of historically conflict-torn Lebanon, but since the mid-2000s subsidies to state-owned entities have been increasing rather than decreasing. Policies implemented in Turkey since 1985 have promoted the privatization of public enterprises, with a sharp increase in the number of privatizations from 2005 – the date of the beginning of Turkey’s negotiations on accession to the European Union, which necessitates a withdrawal of the Turkish state, in full or in part, from economic activity and also substantially increased investor interest in the country. Summing up, for several countries in the region, the private sector remains rather underdeveloped.

We will now present a brief overview of private sector development in each of the countries covered here, and then turn to a treatment of specific factors affecting this.

**Algeria:** Since independence in 1962, Algeria chose socialism and gave preference to the public sector. It was only in 1989, in the wake of a severe financial crisis, that Algeria initiated a phased liberalization of its economy (which included a privatization program initiated in 2001). In spite of these measures, the Algerian business climate remains poor: red tape is rife, the desire to develop business is not highly shared, the financial system is ill-adapted, and the economy is still dominated by the energy sector in the hands of the public sector (Algeria is the largest African producer of gas and the third – after Nigeria and Libya – for oil, and exports of hydrocarbons account for 98% of the country’s total exports). According to IMRI (2011b), the share of the private sector in the national industrial production is a mere 35%. The private sector operates only in pharmacy, the agro-food and fishing industries, public works and civil engineering (foreign firms), chemistry, electric and electronic industries, telecom, plastic processing, banking sector and transport (IMRI, 2011b).

**Egypt:** Much greater space for the formation of new private business opened up in the past 20 years, especially in industry, and attracted greater foreign direct investment flows; however, all of this has halted since the 2011 uprising (Hatem,

2011). Details on the growth in the private sector's share in the economy are provided by Hatem (2011):

*By 2009, the reported employment in public enterprises has declined to about 300,000, less than one-third of what it used to be 20 years earlier. Worthy of note is the increased contribution of private investment to GDP. From single digits until 2004, that contribution has risen to more than 12% on average during the following five years (Egyptian Ministry of Investment, Annual Reports, 2010).*

**Israel:** Among the countries of MED-11, Israel has by far the most developed private sector. During the last decade, the contribution of the Private/Business sector to the GDP of Israel was constantly over 70%, while the rate for the State and NGO sector was declining and was constantly under 20% (Israel Central Bureau of Statistics, 2010). The private sector currently provides almost 80% of employment (Israel Government Companies Authority, 2009).

**Jordan:** Excluding a rise in the percent of state contribution to GDP in 2009 because of governmental policies and procedures, including expansionary monetary policy introduced to alleviate the negative effects of the global financial crisis on the Jordanian economy, the last decade has seen a decrease in the percent of GDP produced by the state-controlled sector from 17.54% in 2000 to 14.18% in 2010 (first three quarters average) (Jordan Department of Statistics, 2010a). However, the share of employment by the state-controlled sector shows almost a continuous increase as percent of total employment in the last decade: from 34.8% in 2001 to 38.6% in 2008 (the highest) (Jordan Department of Statistics, 2010b).

**Lebanon:** Its violent and destructive recent history has left Lebanon in political and economic ruin compared to the Lebanon of the 1970's, which boasted a per capita income similar to Southern Europe. According to MAS (2011e), the ratio of capital formation in the private sector to that in the public sector jumped from about 5:1 in 2002 to about 16:1 in 2009. Additionally (based on statistics from the Lebanon Central Administration of Statistics), between 2004 and 2007, public sector employment rose from 13% to 15% of total employment, while in the private sector, workers moved massively from the formal to the informal sector, as in that period official statistics show a rise of the latter's share from 1.2% to 25.3%. Individual enterprise is the dominant form of business establishment in Lebanon, followed by limited liability companies. Offshore companies and limited companies represent a gradually increasing but still very small portion of the economy. Partnerships remain a minuscule group of firms (Lebanon Central Administration of Statistics, 2008).

**Libya:** For several decades, Libya remained closed to foreign investment. Its socialist and centralized economic system prevented the opening of the economy

to the outside. The period of international embargo in 1980s and 1990s increased this isolation. However, the year 2003 was marked by two significant events likely to promote the country's openness to foreign capital. The first was a major political inflection marked by the appointment of a liberal Prime Minister, the other the lifting of international sanctions imposed against Libya in 1992 and suspended in 1999. Since that year, many legislative measures have been taken to bring the economic environment in accordance with WTO regulations (Libya's request for candidacy was accepted by the General Council July 27, 2004 and negotiations on its membership are still going on). These measures have facilitated the introduction of economic liberalization and partial privatization of the public sector (ITCEQ, 2011). However, despite such tentative efforts to liberalize and diversify the economy, Libya remains a country heavily dependent on hydrocarbons in the hand of the public sector. Indeed, oil accounts for nearly 70% of GDP and generates over 90% of government revenues and 95% of export earnings. The country still suffers from an unpredictable and opaque business environment, and human capital is not suitable to the needs of the new private sector (ITCEQ, 2011). All of the previous regime's liberalization efforts have, moreover, essentially been put on ice since the beginning of the popular uprising against the regime in spring 2011.

**Morocco:** The post-colonial period beginning in 1956 saw the creation of a large number of state-owned corporations in many sectors of the Moroccan economy. In 1990 a policy of economic liberalization and privatization was introduced. On the human side, the period 1999-2008 saw a downsizing in public corporations' personnel, with an improvement of their management-staff ratio and their productivity. Many enterprises in the Moroccan public sector are partially privately owned. The sector includes 256 public institutions and 107 publicly-owned corporations, with 100% capital ownership by the State, 106 public subsidiaries, in which the State holds more than 50% of the capital, and 247 semi-public companies, in which the State's capital is less than or equal to 50%. However, today, the Moroccan public sector remains important, since it continues to run the strategic sectors, either in the form of a monopoly or as part of a competitive market. The state continues to hold monopolies in phosphates, roads and highways, railway, post, water, ports and airports (IMRI, 2011a).

**Palestine:** Overall, the picture appears to have not changed significantly in terms of public versus private sector presence in the economy during the last decade. For instance, GDP dipped substantially during the Second Intifada and then less severely after the legislative elections in 2006, which resulted in a political split between the Fatah-controlled West Bank and the Hamas-led Gaza Strip. Contrary to what would be expected in a privatizing environment, the private sector's share of GDP has declined since 2000 (from around 70% to 62% in 2009), and the public sector component has increased (from around 30% to 36%) (Palestinian

Central Bureau of Statistics, 2011). The economic bust, caused by Israeli measures including the blockade of the Gaza Strip, paved the way for a slight reconfiguration of expenditure and consumption factors. While GDP has continued to rise since the end of the Second Intifada, the influence of factors driving growth has changed, specifically in post-crisis years (Palestinian Central Bureau of Statistics, 2011). Likewise, the distribution of employment in the Palestinian Territory since 2000 has largely remained unchanged. Private sector employment rose in the aftermath of the Second Intifada (from 61% in 2000 to 71%-the highest- in 2003 and to 65% in 2010) (Palestinian Central Bureau of Statistics, 2011). However it has been declining ever since 2003, while government employment has marginally increased (from 20% in 2000 to 24% in 2010).

However, if the Palestinian Territory is analyzed separately as two regions, the West Bank and Gaza, significant differences in employment patterns exist. While employment in the West Bank remained unchanged in the 2000-2010 period in terms of the public- and private-sector share, the government/NGO sector share of employment in the Gaza Strip grew tremendously in that period, from 31.5% to 46.1% (Palestinian Central Bureau of Statistics, 2011). Besides, while public-sector wages in the OPT rose by about 44% from 2000 to 2010, wages in the private sector increased by only about 11% (Palestinian Central Bureau of Statistics, 2011).

Entrepreneurship in the OPT is mostly concentrated in the service sector, which makes up about 45% of all early-stage enterprises. Together, services and agriculture comprise about 62% of early stage enterprises, which indicates a shortage of investments in industrial businesses. In both the West Bank and Gaza entrepreneurship is prevalent in retail trade, hotels, and restaurants, however in Gaza, agriculture, forestry, and fishing are more important activities than in the West Bank. Entrepreneurship that involves the government, health, education, and social services is also more common in the West Bank.

**Syria:** Syria has a large private sector that accounts for more than 60% of GDP. In 2002, the private sector accounted for 75.6 % of an estimated 4.8 million of total employment. The World Bank reports that between 2000 and 2005, the public sector's share of GDP had negative average growth of 2%, while the private sector share grew by 8% on average. Moreover, from 2006-2008 there was a surge in the volume of investment approvals across sectors, indicative of the government's efforts to catalyze growth of the economy and cultivate a more favorable business climate. Between 2008 and 2010, private sector employment rose by 10.6 percent while public sector employment only grew by 4.5 percent (Syria Central Bureau of Statistics, 2009; 2010).

The role of the state in the economy, however, remains substantial. The contribution of ‘government services’ to GDP grew by 145.7% from 2000 to 2009, while that of ‘all other sectors combined’ only grew by 49% in the same period (Syria Central Bureau of Statistics, 2010). The public sector has remained the main source of public revenue. The three key productive sectors of the economy, agriculture, energy and industry, continue to be state-dominated. Agriculture, which is partly government subsidized and controlled, directly generates 30% of GDP and almost half of Syria’s export earnings. The declining hydrocarbon sector makes up the other half of Syria’s exports and around one-fifth of GDP (Bertelsmann Stiftung, 2009).

**Tunisia:** GDP growth depends to a large extent on the private sector, whose contribution has steadily become more important thanks to the various reforms, particularly during the last decade. Correspondingly, overall investment has seen an average annual growth of 3.3% at constant prices ITCEQ (2011). Nevertheless, public assets have not declined noticeably in recent years. Economic activity continued to be driven by relatively higher public investment compared to other countries with similar level of development to Tunisia. Indeed, despite the strong macroeconomic fundamentals and generous incentives to investors, private investment falls short of what was expected. Statistics show that private investment has actually slowed since the mid-1990s. Today, the private sector remains modest in size and is still mainly composed of family-owned small and medium enterprises (SMEs), despite calls from IMF to accelerate reform and privatization (ITCEQ, 2011).

**Turkey:** The private sector’s development started only in the 1960s, after Turkey became a member of OECD in 1961, when the Turkish government started giving incentives in the form of protection of the national industry, financial packages and public procurements. In 2010, Turkey reached a GDP of US\$736 billion – making it the 16th largest economy in the world – and a per capita GDP of US\$10,079. The contribution of the private sector has been increasing since 1986, with the rate of increase accelerating sharply beginning in 2005, though the huge informal sector makes it impossible to provide figures that are both precise and accurate. According to some estimates, Turkish informal sector accounts for 50% of GDP and 40% of employment. It occurs particularly in the sectors of agriculture (90%), construction (60%), trade establishment, hotels & restaurants (40%) and transports (40%) (IMRI, 2011c).

Having provided an overview of the situation in the various MED-11 countries, we now turn to a more detailed discussion of particular aspects of private sector development.



## **2.1. Public-private partnerships**

Infrastructure projects in which both the public and private sectors participate are gaining ground as an infrastructural investment model throughout the world, being seen as a means for mobilizing more funds for investment as well as for circumventing corruption than in traditional models involving the public sector alone (World Bank Institute, 2012). In the MED-11 states, one can observe the beginnings of interest in public-private partnerships (PPP) as a method of investing in infrastructure; among the sectors most heavily affected are water, energy, transport, and telecommunications, though the region is experiencing serious problems with project finance in this area, and regulatory frameworks are still evolving and taking shape (Böhmer, 2010). However, this is very much in a nascent stage currently.

**Egypt** has seen a number of infrastructure projects developed as PPPs, including the large road network in Upper Egypt that connects the Nile Valley with the Red Sea, the sewage and water treatment plant for New Cairo and the oil products storage in East Port Said (Hatem, 2011).

In Israel PPPs have flourished in the past decade due to internal and external pressure to open government-controlled sectors to the private sector. Sectors in which they have developed include transportation (roads, tunnels, highways, railroads and mass transit systems, and the Jerusalem Light Train), health (the Ashdod Hospital), water desalination and sewage treatment systems, and energy (solar and liquefied natural gas). In general, the government owns at least half of the shares of a PPP consortium. By 2010, 20 PPP projects in Israel had attracted the investment of more than nine billion dollars (MAS, 2011b).

**Palestine** has some examples of infrastructure companies in which ownership is shared between the public and the private sector. In particular, it is worth mentioning that the publicly-owned Palestinian Investment Fund (PIF) owns 8.5% of the Palestine Electric Company and 10% of the Gaza Gas Project, a consortium of companies given the right to explore for oil and gas off the coast of the Gaza Strip.

The **Syrian** state has begun to implement a build-operate-transfer (BOT) scheme in order to promote both local and private investors to finance, design, construct, and operate large-scale infrastructure and development projects. In return, the Syrian Government retains the right to generate revenues from the facilities for an agreed period of time, the concession period (usually between 10 to 40 years), to allow investors to recover their invested capital and earn a fair return on investment. At the end of the payback period, the assets of the BOT project are transferred to the ownership of the government or local authority which granted the concession (Badawi, 2003). One example of this arrangement is the agreement,

signed in 2009, with Cham Holdings (a Syrian investment group) and the Kuwaiti conglomerate Al-Kharafi, the deal awards a 25 year build, own and operate license to Cham Holdings and Al-Kharafi in addition to free fuel from the government to run power plants and distribute electricity (Oweis, 2009).

In **Turkey**, similarly, PPPs have boomed following the acceptance of Turkey's application for EU membership at the Helsinki European Summit in 1999, and especially since the start of accession negotiations in 2005. PPPs, with state equity varying amongst projects involves air and maritime transport and electric power facilities (IMRI, 2011c).

## 2.2. Business climate

According to the 2011 World Bank "Ease of Doing Business" report, the MED-11 region is very diverse with respect to the business climate prevailing in its countries (see Table 1). Israel is by far the best-performing country in the region in this respect and ranks 29th in the world. In particular, the Israeli economy excels in the categories of 'getting credit' and 'protecting investors' where it placed 5th and 6th respectively. Tunisia and Turkey are in second and third place in the region, ranking 55<sup>th</sup> and 65<sup>th</sup> in the world, respectively. The poorest performing countries are Palestine, Algeria and Syria. Of course, one needs to bear in mind that these rankings pre-date the unrest in the region experienced in 2011; which has had a dramatic adverse effect on Egypt, Libya, Syria, and Tunisia.

**Table 1. The Ease of Doing Business Ranking for MED-11**

Countries	2009	2010
Israel	30	29
Tunisia	58	55
Turkey	60	65
Egypt	99	94
Jordan	107	111
Lebanon	109	113
Morocco	114	114
Palestinian Authority	133	135
Algeria	136	136
Syria	144	144

*Note.* Missing Libya.

*Source:* World Bank (2010).

**Algeria:** As Table 1 depicts, the 2011 Doing Business Report ranks Algeria 136th in the world for the ease of doing business, below Tunisia (55th), Egypt (94th) and Morocco (114th). Among the rankings by heading are: 150th in entrepreneurship, 74<sup>th</sup> in investment protection, 168<sup>th</sup> in payment of taxes and duties (the highest), 124<sup>th</sup> in cross-border trade, and 57<sup>th</sup> in business development (the lowest). This poor performance is the result of several factors, including the socialist system giving preferences to the public sector since independence in 1962, the widespread disapproval of privatization by the population, the underdeveloped financial system, dominance of the energy sector (oil and gas) in the economy, and the pervasive red tape. The situation is made worse by the compulsory 51%-49% foreign direct investments composition rule, vesting the majority shareholding in the Algerian partner. Other disincentives also include corruption and the State's right of first refusal on the sale of assets in the hands of foreign companies (IMRI, 2011b).

**Egypt:** In the period 2005-2009, the government promulgated several laws and decrees to improve the environment for private investment, e.g., to help international and local investors settle their disputes in fair and equitable ways, to facilitate the operation of small enterprises, to establish uniform tax treatment for large and small enterprises, to promote competition and prohibit monopolies, and to reduce tax rates on corporations to 20%. This included opening branches of the General Authority for Investments in various provinces, which opened the flood-gates for entrepreneurs, especially those outside Cairo, to start companies. As a result of those efforts, the World Bank improved Egypt's ranking in 'starting business' from 126 in 2007 to 94 in 2010 (Hatem, 2011).

**Israel:** Capital markets in Israel have undergone significant deregulation since the beginning of the new millenium. During the 1980s and 1990s the state heavily controlled capital flows. According to the Heritage Foundation and the Wall Street Journal (2011), starting in 2007, financial liberalization gathered pace significantly. Due to numerous liberalization policies implemented during the last two decades, Israel has become a haven for investment. In addition to the Companies Law of 1999, which reduced bureaucracy, there have also been reforms and advances in important areas such as intellectual property protection, competition law, and anti-corruption initiatives. Foreign investors are not required to gain approval for acquisitions, with the exception of buying land and industries related to the security apparatus. According to the World Economic Forum, Israel ranked 23rd out of 134 countries for competitiveness (MAS, 2011b). However, Israel's ability to attract FDI is affected by its occupation of Palestinian territory, which has caused the Israeli state to limit foreign investment in security-related industries, and also deters some foreigners from wanting to invest in any part of the Israeli economy. The Boycott-Divestment and Sanctions (BDS) movement against Israel has influenced

a number of organizations, including churches, governments, universities and food retail companies (Horowitz & Weiss, 2010).

**Jordan:** As MAS (2011c) notes:

*Finding well-trained and qualified employees is difficult for Jordanian businesses due to a lack of solid vocational training programs and desire to do work outside of management or the public sector. Regional security and stability also appear to effect business, especially in the tourism sector. Other problems widely mentioned by businessmen are: difficulties in registering a business, taxation barriers, lack of government support, customs procedures, labour regulations, and intellectual property rights. Various reports from a diverse set of institutions have characterized the Jordanian business climate as average at best. Although investment promotion has usually come through the avenue of tax exemptions, the main problem for investors continues to be high transaction costs (Loewe et al., 2007).*

On a positive note, however, the authors also mention that:

*Over the past ten years reforms have advanced privatization, encouraged foreign investment, reduced the regulatory burden for business, and strengthened property rights. These measures have improved productivity and increased foreign investment in Jordan and intellectual property protection has spurred significant growth in the IT and pharmaceutical industries.*

**Lebanon:** Lebanon has a solid reputation for containing a highly educated population compared to the rest of the Middle East, along with marketing expertise that is evident in Middle Eastern media. Before the 1970s, Lebanon was the main commercial hub for the Middle East. As a result, the country possessed a developed consumer base, specifically in population centers like Beirut. However, with a 20-year war that lasted until 1991, national infrastructure, education, and technology were greatly damaged. Since the end of the conflict, tourism and banking have become Lebanon's primary growth sectors. Banking particularly took off on account of Lebanon's banking secrecy laws. Nevertheless, over the past decade Lebanon has had to deal not only with Syrian and Israeli border threats and limited territorial occupation, but also internal political instability caused by the various feuding ethnic/cultural groups (MAS, 2011e).

**Libya:** In August 2009, the Office of Privatization and Investment (OPI) created a one-stop shop to centralize, standardize, speed up and clarify the allocation of licenses. All these would improve the business climate and strengthen investor confidence if the country could keep its political, and hence economical, stability (ITCEQ, 2011).

**Morocco:** The 2011 Doing Business Report ranked Morocco 114<sup>th</sup> out of 183 countries. This shows substandard marks for the Moroccan business environment. The worst is related to protection of investors (154<sup>th</sup> place) and the best for business closures (59<sup>th</sup> place). The Government is aware of the problem and has implemented a number of reforms and measures geared to improving the general situation throughout the next decade, including measures to reform and improve the performance of publicly owned institutions (IMRI, 2011a).

**Palestine:** A 1995 analysis of the first PNA attempt to formulate a ‘Law on the Encouragement of Investment in Palestine’ outlined some challenging issues (Fidler, 1995): broad discretionary powers of the authorities; a lack of transparency and international standards and practices; restrictions on asset sales; potential problems with the free transferability of investment sale proceeds, asset sale proceeds, capital, and profits; a lack of standards for expropriation; and a flawed dispute settlement procedure. Some attempts have been made to improve the situation. The 1998 Law on the Encouragement of Investment “encourages capital investment in all sectors of the Palestinian economy by both local and foreign corporations registered to do business in Palestine” (PIPA, 2011). Other recent reforms include the adoption of most to International Accounting Standards, laws regulating (and liberalizing somewhat) foreign ownership of real estate, and the drafting of a law to promote competition and prevent anti-competitive practices (PIPA website).

**Syria:** Some of the barriers that have prevented growth in the private sector include: financing difficulties and restrictions (including the great difficulty in obtaining bank loans in order to start a business, with incredibly long procedural times); corruption in many administrative bodies; administrative restrictions such as difficulty acquiring licenses and foreign trading documents; various restraints imposed by many monopolistic bodies that disrespect transparency rules, coupled with the existence of some interest groups protecting their monopolies (principally the communications and interior trading sectors), and legal and institutional constraints which raise transaction and opportunity costs, creating barriers to entry for entrepreneurs (MAS, 2011d). On the other hand, there have been some positive recent developments. The government has attempted to attract strategic investors by expanding the rights of private investors, enabling them to sell and lease land, and to grant them equal footing in disputes with public sector bodies (Selah, 2007). Private companies have been permitted in virtually all fields, although they still require non-transparent official approval, and business start-ups have been facilitated by reducing the minimum capital requirement for limited liability companies by two-thirds. The government also enhanced access to credit by eliminating the minimum threshold for loans included in the database, which expanded the coverage of individuals and firms to 2.2% of the adult population (The World

Bank Group, 2010, p. 142). Under President Bashar al-Assad, property rights have been legally consolidated by laws on commercial arbitration, foreign direct investment, and the protection of commercial and industrial ownership. Capital can be repatriated. The 2005 legislative decree abolishing economic security courts, which had been in operation since 1977, removed one of the main threats to property rights (Bertelsmann Stiftung, 2009). Labor laws have been relaxed. Furthermore, the government has issued decrees for protection of competition and prevention of monopoly (Syrian Ministry of Economy, 2008). According to MAS (2011d), the government

*has implemented modest economic reforms in the past few years, including cutting lending interest rates; opening private banks; consolidating all of the multiple exchange rates; raising prices on some subsidized items, most notably diesel, other oil derivatives, and fertilizers; and establishing the Damascus Stock Exchange, which began operations in 2009. However, [with regard] to the entrepreneurial activity in Syria the GEM 2009 shows that the nascent entrepreneurship rate in Syria (3.4) is weak in comparison with the average [for] factor driven economies (10.2). Similarly, the new business ownership rate in Syria is less than the average [for those based on natural resource and/or cheap labor] (Bosma and Levie, 2010).*

**Tunisia:** Tunisia ranked 55th for ease of doing business in 2011, an advance of three places since 2009 (ITCEQ, 2011; World Bank, 2010) and the second best rating for the countries in the sample. The indicators used by Doing Business (DB) reports show how the number of procedures and time required to create and shut down enterprises, the costs involved and the issuance of permits, in addition to other constraints on the private sector, lead to its failure to invest and do business effectively (ITCEQ, 2011).

**Turkey:** As of 2011, Turkey's rating of 65 – slightly lower than Tunisia's – was the result of various reforms adopted by the Turkish Government, partly in the context of its negotiations for accession to the European Union. The Turkish economy has grown at an average of 4.8% each year over the last 8 years. Turkey weathered the world economic crisis quite well, with a growth rate of 8.9% in 2010. UNCTAD has ranked Turkey the 15th most attractive country for FDI, while the OECD has predicted that Turkey will be first in the world in terms of economic growth for the period 2011-2017, with a rate of 6.7%. In 2010, the Turkish economy was ranked 16th in the world and would have been the sixth largest in the European Union. Several factors explain the success of the Turkish economy. The first is the size of the population (74 million), and its youth (50% aged under 29). Labor is cheap, skilled and motivated, and undaunted by hard work, with 53.2 hours worked per week on average and only 4.6 days of sick leave per

employee/year. The Turkish educational system produces about 500,000 graduates each year and more than 600,000 high school graduates (one third from technical and vocational colleges). The private sector generated US\$114 billion dollars of exports in 2010. Businesses can be created in six days, and all investors get equal treatment, whether nationals or foreigners. However, these favorable results have been offset by other outcomes which have remained negative: the uneven distribution of wealth, the still significant importance of the informal sector, and high unemployment. Turkey's standard of living, on average, is consistent with European Union membership, but incomes in the South-East region remain very low, accompanied by a high unemployment rate (IMRI, 2011C).

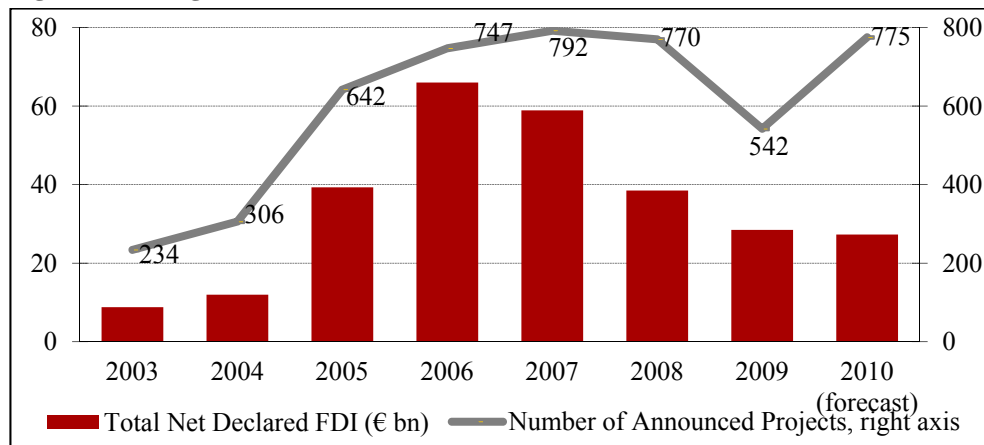
### **2.3. Foreign direct investment**

When many MED-11 countries started to engage in privatization processes, it quickly became evident that the pool of domestic investors who are capable of launching successful bids to privatize public companies was too small. As a result, the last decade saw a great effort to attract FDI. Figure 1 shows the total net inflow of declared FDI into the MED-11 along with the number of announced projects between 2003 and 2010. The global economic crisis negatively affected FDI flows to the region in 2009, though it was expected to recover in 2010. (Due to the aftermath of the Arab Spring, however, it is now expected that 2011 will once again bring a slowdown of FDI flows.) As one can see in the figure, although the region recovered in terms of the number of FDI projects at the end of the decade, it had not yet recuperated in terms of the amounts invested (while in 2010 43% growth in the number of announced projects was forecast, the amount was forecast to decline by 8% in comparison with 2009). Table 2 takes us beyond the year-by-year perspective of FDI inflows, showing accumulated FDI stocks (according to CIA estimates) as of 2011 (data were not available for all MED-11 countries; Lebanon, Syria and the Palestine Authority are missing). The table shows that countries with the most diversified economies (such as Turkey and Israel) tend to attract more investment than those whose economies are more concentrated in a single sector, even if that sector is very attractive to investor (as in the case of hydrocarbons).

Comparison among the countries in different regions can give us a better understanding of FDI inflows into the area. The Maghreb, consisting of 5 North African countries (Algeria, Libya, Morocco, Mauritania and Tunisia), is still awaiting

recovery from the worldwide credit crunch, while the Machreq<sup>2</sup> (Iraq, Kuwait, Egypt, and Sudan) and other MED-11 countries (Israel and Turkey) have already recovered and show signs of growth (Figure 2).<sup>3</sup>

**Figure 1. Foreign Direct Investment into the MED-11**



Source: ANIMA – MIPO (2010).

**Table 2. MED-11 FDI stocks (2011)**

Country	FDI stock (billions of USD)	Country rank in the world	FDI stock per capita (in USD)
Turkey	99.0	36	1307.7
Israel	82.8	43	10927.8
Egypt	75.7	45	896.1
Morocco	45.0	56	1389.7
Tunisia	32.5	60	3084.9
Algeria	24.5	65	691.6
Jordan	22.6	66	3709.2
Libya	19.6	69	2994.4

Source: CIA World Factbook.

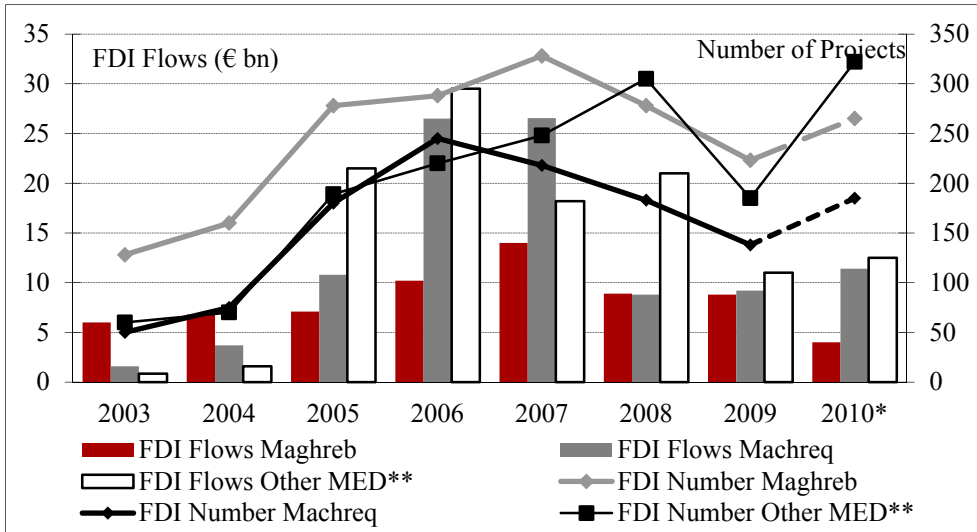
<sup>2</sup> Sometimes spelled Mashregh, Machreq, or Machreck, the term refers to a large area in the Middle East bounded by the Mediterranean Sea and Iran. It is the companion term to Maghreb. Although there is no clear cut but it commonly includes Egypt, Iraq, Kuwait, and Sudan.

<sup>3</sup> The data used in Figures 2 and 3 and Table 3 come from the ANIMA-MIPO (Mediterranean Investment & Partnership) Observatory, which, since 2003, has monitored more than 5000 announcements of FDI and partnerships. The latter are defined by ANIMA-MIPO as projects where a foreign corporation enters a domestic market either through an identified partner or by opening local representation (see ANIMA-MIPO, 2011).



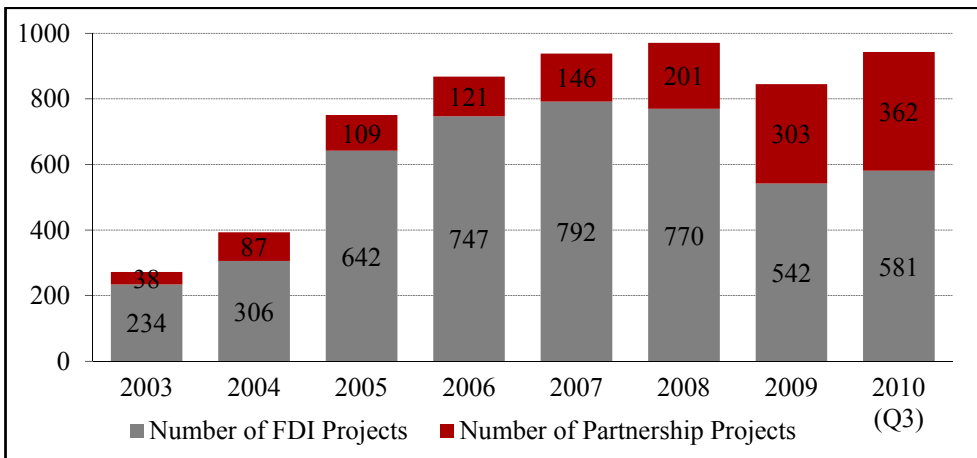
Figure 3 shows that foreign investors are counting more and more on partnerships with domestic businesses. For example, in the three quarters of 2010, 362 partnership projects (local representatives, franchises, joint production and R&D projects, etc.) were announced, which represented 59% growth over 303 for the whole of 2009.

**Figure 2. Foreign Direct Investment into three different regions of MED-11**



Note. \* Forecast for 2010. \*\*Other MED means Turkey and Israel.  
 Source: ANIMA – MIPO (2010).

**Figure 3. Total number of detected FDI & partnership projects**



Source: ANIMA-MIPO (2010).

While we have seen that overall FDI in the Maghreb has been slower to revive than elsewhere, Table 3 shows the strong appetite of European businesses for partnerships with Maghreb-based counterparts in terms of the number of detected partnership projects.

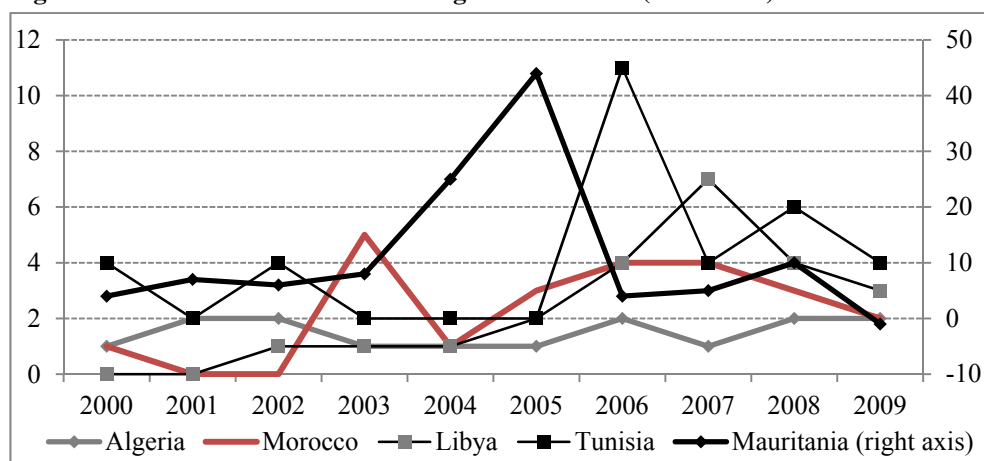
**Table 3. Total number of detected partnership projects, per region of origin and region of destination**

Origin/Target	Machreck	Maghreb	Other MED	% Total
Europe	142	<b>392</b>	171	52%
Gulf	72	40	9	9%
MED-11	31	31	16	6%
Other Countries	56	62	26	11%
USA-Canada	90	101	128	23%
% Total	29%	<b>46%</b>	26%	100%

Source: ANIMA-MIPO (2010).

As we see in Figure 4, in the Maghreb region, particularly Tunisia and Morocco show a significant recovery in terms of the number of FDI projects (for Tunisia, 92 in the first 3 quarters of 2010, over 78 for the year 2009), while Algeria and Libya saw drops of over 25% (ANIMA – MIPO, 2010).

**Figure 4. Net Inflow of FDI for the Maghreb Countries (% of GDP)**



Source: World Bank Data Bases (2000-2009).

Finally, before turning to a more detailed look at the experience of individual countries, in Table 4 we present data on FDI as a percentage of GDP for all of the MED-11 economies since 1995. Data not presented here show that FDI into the region was very low before the second half of the 1990s. For two countries, Alge-

ria and Syria, which can perhaps be regarded as the poorest reformers in the group, this situation has not changed in the last decade and a half. Turkey's FDI boom in the mid- to late 2000s was relatively moderate, measured against GDP. All of the others, including Libya, saw significant increases in FDI as a percentage of GDP at some point during the 2000s (for Palestine, this period came in the late 1990s; the 2000s were rather bleak for Palestine, although the situation improved again in 2009). Measured in GDP terms, the biggest – and longest – FDI booms were seen in Lebanon and Jordan.

**Table 4. Inward foreign direct investment flows, annual, 1995-2010 (% of GDP)**

	Algeria	Egypt	Israel	Jordan	Lebanon	Libya	Morocco	Palestine	Syria	Tunisia	Turkey
1995	0.00	0.86	1.67	0.20	0.32	-0.31	0.90	3.81	0.52	2.09	0.39
1996	0.58	0.83	1.57	0.22	0.62	-0.36	0.79	5.26	0.59	1.79	0.30
1997	0.54	1.04	1.85	4.98	11.54	-0.20	3.23	4.40	0.49	1.93	0.32
1998	1.26	1.19	1.79	3.92	6.71	-0.50	1.00	5.53	0.47	3.37	0.35
1999	0.60	1.11	3.78	1.92	5.12	-0.38	3.43	4.51	1.48	1.77	0.31
2000	0.51	1.24	5.58	10.79	5.78	0.37	1.14	1.48	1.37	4.01	0.37
2001	2.01	0.54	1.44	3.05	8.50	-0.33	7.44	0.49	0.52	2.44	1.71
2002	1.87	0.72	1.40	2.49	7.14	0.66	1.19	0.27	0.53	3.90	0.47
2003	0.93	0.31	2.79	5.36	14.44	0.55	4.65	0.47	0.77	2.34	0.56
2004	1.03	2.62	2.32	8.21	11.57	1.07	1.57	1.16	1.30	2.26	0.71
2005	1.05	5.47	3.59	15.76	15.19	2.28	2.78	1.00	2.05	2.69	2.08
2006	1.53	8.95	10.49	24.21	13.96	3.65	3.73	0.40	2.02	10.64	3.80
2007	1.24	8.76	5.27	15.42	13.47	7.48	3.73	0.61	3.09	4.54	3.41
2008	1.52	5.76	5.38	12.46	14.48	5.05	2.80	0.87	2.98	6.74	2.67
2009	1.96	3.57	2.29	9.68	13.91	4.55	2.15	4.52	2.66	4.27	1.37
2010	1.43	2.98	2.39	6.19	12.77	5.35	1.43	na	2.32	3.76	1.21

Source: UNCTADstat (<http://unctadstat.unctad.org>).

**Algeria:** According to IMRI (2011b),

*FDI has never contributed more than 2% to the GDP during the last decade (World Bank Data Bases, 2010). Yet the State of Algeria has taken a set of measures geared to offer financial incentives, improve the business climate and reduce the costs and times for the creation and startup of new companies. However, the Algerian State wishes rather to direct FDIs to highly capital-intensive activities, the dissemination of the use of ICTs, the improvement of managerial capacities, better access to the global market, and a wider diversification of national exports.*

**Egypt:** According to the Egyptian Ministry of Investment estimates, 13% of private investments in recent years come from Arab countries, 15% from other

international sources (first the US, then Europe), and 72% from Egyptian sources (Egyptian Ministry of Investment, Annual Reports, 2010). Despite a 2007 law establishing 12 investment zones in seven governorates to encourage investment in industry, finance, agribusiness, services, commerce, education, and research, 42% of the increase in FDI flows went to energy, particularly for the national gas sub-sector in all its connected phases: exploration, development, distribution and marketing (Hatem, 2011).

**Israel:** Since the Israeli government seriously opened up to privatization in the 1990's, vast sums of foreign (as well as domestic) investment have flown into Israel to buy shares of state-owned enterprises (Israel Central Bureau of Statistics, 2011). The liberalization of the telecommunications and financial sectors in the 1990s gave a boost to investments in the high-tech sector, which had developed within state-controlled or subsidized enterprises in previous decades. Within this sector FDI has specifically targeted software, semi-conductors, internet, communications, and medical devices (OECD, 2002). Foreign investors have also targeted banking and insurance activities. Due to the opening of Israel's capital account, Israeli firms are able to access capital not only through the Tel Aviv stock exchange but also through the technology oriented NASDAQ. Almost 50 percent of total FDI going to Israel in the early 2000s originated from the United States and Canada (MAS, 2011b).

**Jordan:** The government has facilitated foreign-domestic partnerships and created free trade zones. As a result FDI grew rapidly in the first half of the 2000s, rising from about 4% of GDP in 2003 to about 23% in 2006 before falling back to about 10% in 2008 (ESCWA, 2008, 2009). As part of the Jordanian government initiative to boost trade and incentivize investment, it has created a network of agencies that work to attract investments into the country. These agencies work with foreign investors and direct them to profitable sectors in need of more investment as well as offer investors incentives and exemptions depending on the nature of the investment and its sector direction. In the last decade, FDI inflows have concentrated in free trade zones, such as industrial and development zones created to attract foreign capital. In total, there are nine industrial estates that incorporate foreign and mixed foreign-domestic ventures. The United Kingdom (29%), United Arab Emirates (26%), Kuwait (16%), and Saudi Arabia (11%) have been the main investors, while other countries together have made 18% contribution to the FDI inflows (Jordanian Investment Board, 2008).

**Lebanon:** The government of Lebanon allows free movement of capital through borders without regulation. Additionally, there are no restrictions regarding foreign exchange or repatriation of capital and funds. Moreover, in the past decade, the government passed various laws aimed at attracting foreign capital (MAS, 2011e). FDI has surged in Lebanon over the past 15 years, but particularly

after 2002. Although it is marked by sharp peaks (2003 and 2005) and declines (2004 and 2006), indicating the irregularity and unsteadiness of investment flows (UNCTAD, 2011), Table 4 shows that the figures remain above all countries in the region for almost all years.

**Libya:** In the late 2000s, ITCEQ (2011) writes,

*the Libyan Foreign Investment Board was created to facilitate access to foreign investors who are eligible for tax benefits under Law No. 5 of 1997. The law provides for exemption of customs duties, the total exemption of tax on earned income from the project and reinvested earnings, and the repatriation of all profits during the license period. The sectors covered by this law are industry, services related to health, agriculture and tourism.*

About 110 companies have been marketed since 2004 for a total of 2 billion USD. The list includes utility industries and chemical industries. The goal for 2015 is to attract 5 to 10 billion LYD of foreign investment (ITCEQ, 2011).

**Morocco:** Privatization has fostered the integration of some large privatized companies into the development strategies of large international groups, as well as attracting FDI in industry, telecommunication, tobacco, energy and finance. The FDI inflows stemming from privatization for the period amounted to DH 257 billion (US\$32 billion) during 2000-2010, when Morocco ranked 3<sup>rd</sup> or 4<sup>th</sup> in Africa after South Africa, Egypt and Nigeria, as a result of a policy to attract more FDI. Nevertheless, FDI accounts for only a very modest share in the GDP (3.8% in 2010). The flow of FDI was uneven during this period, “inflated” in part by the privatization of Maroc-Télécom in 2001 and Tobacco Monopoly in 2003. Also, the world economic crisis has had an effect on FDI in Morocco, with a drop from 26% in 2008 and 10% in 2009, followed by a sharp rebound to 28% in 2010. During the 2000-2009 period, major investors hailed from the following countries: France (46.5%), Spain (18.4%), United Arab Emirates (5.6%), Great Britain (3.7%), and Switzerland (3.4%). For the same 2000-2009 period, below are the sectors that have attracted most investments: telecom (23.6%), industry (19.9%), real estate (17.4%), tourism (15.8%), and banks (7.7%) (IMRI, 2011a).

**Syria:** According to MSA (2011d), FDI in Syria has risen dramatically in the last decade albeit from a very low initial level:

*From 2000 to 2009 FDI rose by 431 percent, increasing rapidly from 2003 to 2004 and then most notably from 2006-2007. As a percentage of GDP, FDI has gone from less than half of a percent before Bashar Al-Assad came to power in 1999 to almost 3 percent of GDP in 2009 (United Nations Conference on Trade and Development, 2011). Foreign Direct Investment outside the Middle East has mainly come from European*

*countries like England and Switzerland; Latin American countries like Venezuela and Brazil, and Asian countries like Indonesia, China and the Philippines. Within the Middle East, the heaviest sources of FDI are Saudi Arabia, Iran, Jordan, Kuwait, the United Arab Emirates and Lebanon (Syria Central Bureau of Statistics, 2009). The most important targets of FDI flowing into Syria in 2009 were telecommunications and financial intermediation. Other minor but still important investment sectors include Food, Textiles, tourism, electronic infrastructure, vehicle motor industry, insurance, real estate and education (Syria Central Bureau of Statistics, 2009).*

**Tunisia:** FDI reached a relatively high level of 19% of total investments during the last decade. These investments are mainly directed towards the energy sector, whose share saw a downward trend between the periods 1992-2001 (58.3% of total FDI inflows) and 2002-2009 (43.3%), and the service sector (whose share grew from 6.6% to 14.8% for the same period). The fact that the share of the service sector has more than doubled is due partly to the wave of privatizations in the banking sector and market opening in telecommunications. The share of manufacturing in FDI inflows shows a decline from 32.9% in 1990s to 21.6% in 2000s (ITCEQ, 2011). Macroeconomic stability (particularly with regard to low inflation) has allowed Tunisia to improve its image among international investors and expand its access to international capital markets. However, as ITCEQ (2011) notes,

*Tunisia has been very cautious in regard to opening its capital account. Inputs and capital outflows are indeed limited and even though these restrictions have limited the growth and efficiency of private investment, since the Tunisian authorities consider that financial integration thrust combined with weaknesses that are prevalent in the productive sector could lead to financial instability and increased vulnerability to external shocks.*

**Turkey:** Foreign Direct Investment in Turkey has increased significantly since 2005. As mentioned before, UNCTAD ranked Turkey the 15th most attractive country for FDI in 2010. Although FDI rose to record highs in 2006 and 2007, with over US\$20 billion, it was negatively impacted by the global financial crisis, falling to US\$8.2 billion in 2009 and US\$9.1 billion in 2010. FDI from European Union countries was predominant even after the global financial crisis and amounted to 84% of total FDI in 2009 and 80% in 2010. The increase in FDI can be explained primarily by the success of the Turkish economy, which, as mentioned above, has grown at an average of 4.8% each year over the last 8 years. Additionally, in order to offer the best environment to both domestic and foreign firms, several organizations were created for the regulation and oversight of the

various types of contracts and procurements. These are independent bodies, both from an administrative and tax perspective. The 25,000 foreign businesses operating in Turkey have recourse to international arbitration and the guarantee of transfer. Furthermore, Turkey offers the most modern technical infrastructure in all areas of transport, telecommunications and energy. Turkey enjoys a prime geographical location, as a natural crossroad between East-West and North-South corridors, in addition to being a main energy platform for Europe. Furthermore, it is conceivable that the regional instability resulting from the “Arab Spring” will increase the relative attractiveness of the stable political situation in Turkey, encouraging more foreign investors to invest in Turkey (IMRI, 2011c).

#### **2.4. Development of the financial sector**

As noted in Woodward et al. (2011), the banking sector represents one of the greatest weaknesses of the region. An overview of domestic credit to the private sector (as a share of GDP in 2009) can be found in Table 6 in section 4 of that publication. The figures show a yawning gap between countries with relatively high figures (Israel, Jordan, Lebanon, Morocco and Tunisia, all above 64%) and the others, where shares range from 11% (in Libya) to 37% (in Turkey). Here we attempt to describe recent developments with respect to both credit and equity markets.

**Algeria:** The Algerian banking sector has remained dominated by public sector, and there has been little opening towards foreign banks. Three banks are slated for privatization: *Crédit Populaire d’Algérie (CPA)*, *Banque de Développement Local (BDL)* and *Banque Nationale d’Algérie (BNA)*. However, after the international financial crisis of 2008-2009, the plan for the privatization of these banks has been postponed. Apart from banks, other financial institutions exist, providing financial leases, mortgage loans and consumer credits, albeit not more than 5 in total. Indeed, there are not many other financial institutions other than banks, and the stock market is still in its infancy (IMRI, 2011b). Every year, the 100,000 newly created small and medium enterprises and industrial startups find it quite hard to access bank loans. The bank penetration rate is still low, with a small number of branches (1,200); however, closer cooperation with the European Union has brought some improvement (for example, by providing training to bank staff and assisting in the consolidation of prudential rules and implementation of a sound prevention and warning system in order to strengthen money-laundering control).

The banking system suffers from excess liquidity (derived from the exports of hydrocarbons) which is not translated into credit (IMRI, 2011b).

**Egypt:** According to Hatem (2011), Egypt's financial sector is

*dominated by four public commercial banks (70% of the banking market) and another four major insurance companies (90% of the insurance market). Combined, 40-45% of the portfolios of the four banks were non-performing loans to public enterprises. Until 2010 none of those financial institutions were privatized. However, the non-performing loans and debt arrears of public enterprises were cleared by June 2010.*

With regard to the equity market, Hatem (2011) writes:

*In 1991, when Egypt committed to privatization in earnest, some capital market reforms had already been in place, but the market was still lag-gard after decades of inactivity. The value of securities trading reached its peak ever at L.E. 446 billion (US\$85 billion) in 2009 (Capital Market Authority). The ratio of market capitalization to GDP has spectacularly increased since the late 1990s until it reached a peak of 91% in June 2008. However, the local market could not escape the global recession, which rattled investors everywhere. As a result, the ratio fell to 45% in June 2009 and again to 34% in June 2010.*

Egypt's stock market capitalization dropped from 107 % of GDP in 2007 to 38% of GDP in 2010 as per the World Bank data base, reflecting the drastic drop in stock market prices.

**Jordan:** In terms of finance, large firms appear to have no significant problems in acquiring capital because of their size. Micro firms have access to a well developed system of micro loan enterprises. Medium-size firms suffer the most in terms of entry and finance since they are not small enough for micro loans and not large enough (or do not own enough capital) to receive large scale finance (MAS, 2011c). Beginning in 2005, the Ministry of Planning and International Cooperation in Jordan created a Microfinance Committee to plan the first national strategy for microfinance in the Arab world. This plan would include specific recommendations on development strategies for the microfinance sector in Jordan for the ensuing decade (Khaled, 2011). The stock market is rather well developed; its overall capitalization as a percentage of GDP dropped from 232 in 2007 to 112 in 2010, as per the World bank data base; again reflecting the sharp drop in equity prices in that period of global financial turmoil.

**Libya:** The privatization of the banking sector led to turning control over two of the five state commercial banks to international banks, with the transfer in July 2007 to 19% of the capital of Sahara Bank to BNP Paribas for 145 billion Euros



and 19% of Wahda Bank to Arab Bank, as well as the merger of state banks Umma Bank, and Joumhouriya Bank in April 2008 (ITCEQ, 2011).

**Morocco:** Credits to the Moroccan economy nearly tripled between 2002 and 2010. It is noteworthy that starting from 2005 there was double-digit growth with a peak in 2007 (+29.6%). However, the global financial crisis has slowed down growth, which fell to 21.1% in 2008, 11.5% in 2009 and 7.5% in 2010.

With respect to equity markets, the privatization policy has had a positive impact; market capitalization has risen from DH 5 billion (US\$550 million) in 1989 to DH 532 billion (US\$64 billion) in 2008. As of 2010, there were 74 companies listed on the Casablanca Exchange, the only Moroccan stock market. Privatized companies account for more than 50% of that exchange (IMRI, 2011a). Overall stock market capitalization dropped between 2007 and 2010 from 100% of GDP to 75% as per the World Bank data base.

**Syria:** As mentioned above in section 2.3, Syria suffers from financing difficulties and restrictions, including the great difficulty in obtaining bank loans in order to start a business, with incredibly long procedural times (MAS, 2011d). In many cases companies operating in Syria choose to avoid financial institutions altogether for finance, preferring rather informal means such as family connections (United Nations Development Program, 2007; Bertelsmann Stiftung, 2009). In 2004, Syria witnessed the opening of the first private banks, with six currently in operation. By 2006, the privately-owned banks captured 25% of private sector deposits and 14% of loans to the private sector (CGAP, 2008). In February 2007, the Syrian Government issued the General Microfinance Decree (Syrian Legislative Decree no. 15), the first of its kind in the region. This new legislation reflects a significant opening of the financial markets; it is expected to catalyze greater access to affordable financial services for microfinance clients, who are typically lower-income and “unbanked” by traditional financial institutions. The decree allows the Credit and Monetary Council (CMC) of the Central Bank of Syria to license Social Financial Banking Institutions (SFBIs) with the objective of providing microfinance services (CGAP, 2008). Despite new legislation like this, the demand for microfinance products and services in Syria is not being satisfied. In the absence of any formal market assessments, conservative estimates of current demand are upward of at least one million clients; meanwhile the total number of active clients being served has reached a meager 41,500. The industry has yet to diversify its products and services, with credit being the primary product offered by all providers, and business training the main ancillary service (CGAP, 2008).

A stock exchange was established in Damascus in 2009 but no data was readily available to assess its importance in term of capitalization.

**Tunisia:** The annual survey conducted by the Tunisian Institute for Competitiveness and Quantitative Studies (ITCEQ) highlights some financing difficulties faced by companies. Banks may, for example, require collateral equal to up to twice the amount of the loan. Other sources of financing (leasing, venture capital, and the stock market) are still underdeveloped (ITCEQ, 2011). The stock market capitalization rose from 15% of GDP in 2007 to 24% of GDP in 2010 as per the World Bank data base.

**Turkey:** Between 1945 and 1980, the public sector dominated finance (through state-owned banks). In the last decade, the Turkish banking sector suffered a major crisis in 2001 due to misappropriations of funds, corruption and other abuses. However, as of today, the Turkish banking system is healthy and is made up of public, private and foreign banks (with most of the latter coming from France, Belgium, the US, Netherlands, the UK and Italy), deposit-taking banks and investment and corporate banks. Through the privatization of Sumerbank, Etibank, Denizbank, Anadolu Bank and İş Bank, the government has greatly reduced its presence in the banking sector (IMRI, 2011c). Stock market capitalization was 44% of GDP in 2007 and dropped only slightly to 41.7% of GDP, reflecting the resilience of the Turkish economy during the global financial crisis.

## **2.5. The informal sector**

Hernando de Soto (1989, 2000) has shown how the barriers bureaucrats place in the way of recognition of the property rights of entrepreneurs (especially poor and middle-class ones) in developing countries force them into the informal sector and impede the growth of firms in that sector. He has also argued that the formalization of the property rights of informals and “squatters” could lead to the unleashing of enormous potential for growth and entrepreneurship. All too often, however, governments take exactly the opposite route; instead of recognizing squatters’ rights, they take away the land and property that tribal peoples have had for hundreds of years (see, for example, Roy, 2002, 2010). In this section we examine the role of informal entrepreneurship in the economies of the MED-11. As the country information reported below indicates, shares of the informal sector in GDP are generally high in the region, ranging between 20 and 40 percent for the countries on which we have data.

**Algeria:** The most recent figures (2009) show that the informal sector in Algeria employs 1.7 million people, i.e. 22% of the active population. If one adds informal jobs held in the formal sector and casual employment, the figure comes to

32% of the active population. The annual incomes generated by the informal sector amount to 6 billion Euros per year, i.e. 17% of the net household incomes. According to IMRI (2011b), the Algerian government tries to address this situation primarily through repressive measures, such as the creation in 2004 of the Financial Intelligence Unit, in order to fight money laundering and illegal transfers of capital, and an act passed on 31 March 2011 which makes it obligatory to make any payment in excess of 500,000 dinars (approximately 5,000 Euros) by check.

**Egypt:** According to Hatem (2011), “[s]ome recent studies on Egypt have suggested the number of informal enterprises is above 80% of the total number of production units in the country, and the associated employment is about 40% of the workforce (Attia, 2009).”

According to de Soto (2000), property that is not officially registered represented six times the amount of total savings and time deposits in Egyptian commercial banks, 30 times the market value of the 746 companies listed on the Cairo Stock Exchange, and 116 times the value of the 63 state-owned enterprises privatized between 1992 and 1996.

**Jordan:** Due to high unemployment, Jordan’s informal sector has not significantly diminished since the beginning of the privatization process in the mid-1990s. Street vendors, peddlers and trade stalls still exist throughout the country, often selling their wares at prices below those of licensed traders. To increase the ease of doing business, registration fees and procedures have been reduced substantially in the past decade (MAS, 2011c). However, there are still significant issues that affect the existence of a large informal sector. For example, high taxes limit the entry of less capitalized individuals; there is a lack of registration services in governorates other than Amman, Zarqa, Irbid and Aqaba, and of fines for business violations are applied arbitrarily (UNDP, 2008).

**Lebanon:** As mentioned in section 2, the informal sector witnessed a huge increase in the number of workers between 2004 and 2007, making its share of employment rise from a mere 1.2% to a solid 25.3%. Although some workers have entered the public sector, causing its share of employment to rise from 12.9% to 15.7%, the remaining workers have mainly joined the informal sector (Lebanon Central Administration of Statistics, 2007).

**Morocco:** According to Morocco’s High Commissioner Office of Planning (HCP) 2007 survey, the informal sector represents 14.3% of GDP and 37.3% of nonfarm employment. According to IMRI (2011a), the causes for the development of the informal sector in Morocco include the insufficient level of education and skills of a sizeable portion of the population (40% illiteracy rate), unduly high taxes and social charges, and an excessive and complicated bureaucracy. The government has been striving to formalize this sector (for example, by granting a tax

amnesty, creating units to assist informals in setting up accounting, and reducing the corporate income tax from 30% to 15% for enterprises with turnover under DH 3 million), but has achieved little success to date.

**Syria:** The informal sector in Syria is growing and represents about 30% of employment and 40% of GDP. It employed about 48% of the rural poor and 31% of the urban poor as of 2003-2004 (Bureau for Gender Equality, 2010). For women with only basic education, the informal sector is the largest source of employment, while men with basic education are employed in the private formal sector. The informal sector in Syria acts as an entry point to the work force for young adults who, as they age and gain work experience, move to the formal sector later in life (Syria Central Bureau of Statistics, 2010).

**Turkey:** As is the case with all other developing countries, Turkey suffers from a significant informal sector. According to some estimates, it accounts for 50% of GDP and 40% of employment. It occurs particularly in the sectors of agriculture (90%), construction (60%), trade establishment, hotels & restaurants (40%) and transports (40%). It assumes many forms: self-employed, unpaid family workers, regular and casual employees. In 2006, statistics referred to 10.8 million informal jobs, against a total of 22.3 million jobs (IMRI, 2011c).

## **2.6. Cultural factors that may influence private sector development**

In this section we will consider the role of three cultural factors that may influence private sector development. These are: entrepreneurship, the political activity of interest groups, and the role of Islamic finance and Islamic rules on interest.

*Entrepreneurship.* Although in the MED-11 countries, the state has often restricted the activities of the private sector, favouring the development of the public sector, entrepreneurship is an age-old tradition in the region, which is the home of the bazaar; maritime merchant trade here dates back thousands of years, to the Phoenicians. Culturally, the region has a high degree of respect for private property and entrepreneurial behaviour, although the dominant role of the family business sometimes leads to difficulties for the development and growth of businesses.

The entrepreneurship literature often makes a distinction between necessity-based entrepreneurship, in which individuals are self-employed due to a lack of employment opportunities, and opportunity-based entrepreneurship; i.e., the entrepreneurship described in the work of Schumpeter (1934) and Kirzner (1997), in which a firm is founded as a result of a conscious choice to take advantage of a perceived business opportunity. Typically, it is the latter type that is responsible

for employment growth and innovation, whereas the former is oriented exclusively to survival. We expect to see relatively higher shares of necessity-based entrepreneurship in lower-income countries.

**Table 5. Necessity- and opportunity-based entrepreneurship (% of adults in the economy engaged in relevant activity)**

Country	Opportunity-based entrepreneurship			Necessity-based Entrepreneurship		
	2008	2009	2010	2008	2009	2010
Algeria	-	51	-	-	18	-
Egypt	60	-	25	19	-	53
Israel	53	48	55	20	25	24
Jordan	-	35	-	-	28	-
Lebanon	-	60	-	-	18	-
Morocco	-	57	-	-	25	-
Palestine	-	33	33	-	37	32
Syria	-	43	-	-	37	-
Tunisia	-	57	48	-	20	24
Turkey	41	-	47	39	-	37

Source: Global Entrepreneurship Monitor Database.

Table 5 presents the situation in all the countries for which GEM data exist for at least one of the years 2008-2010. In the case of Egypt there is an inexplicable and huge shift from opportunity-based to necessity-based entrepreneurship in the space of just two years (such a jump raises questions about the measurement of the phenomenon; however, fortunately we do not observe such discontinuities for the other four countries for which there are data for two or more years – Israel, Palestine, Tunisia, and Turkey). In Palestine, Jordan, Syria, and Turkey, necessity- and opportunity-based entrepreneurship seem to be roughly balanced. In all other countries (i.e., Algeria, Israel, Lebanon, Morocco, and Tunisia), opportunity-based entrepreneurship clearly dominates necessity-based entrepreneurship.

*Interest groups.* The activity of interest groups can affect policies that are important for private sector development (see, for example, Acemoglu & Robinson, 2008). In Egypt, for example, where the socialist policies of the past created a large state sector, the employees of that sector constitute a strong force resisting change (Hatem, 2011). As noted above the military, which own a large share of total proactive assets, also resist privatization and adhere to their privileges, such as tax breaks and exemption from a number of government regulations that apply to the private sector.

Jordan faces similar difficulties, but for a different reason, as reported in (MAS (2011c):

*Almost two-thirds of the entire population in Jordan is not historically Jordanian but Palestinian. However, it has been the trans-Jordanians who have long controlled the state and policy making, with the majority of the Palestinian population largely participating in the private sector. As a result, the most problematic issue with privatization has been the idea that state capital or national assets will be transferred from the public sector, where Jordanians exhibit control, to the heavily Palestinian-controlled private sector.*

*Islam and finance.* Finally, we turn to one factor that might be hypothesized to affect the region's private sector development in the future. Do regulations compliant with Islamic law (shariah), which prohibits the taking of interest, impede the development of private sector capital?

In most of the countries (excluding Israel for obvious reasons), shariah-compliant investment and business operate alongside conventional banking. However, solely Islamic banks are increasingly using shariah-compliant financial instrument in business.

Although in some countries Islamic banks are refused licenses on account of perceived political affiliation, in some countries like Jordan, Tunisia, and the Sudan, the general population has been receptive to Islamic finance as an alternative to capital growth and availability, which could potentially attract alternative forms of capital and speed up economic development (Ilias, 2010).

Although there have been clashes in the last decade between Islamic fundamentalist groups and government loyalists in which protesters demand shariah law rule in Jordan, the predominant business climate is open to a mix of conventional and shariah-compliant businesses (International Business Times, 2011). Another example can be seen in Egypt, where, after the 2011 uprising, Islamic fundamentalist groups call for implementing shariah rules in Egypt, while the military authorities currently governing the country resist this. As for Lebanon, in the past couple years, the government has started a process of reforming the 2004 Shariah-compliant banking law to boost Shariah-compliant banks' ability to compete with conventional banks (El Baltaji and Hall, 2010). Islamic banking represents less than one percent of US\$251 million of the total assets of banks in Lebanon. Nevertheless, the central bank of Lebanon is attempting to access a perceived large demand for Islamic banking that, according to the Central Bank's first vice governor, can be divided into two groups: "customers who for religious reasons want to deal with a bank that has an Islamic dimension and customers who benefit from using such a system" (Halawi, 2010, p. 3). In Syria, the establishment of Islamic banks comes as an attempt to diversify the investment sector, and to conform to Shariah laws. In a nationwide survey conducted by Bankakademie International, it

was reported that some 34% of Syrian companies that had not requested a bank loan refused to do so for religious reasons. The size of the Islamic banking market has been steadily increasing year after year. It is estimated that the assets of Islamic banks in Syria were worth over US\$265 billion in 2006, with an annual growth rate of 20%, providing a boost to the Syrian economy (CGAP, 2008). In Morocco, to meet hitherto marginal needs, the State has put in place alternative products (with an Islamic reference framework) which banks have recently started using (IMRI, 2011a).

It therefore appears that, since none of these countries has banned conventional lending, shariah-compliant banking exists alongside conventional banking and is therefore more likely to have enhanced capital development (by making finance acceptable to people who might otherwise not seek it for religious reasons) than to have impeded it.

## **2.7. Business support policy**

The country reports have little to say on policies for supporting the development of business beyond general improvements in the business climate. Detailed programs to develop incentives are described in the case of only four countries, two of which (Algeria and Syria) are rather surprising.

**Algeria:** Under the system of incentives offered to projects sited in priority areas, the following advantages are granted over and above those included in the general system of incentives: exemption from the payment of registration fees, possible payment by the State of expenditures for infrastructure works necessary for the investment, 10-year exemption from the payment of the corporate income tax and the business tax, the real estate tax as well as other accounting advantages (carry forward of the deficits and extension of the grace period). Besides, for the advantages granted under the convention system, on top of the above advantages, other incentives are also given by the National Investments Council. Note must be made of the fact that the corporate tax of 25% may be reduced to 12.5% in case of reinvestment of profit. As mentioned before, to support the investment, the National Investments Promotion Agency (ANDI) was created in 2001 under the supervision and oversight of the Ministry in charge of investment promotion. Its mission statement includes: providing support and guidance to investors, facilitating investments, promoting investment in Algeria and abroad, helping investors with other departments, participating in the management of the economic aspects of land use, managing the benefits given to investors, and finally tracking the pro-

gress of projects. In order to improve its efficiency, ANDI created Decentralized One-Stop-Shops with the mandate to facilitate the setup and launch of projects (IMRI, 2011b).

**Morocco:** In addition to an export promotion program, the Moroccan government has developed some initiatives to support the development of SMEs. In 2002, the National Agency for the Promotion of Small and Medium Enterprises (ANPME) was founded to support companies in their competition-induced modernization process. The tools at ANPME's disposal are information, publications, studies and, most importantly, two flagship products: IMTIAZ and MOUSSANADA. IMTIAZ is an investment premium likely to reach DH 5 million which is offered to those SMEs whose investment projects are selected. MOUSSANADA is a program for the support of SMEs which assumes 60% of the costs of investment projects, where the global support amount can reach DH 1 million (IMRI, 2011a).

**Syria:** The Syrian government has taken several measures which ostensibly support businesses. The Syrian European Business Center was launched in 1996 and implements the SME support program. The support program is focused on 'improving efficiency and competitiveness, developing local consultancy, providing long term finance, and promoting exports' (Chahoud, 2009, p.22). In 2006, the government established the Public Commission for Employment and Enterprise Development (PCEED), which aims to support small enterprise development by facilitating the provision of loans to SME. In addition, the government reduced the minimum capital requirement for limited liability companies by two-thirds, and eliminated the minimum threshold for loans included in the database to ease access to credit. This effectively expanded the coverage of individuals and firms to 2.2% of the adult population (The World Bank Group, 2010, 142). In June 2011 President Assad issued a decree exempting investors in "free zones" from interests and penalties (Syrian Ministry of Economy and Trade). Business support policy also includes:

- The Exports Promotion and Development Committee, founded in 2009 and linked to the Ministry of Economy And Trade, which aims to 'increase marketing exports and to enhance the quality of the Syrian products and their competitiveness.' Export promotion policies include exempting agricultural exports from taxes and waiving export licenses (Jouhina News, 2011).
- Elimination of many administrative barriers, like export licenses and exclusive (nationalist) agency, amendment of import licenses, and unification of the customs tariff (Syrian Ministry of Economy and Trade).



**Turkey:** The policies initiated by Atatürk in the early 20<sup>th</sup> century had privileged the development of the state sector. In the 1950s, the average number of employees per firm in the private sector was 34 to 35, while in the public sector it exceeded 700. Privatization policy in Turkey has been an attempt to balance two priorities: on the one hand, that of upholding the role of the state in such functions as defence, health, education, social security and infrastructures, and on the other, the will of the state to provide the private sector with an environment conducive, both legally and structurally, to increasing its productivity and enhancing its value-added. Another aim has been the development of the capital market by broadening the base of private shareholders. The privatizations have proven quite successful in expanding private ownership and in consolidating the Istanbul Stock Exchange. Buyers of privatized companies have included Turkish purchasers as well as international private groups such as the Nokia, Gan International, Primagaz, Fiat, Alcatel, and Taiwan Furisthen (although on very rare occasions they have also included other public institutions such as the Ministry of Finance and the Ministry of Trade and Industry). It is interesting to note that the privatization program also involves infrastructure such as highways, ports and railway stations (IMRI, 2011c).

## 3. Privatization of State Assets

### 3.1. Privatization programs

Even in the least reform-minded countries in the region (e.g., Syria), the government has adopted a privatization program. Woodward et al. (2011) provide a discussion of the arguments for privatization and an overview of the privatization programs in other parts of the world. Overviews of these programs in MED-11, as reported in the country reports, are presented below.

**Algeria:** Algeria enacted a law on competition and privatization in 1995. In the same year, Algeria set about to reform its commercial code and created the Algiers stock Exchange. 2001 saw the initiation of the process for the privatization of public corporations, aimed to upgrade their capabilities and promote modern management modes. The State's withdrawal from economic activity and the rehabilitation measures have resulted in the dissolution of more than 800 companies and in the redundancy or early retirement of more than 260,000 employees, accounting for 6% of the active population. What little privatization has taken place in Algeria involved 417 companies privatized (either wholly or partially) between 2003 and 2007, and despite the trade liberalizing measures initiated in 1989, the Algerian economy is still dominated by the public sector, covering the energy sector, the financial system and the bulk of the industry and services related activities (IMRI, 2011b).

**Egypt:** In the past 20 years, Egypt – which had built a socialist model of economic development under Nasser – achieved a significant degree of privatization, selling off three quarters of its state-owned enterprises by 2010, mostly via the classic trade-sale, case-by-case method. In the period 2001-2009, a total of 241 public enterprises were privatized; proceeds were L.E. 41.5 billion (US\$7.6 billion), at an average of L.E. 172 million (US\$31.5 million) per enterprise. By comparison, between 1991 and 2000, in which 165 enterprises were removed from the public sector through privatization at an average of L.E. 98 million (US\$28.7 million) per enterprise, for a total of L.E. 16.2 billion (US\$4.7 billion) (Hatem, 2011). As of 2010, the Ministry of Investment (MOI) estimated that there were 147 enterprises in the public sector, meaning that about one in four of the state-owned enterprises slated for privatization still remained to be privatized (Nestor and Desai, 1997). However, due to the rigid labour laws that came into force in the 1960s,

redundant employment in the remaining state-owned enterprises constitutes a formidable obstacle for potential buyers of public enterprises. Moreover, the government quietly announced that the sale of public enterprises to private investors effectively ended in May 2010 (New York Times, 06/27/10).

It should be noted, however, that the Egyptian military structures does own and operate a large part of the productive sector which traditionally is not classified as belonging to the public sector. Some of the military's portfolio of productive assets includes the production of military hardware, data for which are secret under the guise of "national security concerns". However in addition the military's economic interests encompass a diverse range of revenue-generating activities, including the selling and buying of real estate on behalf of the government, domestic cleaning services, running cafeterias, managing gas stations, farming livestock, producing food products, and manufacturing plastic table covers (Abul-Magd, 2011). The army's control over economy began in the aftermath of the 1952 revolution/coup, which paved the way for Egypt's experience with state socialism. During this era, the state came to own a large share of economic assets and means of production through nationalization programs. In the 1970s, the army's monopoly over power started to erode as the late President Anwar al-Sadat decided to take Egypt off its socialist path, and reintroduced market economics as a means for fostering strategic and economic ties with the West. Yet, after the 1979 peace treaty with Israel and also to absorb many well-trained army officers, the state established an economic body known as the "National Services Projects Organization," (NSPO) which founded different commercial enterprises run by retired generals and colonels. Through various subsidies and tax exemptions, the state granted military-owned enterprises privileges not enjoyed by any other company in the public or private sectors. The military's enterprises were not accountable to any government body, and were above the laws and regulations applied to all other companies, including traditional union or government regulations. After 1992, when President Hosni Mubarak initiated economic liberalization—as proscribed by blueprints devised by the IMF and the World Bank, the privatization program steered clear of military-owned enterprises. On the contrary, some of the privatization in state-owned enterprises went to the military. Its interests in strategic areas, such as port facilities, ship repair and building, increased. Abul-Magd (2011) suggests that the Egyptian Armed Forces owns about twenty-five to forty percent of the Egyptian economy. Other sources suggest a range between 5% and 40% of the nation's economy (see e.g. Marroushi, 2011).

**Israel:** Israel, which had also followed a socialist path until the 1970s, embarked on a program of privatization a quarter century ago, and has also privatized a significant portion of its public sector. As MAS (2011b) writes:

*The first noteworthy changes in state company structure occurred in the period between 1986 and 1992 when five state enterprises underwent partial restructuring. Initially, this included the privatization of small divisions of state companies and the sale of corporate bonds on the stock market (Gurkov, 1994). [In the early stages] state company modifications through privatization would be limited to small sales of ownership interest and the parcelling off of inconsequential company branches. In effect, the state did not lose majority power or interest in its most significant companies during this period.*

However, the pace then picked up, and by 2009, 89 state companies had been privatized (Israel Government Companies Authority, 2009). Of the six largest state-owned companies – Bezeq (telecommunications), Israel Chemical Ltd., Haifa and Ashdod oil refineries, El Al, Israel Aircraft Industries (IAI), and the Israel Electrical Company (IEC) – that ranked among the ten largest Israeli companies in 1993, only two - IAI and IEC - remain in the public domain today (see section 4.1 for their further fates). Security Industry News Today reported that IAI will probably be privatized throughout the coming years depending on a proposition to merge with Rafael Advanced Defence Systems Ltd and Israel Military Industries Ltd (“Israeli Defence Merger Gets Green Light”, 2011). IAI chairman, Yair Shamir, announced a plan in 2009 to begin the privatization of IAI by selling around 30-40% of the company to private investors. Of the six state companies referred to above, the IEC firmly remains under state control – it owns 99% of the business.

**Jordan:** In this country, too, privatization has been very significant, and in the industry with the highest state share – media – that share is below half (even the transport and utilities and energy sectors have lower state shares). As of 2009, in the infrastructure sector, telecommunication, electric power, and transports (airlines, urban transport, railways and ports) have been already privatized by divestiture after “corporatization” (restructuring into corporate structure prior to privatization); water and sanitation remain unprivatized. In non-infrastructure sectors like cement, potash and phosphate, privatization happened by partial divestiture without restructuring prior to privatization (Gokgur and Roger, 2009). Regarding the percent ownership of firms in various sector, the highest governmental ownership is in media (43.2%), followed by utilities and energy (33.7%), steel, mining and heavy engineering (21.04%), hotels and tourism (18.02%), transportation (15.96%) and textiles and clothing (14.95%). The smallest state shares are found in medical services, which have been totally privatized, being followed by educational services (1.36%), real estate (2.57%), and chemical and petroleum (2.78%). The highest share of foreign ownership is found in steel, mining and heavy engineering (16.05%), followed by tobacco (13.41%), medical services (12.58%) and chemicals and petroleum (12.06%). The dominant shareholders in most of the privatized sector are individuals

rather than companies. Exceptions are transportation and real estate sector, in which corporate ownership is dominant (Zeitun, 2009).

**Lebanon:** The Higher Council for Privatization (HCP) was established in the year 2000 (by the Law 228). The HCP is composed of four ministers (of Economy, Labour, Justice and Finance), headed by the prime minister, and has the authority to plan and execute privatization programs. A minister is in charge of handling the privatization process of a public sector/industry. However, actual privatization of major state-owned companies has not materialized due to the constantly changing political environment. Every Minister is assigned responsibility of a sector, be it Telecommunications (has been an ongoing process for the last decade), Energy (no significant progress in privatizing either transmission or distribution), Water (privatization process has materialized although there have been foreign companies), Health (no privatization), or Public Works (Halabi, 2009). The main method for the privatization of telecom sector was management contract. Other methods such as sale of a stake in a particular operation or full sale of an operation have not occurred.

**Libya:** Several laws on the ownership and disposition of assets have been introduced and several simplifications of procedures for registering foreign companies have been implemented. The privatization of public enterprises has been initiated with the financial participation of sovereign wealth funds. The Economic and Social Development Fund, with a capital of US\$8 billion, from employee pension funds, was established in December 2006. It joined foreign companies in sectors such as banking, insurance, construction, cement, food processing, tourism, hotel trade, services, etc. and has also contributed to the rise of the Tripoli stock exchange in June 3, 2006 (with a capital of about US\$16bn.) (ITCEQ, 2011).

**Morocco:** Privatization in Morocco was started in the wake of a speech by the king in April 1988. Initially a list of 114 public corporations slated for privatization was drawn up, of which 73 have been effectively transferred. During the period 1993-2006, ten other public corporations were added to this list (IMRI, 2011a).

**Palestine:** As noted above, the push towards developing a resilient private sector has mainly been shaped by major international donors and the State of Israel, as MAS (2011a) reports:

*With an overall agenda of breaking down government ownership of productive capital, numerous government assets were partially privatized with the creation of PIF [Palestinian Investment Fund] in the year 2000. Pressure from the World Bank and the IMF to divest from managing state assets while increasing transparency caused the PNA to transfer ownership and management of shares in various companies in 2003 (Palestine Investment Promotion Agency [PIPA], 2011). Continued aid-assistance from Europe*

*and the United States is contingent on continued PNA reforms, of which privatization is a major component.*

The PNA's privatization strategy is to gradually phase out its existing equity holdings and to privatize most public enterprises. Yet it has been recognized that it would not benefit the population to turn a public monopoly into a private one. For that reason, the privatization of some public enterprises will take time and will have to go hand in hand with reforms; this step should ensure the availability of some competition in the concerned sector. Meanwhile, privatizing minority equity positions in listed companies can and is being done more quickly (PIPA website). However, instead of emanating from a local desire to privatize government functions, the push towards developing a 'resilient private sector' has mainly been shaped by major international donors and the State of Israel (Khalidi & Samour, 2011, p. 8).

**Syria:** Although privatization has been underway in Syria for some time, it has intensified over the last ten years under the rule of President Bashar Al Assad. In 2009, the Damascus Stock Exchange was founded for further funding of private enterprise (Syrian Ministry of Economy and Trade). Privatization, though evident, has been partial. This comes from a desire to maintain strict government control and also to avoid open social dissent (particularly after the beginning of the Syrian uprising in 2011). Since the state insists on retaining control, the bulk of privatization programs have taken the form of joint ventures with the public sector, and/or opening the management of public companies to private investment (to a limited extent). Syria was on the road to attract around US\$50 billion from foreign investments in the next five years and privatize several other companies. However, both the political instability and the fact that Bashar Al-Assad's cousin, Rami Makhlouf, stands to benefit from government privatizations have made other Syrian and international investors wary of putting money into state firms. While no existing public companies are available for wholesale privatization, new private enterprises are emerging within industries like banking (MAS, 2011d).

The Syrian government has contradicted its own position at times. For example, despite approving the transfer of multiple public firms' management into private hands, government officials have insisted that "no privatization of state enterprises would take place during the tenth Five-Year Plan, which ran through 2010, or the coming eleventh Five-Year Plan, which runs from January 2011 through December 2015" (US Department of State, 2011). Similarly, the Minister of Industry has claimed that "there will be no privatization of the public sector in Syria." He insisted the public sector is simply being reformed and its competitiveness enhanced. Such obscurity on the nature of government policy perhaps indicates social opposition to the program—as the Minister assured attendees there would be no worker layoffs—as well as internal Baathist disagreement about the merits

of privatization, foreign capital, and the neoliberal agenda in general (Syrian Ministry of Industry).

**Tunisia:** According to ITCEQ (2011), since being launched in 1987, the privatization program in Tunisia has led to the privatization of 219 companies, with 116 being privatized completely and the others either partially privatized or liquidated. ITCEQ (2011) describes the evolution of Tunisia's privatization program as follows:

*Since 1987, the Tunisian privatization program showed an evolution in three phases: the first, from 1987 to 1994, involved the privatization of enterprises operating in purely competitive industries suffering from financial difficulties and generate a burden on the budget balance. This privatization was carried out as asset sales or, generally, with the dismemberment of the company into autonomous business units to facilitate their transfer and, more importantly, reach a broad range of investors. These operations have mostly concerned the service sectors (tourism, trade, agriculture and fisheries); the second, from 1995 to 1997, was concerned with businesses with sound financial structure and has established a legal and institutional framework to improve governance of privatization, which has accelerated the speed of privatization. During this period, 45 companies were privatized, giving a rate equal to 15 companies per year while in the first phase this rate was around 6 companies per year (48 privatized firms in eight years); the third phase, since 1998, has promoted the privatization of large successful companies, and especially attractive to domestic and foreign investors such as cement, engineering industries and telecommunications. This phase was characterized by the use of banks and the adoption of more sophisticated techniques including concessions.*

**Turkey:** The first laws relating to privatization were enacted in 1984 and 1986. The 1986 law entitled the Council of Ministers to transfer state enterprises to the Public Participation Administration (PPA); it also authorized the Higher Council for Planning to transfer partly state-owned companies and subsidiaries to the PPA for privatization. In 1992, Statutory Decree No. 473 entitled the High Public Shareholdings Council to approve privatization transactions. A new Privatization Act was enacted on November 27, 1994. This important act established the public institutions responsible for privatization: the Privatization High Council (PHC), the Privatization Administration (PA) and the Privatization Fund (PF). The Act also laid down rules respecting the social and financial rights of the staff likely to become unemployed following privatization. Another regulation prohibits the appropriation of privatization proceeds to the state budget, as well as the transfer of to-be-privatized companies to public institutions or organizations, except where the national security or public interest so require. Other rules were enacted to pre-

vent the creation of monopolies after the privatization, and to select those buyers in the best position to run and develop the company to be privatized (IMRI, 2011c).

Privatizations between 1986 and June 2011 totalled 188 public companies – of which 23 were privatized in 2011 - and earned the state proceeds of US\$42 billion. Most involved a combination of public offering and block sale (48%) and asset sales (31%). The highest proceeds from privatization were realized in 2005 and 2006, with over US\$8 billion in each of those years (IMRI, 2011C). The completion of these privatization transactions meant complete state withdrawal from the following industries: cement, animal feed, dairy products, forestry products, handling and supply (catering), and distribution of petroleum products. The state has also reduced its holdings in the following industries by over 50%: tourism, textile, iron and steel, ocean freight and meat processing. The government has also partly discontinued its activities in seaports, oil refineries, and banks. Such privatizations, which have also included infrastructural sectors, have allowed for the extension of private shareholding and for the expansion of the Istanbul Securities Exchange, which ranks among the thirty largest exchanges in the world (IMRI, 2011c).



## 4. Conclusion

Table 6 summarizes some of the key variables for MED-11 countries. Looking ahead to what the next two decades may have in store for the MED-11 region in the area of private sector development, we can consider a number of possible scenarios, which we will now characterize briefly. The last decade, as we have seen, has brought rapid development in terms of GDP per capita even to the poorer countries of the region. However, the recent political instability in the region, coupled with its general resistance to the democratization trends observed in Latin America and the post-Communist countries of Central and Eastern Europe (as discussed in the background report), makes the future exceptionally uncertain.

**Table 6. Summary of key variables for private sector development in MED-11**

	Private sector share of GDP (%)	Ease of Doing Business rank (2010)	Share of informal sector in employment	Necessity-based entrepreneurship as share of total entrepreneurial activity	Domestic credit to private sector, 2009 (% of GDP)
Algeria	35*	136	22	18	16
Egypt	na	94	40	53	36
Israel	74	29	na	24	85
Jordan	85	111	na	28	72
Lebanon	79	113	25	18	74
Libya	na	na	na	Na	11
Morocco	88	114	37	25	64
Palestine	62	135	na	32	na
Syria	59	144	30	37	20
Tunisia	na	55	na	24	68
Turkey	na	65	40	37	37

*Note.* \* Percentage of industrial production.

*Sources:* Country reports for private sector share of GDP and employment and share of informal sector in employment, Global Entrepreneurship Monitor Database for necessity-based entrepreneurship, World Bank (2010) for Ease of Doing Business rank, World Bank data base for domestic credit to private sector.

One of the possible political scenarios emerging as a result of the upheaval currently underway in many of the MED-11 countries is a turn to a more Islamist policy. However, there is no evidence that this would result in policies harmful to

the development of the private sector. On the contrary, the experience of Turkey under the relatively moderate Islamist Justice and Development Party (Turkish acronym: AKP) shows that rule by such a party can be pro-developmental in economic terms. The AKP model, in which institutional reform has been driven by the EU accession process, is currently the one that Islamist movements such as the Muslim Brotherhood in Egypt and Hamas in Palestine seek to emulate (Sayigh, 2010; Daly, 2011; Yezdani, 2011). We therefore see no reason to view an Islamist turn in politics as necessarily constituting a threat to private sector development (providing such a turn takes the relatively moderate form of Egypt's Muslim Brotherhood rather than the more extreme form of the Salafi/Wahhabi or similar movements), and will ignore this factor in the ensuing discussion of possible scenarios, while noting the importance of EU engagement (as in the case of the Turkish developments).

- *Optimistic rapid development scenario, corresponding to scenarios 2 and 3 from Sessa (2011).* If peaceful democratic development takes place, with a decrease in corruption and the regulatory burden, then private sector development could take off in an explosive way. This would be signalled by significant increases in the Ease of Doing Business scores, significant progress in privatizing remaining state-owned enterprises, and a fall in the share of the informal sector in GDP, and could entail high rates of entry for new firms, dramatically improved performance of the banking sector in terms of lending to private firms, and diversification of the relevant countries' economies and exports. It would involve dramatically increased FDI, and presumably greater integration with the EU and other world markets as well. It is important to remember, however, that rapid GDP development and rapid private sector development are by no means synonymous (particularly in the case of economies based on oil and natural gas reserves that remain state-owned).
- *Reference scenario, corresponding to scenario 1 from Sessa (2011).* Under this scenario, the Ease of Doing Business scores would remain essentially unchanged, further progress in privatization would be stalled, and FDI flows would also remain fairly stable. Such an outcome could be driven by economic policy inertia, which might result from the inability to generate a consensus around a clear political direction in the case of countries which have recently undergone revolutionary uprisings.
- *Pessimistic regression scenario, corresponding to scenario 4 from Sessa (2011).* Regression appears to be relatively unlikely for the region as a whole, though we have seen areas of regression for individual countries in recent years that could continue. A return to a statist or socialistic development model seems unlikely; however, if the polity were to develop

along despotic lines, one could expect an increase in corruption and deterioration in the business environment (which could be accompanied by rapid GDP growth in an oil-rich state). This scenario would resemble the development of Russia under Putin in the last decade. Countries in which particularly poor trends have been noted in the last decade and which for that reason might be particularly at risk for regression include Algeria, Lebanon, Libya, Palestine and Syria. Of course, political destabilization could lead to developments that are currently unforeseeable in other countries as well. As a result of deterioration of the business climate and a turn to nationalism and/or protection in economic policy, one could expect a decrease in FDI under this scenario (though again, the presence of oil resources in some countries might override this tendency, as has been the case in Putin's Russia). While new firm entry might not vanish, the growth prospects of entrepreneurial start-ups would be limited, start-up activity could largely be limited to necessity-based entrepreneurship, and the share of the informal sector in GDP would rise.

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