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**ECONOMIC AND SOCIAL COMMISSION FOR WESTERN ASIA (ESCWA)**

**WORKING PAPER ON APPROACHES FOR RURAL DEVELOPMENT  
IN THE ESCWA REGION:  
ENHANCING SME COMPETITIVENESS AND  
INFRASTRUCTURE SERVICES**

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## Preface

The challenge of addressing rural decline has long been debated. A complex, multidimensional and multidirectional relationship exists between the urban and rural spheres, which affects economic, social and political life in Arab countries. There are wide divergences between countries, but also common issues and approaches. In a time of political uncertainty arising from the failure of centrally planned economic intervention, stimulating greater freedom and facilitating small and medium sized enterprises (SMEs) to create jobs is emerging as a key development issue.

In the light of the importance of poverty reduction and job creation for member countries of the Economic and Social Commission for Western Asia (ESCWA), this paper considers SME development opportunities for rural areas, as well as the opportunities and constraints. It suggests ways in which rural development could be managed more effectively. In particular, it highlights the importance of integrating rural SMEs into development strategies.

This paper is part of the working paper series of the Sustainable Development and Productivity Division (SDPD) at ESCWA. These papers are written by ESCWA staff members as part of the work programme and are intended to stimulate discussion on a given subject.

The research presented in this issue was conducted by Mr. Fidele Byiringiro and Mr. Robert Travers within the context of the work of SDPD on the green economy, poverty alleviation and sustainable development. The research was carried out under the overall guidance and support of Ms. Roula Majdalani, Director, SDPD, with the valuable assistance of Mr. Riccardo Messiano, acting Head of Section.

The research set out in the working paper series is preliminary and has not been subjected to the usual review process for ESCWA publications. Feedback from readers would therefore be welcomed, and comments and suggestions may be made at <http://www.escwa.un.org/main/contact.asp/>.



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## **LIST OF ABBREVIATIONS**

ESCWA	Economic and Social Commission for Western Asia
GDP	Gross domestic product
MSME	Micro and small and medium enterprise
NGO	Non-governmental organization
SME	Small and medium enterprises

## Introduction

In the Economic and Social Commission for Western Asia (ESCWA) region,<sup>1</sup> it is estimated that 70 per cent of the poor live in rural areas, even though rural areas support only 43 per cent of the total population. Unlike many other parts of the world, it is estimated that most of the poor will still be located in rural areas for at least another twenty years.<sup>2</sup> This makes rural development in the region a key policy objective. Moreover, if urban migration is to be eased, rural areas will have to provide increased income opportunities, as well as improved living conditions and more attractive employment opportunities.

In many parts of the ESCWA region, agriculture remains the most important sector for rural income generation. As arid and semi-arid areas prone to frequent droughts account for 85 per cent of total land in the area, the region and its rural poor are particularly vulnerable to the negative effects of climate change, making water resources and well-being critical issues. Stronger linkages between rural areas and urban centres are necessary and can be achieved through integrated development initiatives.

Remote areas remain characterized by low access to quality services and infrastructure such as water, education and information and communication technologies. Despite the fact that rural spaces are home to the majority of the region's poor, urban bias appears to have prevailed, mostly as a result of policies that have led to widespread environmental degradation while doing little to improve the lives of the rural poor.<sup>3</sup>

The rural sector is important for the region for the following reasons:

- It is a major source of food, despite the fact that 50 per cent of the region's food is imported. However, high food prices and international market volatility mean that domestic agriculture will keep its strategic importance in all countries of the region that are able to produce food;
- Poverty is mostly a rural phenomenon which affects certain social groups more than others, including female-headed households, the landless and farm labourers;
- A high unemployment rate in rural areas is leading to urban migration and greater unemployment among new migrants in urban areas. Unemployment is particularly worrisome among youth;
- Instability has increased considerably due to a failure to address the needs of the population and particularly to create enough jobs for the youth;
- Fresh water is becoming increasingly scarce in the region. Rural areas and the agricultural sector are still receiving large quantities of freshwater despite their low productivity. However, any reallocation of water resources will strongly affect the well-being of rural populations with ensuing displacement and potential unrest.

Thus a new development paradigm is needed for the region whereby greater efforts would be exerted towards improving the livelihood conditions in rural areas. The provision of adequate non-farming related employment opportunities would entice rural dwellers to remain and enjoy their communities. Small and medium enterprises (SMEs) fit well into this new paradigm and into the rural economy. An ESCWA review of environmental goods and services and SME development opportunities<sup>4</sup> points out that SMEs are generally found in traditional sectors of light industry including food processing, textiles, furniture making, minerals and metals, and in construction, all of which are relevant to the region's rural communities.

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<sup>1</sup> The ESCWA region is made up of fourteen member countries (Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Oman, Palestine, Qatar, Saudi Arabia, the Sudan, Syrian Arab Republic, United Arab Emirates and Yemen). Throughout this report, The Sudan refers to the former country which combined both the current Sudan and South Sudan as separate data is currently unavailable.

<sup>2</sup> ESCWA (2008), pp. 8-9.

<sup>3</sup> Juma (2003), p. 1.

<sup>4</sup> ESCWA (2011), p. 6.

A few decades ago when communication was more difficult, rural areas mostly served their own rural market, with surpluses going to the cities. In some areas where there is still a reliance on self-subsistence, this is still the case. However, globalisation is advancing everywhere, and rural areas are not only competing with urban centres but also with the worldwide market, as a result of new trade regimes.

An improved service sector can provide SMEs new development opportunities, if, for example, there are good communication links with markets. As cities become more and more overcrowded, it has become a lifestyle choice to relocate to rural areas, such as on retirement. However this will generally only happen where services and infrastructure are at an acceptable level.

If rural SMEs are to compete successfully, infrastructure in rural areas will have to be substantially improved. Improvements will be especially required in the following areas:

- Clean water supply;
- Reasonable access roads in order to get goods to the market;
- Efficient telecommunications linkages, to link to the wider market;
- Reliable electricity supply (can be locally generated);
- Good schools to provide training for young people and to attract families into rural areas;
- Banking and postal services;
- Adequate sewage and planning controls to protect the environment;
- Accompanying government and public support services.

## I. OVERVIEW OF RURAL AREAS AND SMES IN THE ESCWA REGION

### General overview of ESCWA member countries

ESCWA member countries are diverse in terms of size, level of economic development, resource endowment, labour abundance and urbanization levels (table 1). Considerable differences are also observed across these countries in terms of population and gross domestic product (GDP) growth rates, income, poverty levels, literacy rates, industrial structures, economic performance, official development assistance (ODA) per capita and others. They range in population from around 1.3 million in Bahrain to more than 80 million in Egypt, while the GDP per capita ranges from US\$550 in Yemen to US\$1100 in Palestine, to over US\$70,000 in Qatar, based on world development indicators (WDI). Some countries are rich in oil resources, while others rely heavily on their agricultural sectors.

Countries of the region also differ substantially in their urban/rural population distribution. The overall urbanization rate is 54 per cent for the ESCWA region. However, the urbanization rate is over 70 per cent in Kuwait, Lebanon, Jordan, Palestine, Oman and Saudi Arabia, while it is under 50 per cent in Egypt (45 per cent), the Sudan (40 per cent) and Yemen (32 per cent). Each country of the region has its own peculiarity in terms of history, politics, economics and socio-cultural background though they all share the same willingness to transition towards a more liberalized and market-oriented economy. All are at various stages of making that transition notwithstanding the recent socio-political upheavals, which have affected a number of countries.

TABLE 1. ESCWA REGION INDICATORS<sup>5</sup>

Country	Population			Urbanisation			Labour		GNI/Cap			Land/cap		Water/cap		Other resources		
	S	M	L	L	M	H	S	A	L	M	H	S	A	S	A	S	A	
Bahrain	x				x		x				x	x		x				x
Egypt			x	x				x		x	x	x		x				x
Iraq			x		x			x		x			x		x			x
Jordan	x					x		x		x		x		x				x
Kuwait	x					x	x				x	x		x				x
Lebanon	x					x		x		x			x		x			x
Oman	x					x		x			x	x		x				x
Palestine	x					x		x		x		x		x				x
Qatar	x					x		x			x	x		x				x
Saudi Arabia		x				x		x			x		x	x				x
The Sudan			x	x				x		x			x		x			x
Syrian Arab Republic		x				x		x			x		x		x			x
United Arab Emirates	x					x		x			x	x		x				x
Yemen		x		x				x		x		x		x				x

Population: Small (S) <10 million, Medium (M) >10 million & <30 million, Large (L) >30 million.

Urbanization: Low (L) <50%, Moderate (M) >50% & <70%, High (H) >70%.

Labour: Scarce (S) <1 million, Abundant (A) >1 million.

GNI/Cap: Low (L) <US\$2,000, Middle (M) >US\$2,000 & <US\$10,000, High (H) >US\$10,000.

Land: Scarce (S) <0.07Ha/cap, Abundant (A) >0.07Ha/cap.

Water: Scarce (S) <1000m<sup>3</sup>/cap, Abundant (A) >1000m<sup>3</sup>/cap.

Other Resources (oil, etc.): Scarce (S), Abundant (A).

<sup>5</sup> United Nations (2011); World Bank (2011).

## *Characteristics of rural areas in the ESCWA region*

The economic activity and performance of rural areas in the ESCWA region is strongly intertwined with its demography. Rural economic activities are mostly in the farming sector and to a lesser extent in the non-farming sector, both of which are crucial for the economic success of rural and urban centres, and thus the region as a whole. Agricultural productivity and efficiency serve as an important economic base in many ESCWA member countries, and it is therefore important to ensure that these areas grow economically.<sup>6</sup>

While rural populations differ from one area to another, there are a number of common demographic and economic characteristics shared by rural populations in the region. Rural populations are distinguished from their urban counterparts mostly by their unequal development, which sometimes leads to a duality of societies. On the one hand, urban residents tend to be rich and powerful (political voice) and to enjoy the fruits of the development process in terms of education, wealth, and services. On the other hand, rural populations tend to be saddled with illiteracy, lack of education and skills, poverty, poor services and informal institutions.

Recent years have witnessed important changes in growth rates, age structures and migration patterns among rural populations. Studies have shown that the age structure of a population has a significant impact on per capita GDP growth and the economic constitution of a population, therefore making it essential to recognize the age-structure of populations.<sup>7</sup> Changes in the age structure of rural populations are determined by three main factors: rural-urban migration, urban-rural migration, and mortality rates. In rural areas, rural-urban migration is often associated with individuals who migrate to cities seeking education or work, while urban-rural migration often reflects the incidence of retirees who return to their villages after spending their working-age lives in urban centres.<sup>8</sup> The prevalence of these phenomena has a strong potential impact on the region's economy, environment and population.

An ESCWA study<sup>9</sup> focusing on eight Arab countries indicates that rural populations are ageing at a faster rate than urban populations largely due to the rural-urban migration of the working class age group as it seeks education or work in urban centres. This shift has a significant impact on the social and economic structure of rural populations. The loss of labour for rural centres could prove disastrous for the region, as it heavily relies on agriculture and other rural industries.<sup>10</sup>

Rural populations in the region are also distinguished from urban populations by income levels. Rural centres are generally much poorer than urban centres. On a global scale, poverty is very much a rural problem.<sup>11</sup> The *Rural Poverty Report* published by the International Fund for Agricultural Development (IFAD, 2011) found that 70 per cent of the world's population living in extreme poverty comes from rural areas.<sup>12</sup> Rural poverty is a general phenomenon, but is of particular concern in certain parts of the region, including Upper Egypt, regions in Iraq, Jordan and Lebanon, as well as in the two least developed countries of the region, the Sudan and Yemen. For example, according to the world development indicators, 25 per cent of the population in Iraq lives on less than US\$2 per day, while in Jordan it is only about 3 per cent of the population. Poverty is usually associated with specific rural groups including the landless, farm labourers, some religious minorities and households headed by women.<sup>13</sup>

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<sup>6</sup> United Nations (2011), p. 4.

<sup>7</sup> ESCWA, (2008), p. 9.

<sup>8</sup> *Ibid.*, pp. 9-10.

<sup>9</sup> *Ibid.*

<sup>10</sup> International Fund for Agricultural Development (IFAD) (2010), pp. 59-60.

<sup>11</sup> ESCWA (2008), pp. 9-10.

<sup>12</sup> IFAD (2010), p. 42.

<sup>13</sup> IFAD (2010), p. 50.

Low rainfall and water scarcity are a common problem in the region and in the past have long determined where rural people lived, be they nomadic or settled. Hence oases in the Western Desert of Egypt are centres of rural population, and rural villages in Jordan, Lebanon, Palestine and the Syrian Arab Republic were often located near springs. As the resources necessary for agricultural activities, namely land and water, are being degraded or used for other purposes, food and other agricultural products are becoming scarcer. Unsustainable water extraction practices have led to a drop in the water-table causing wells to dry up and whole villages to be abandoned: The historic community surrounding Shobak Castle in Jordan is an example. Water scarcity is likely to be exacerbated by climate change and as such it is crucial to start focusing on the more efficient use of land and water resources, especially as it concerns rural areas and agriculture.<sup>14</sup>

An additional obstacle facing rural communities is that small producers or farmers are often poorly linked to markets. More attention needs to be devoted towards how to encourage small scale producers to engage in sustainable business activities more oriented towards markets.<sup>15</sup> This does not concern the farming sector only but also the non-farming sector, which is similarly inhibited and thus unable to offer more employment opportunities.

### *SMEs in economic development*

SMEs can be defined in various ways. They can be defined by either the number of their employees, their annual sales or their total assets. However, given the difficulty to obtain accurate annual sales or total assets in most countries, the number of employees is usually the preferred denominator though even using this single indicator there is no agreed upon global definition of what constitutes an SME in the world let alone in the ESCWA region. Thus, SMEs have a minimum of between 10-20 employees and up to 50 in Belgium or Greece, 100 in the United States, 200 in Canada, Italy or Spain and as much as 500 in France, Denmark, Germany or Ireland. In the ESCWA region the numbers vary from 4-10 in Yemen, 5-50 in Egypt, 10-100 in Lebanon, 5-100 in Jordan and Oman or 10-500 in the United Arab Emirates. Given these wide variations, in this report SMEs will be defined as firms with between 5 and 250 employees, to be consistent with a previous ESCWA report.<sup>16</sup>

SMEs are significant contributors to growth and are generally recognised as major drivers of economic development and innovation. The availability of profitable market opportunities increase the rate of SME creation, which in turn increases the total number of SMEs and thereby job opportunities and income level. As people become wealthier they increase their consumption, which in turns open up new market opportunities that lead to the creation of more SMEs. Contrary to multinational corporations, the growth of SMEs directly benefits the country because most SMEs are domestic firms that rely on local resources and markets. This reinforcing dynamic is the basis for a long lasting economic growth.<sup>17</sup>

SMEs contribute to the growth of a country's economy and thereby to a reduction of poverty through employment generation. SMEs lead to a virtuous pattern of growth whereby the benefitting population has access to employment and improved goods and services, and in turn has more opportunities to participate in the mainstream of the economy (more consumption which leads to even more demand). The growth of an economy is dependent on the ability and capacity of its SMEs to develop and this cannot happen unless they are allowed to take advantage of the available opportunities effectively. Below are graphs depicting the relationships between the number of SMEs and a number of development indicators such as per capita income, the level of the informal sector, the availability of private credit and the overall investment climate. The higher the number of SMEs the higher the level of income, the lower the informal sector in the economy, the higher the availability of private credit and the better the investment climate.

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<sup>14</sup> Ibid., p. 154.

<sup>15</sup> Ibid., pp. 140-142.

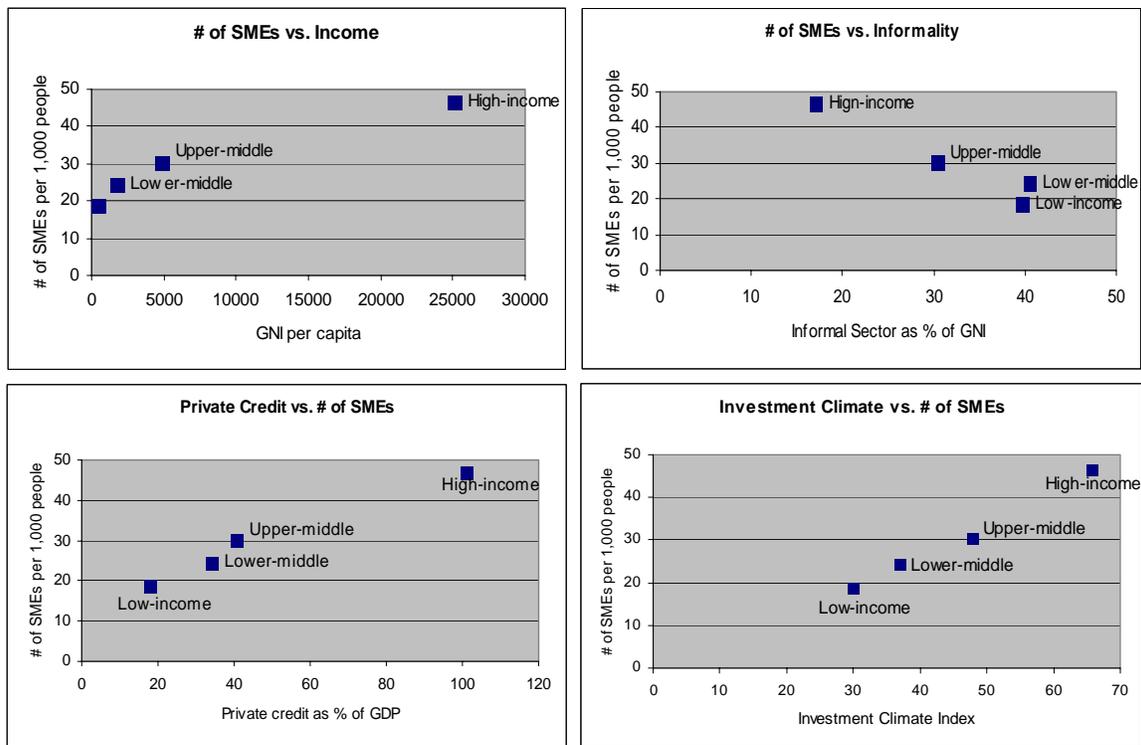
<sup>16</sup> ESCWA (2001), p. 5.

<sup>17</sup> Tambunan (2008), pp. 128-130.

Other studies find also a positive and significant correlation between new business entry rates, the size of the private sector (measured as a percentage of GDP) and income per capita, and a clear positive correlation between SME density and the income level of countries. Findings such as these support the centrality of SMEs to economic growth and thus, the need for governments to put in place enabling conditions for the development and growth of SMEs within a broad strategy for economic development.<sup>18</sup>

Ways of supporting the viability, expansion, productivity growth and effective governance of SMEs have been key elements of policy attention in most developing countries, though few countries have really succeeded in making the transition from informal SMEs, usually family-owned and not registered with public institutions, to formal SMEs which receive proper support from the government and rely on formal channels (banking, research and development, technology acquisition, etc.) to develop. Interest in the development of SMEs is usually underpinned by the understanding that they are the one producing growth and providing better quality jobs that could allow a large portion of the population to transition from low- to middle-income status, which is the backbone of any economy.<sup>19</sup>

**Figure I. SMEs and development indicators**



Source: Kozak (2005).

### *Importance of SMEs for rural areas*

Typically, SMEs are the biggest source of employment providing livelihood to over 90 per cent of families in rural areas (outside of agriculture). The majority of SMEs are scattered throughout the rural space and play an important role in development. As noted earlier, the importance of SMEs resides in their ability to contribute to improving income, employment creation and poverty reduction, initiating industrial

<sup>18</sup> Klapper (2006), pp. 1-4.

<sup>19</sup> Stevenson (2010), pp. 8-10.

development, supporting rural development and enhancing export growth. Other advantages of SMEs includes the following:

- Their numbers tend to be large and they are usually scattered over wide areas thereby improving the economy of the region in which they are based;
- They have considerable employment growth potential and therefore can substantially improve income and livelihoods. They also absorb the excess labour from agriculture which could reduce rural migration and potentially prevent social disturbances linked to degrading livelihoods, particularly among poor urban migrant workers;
- Most rural SMEs are agricultural-based and thus can absorb the excess agricultural output, thereby providing farmers with a stable income and/or added opportunities. Any support to rural SMEs provides indirect support to the agricultural sector;
- Rural SMEs tend to rely on technologies that are more appropriate to the prevailing situation in rural areas, which makes them more resilient;
- Most rural SMEs can expand significantly when they are successful;
- By requiring a relatively small amount of capital, they usually prove to be a good source to tap on the small and scattered rural savings, which are usually outside the formal financial system while also improving the entrepreneurial ability of villagers;
- Many rural SMEs cater to the needs of the local population and particularly the low income consumers (for example, cheap food products such as cheese, oil and simple tools or machinery);
- Rural SMEs adapt to changing local conditions and improve productivity through simple investments and technological change. The extent of these changes will usually be dependent on various factors including economic development, support received or access to foreign direct investments.

*SMEs in the ESCWA region: overview*

In the ESCWA region, a transformation caused by a shift towards economic liberalization, privatization of public enterprises and growth-led exports (reflecting changes in the investment climate and business environment) will open up new opportunities for the creation of SMEs and increase the number of entrepreneurs setting up SMEs. Rural areas, in particular, need more SMEs to create jobs, improve growth and productivity rates, and fight poverty. To achieve this, more efficient and transparent regulatory regimes and better support infrastructures will be needed.<sup>20</sup> However, the region is still characterized by development approaches that put emphasis on the government and public institutions to act as engines of growth by determining resource allocation and production objectives. This approach has failed to deliver the expected results and in some cases have even prevented the development of well-functioning private enterprises.<sup>21</sup>

Throughout the rural areas of the ESCWA region, SMEs account for virtually all non-agricultural and non-government employment. Al-asrag, while examining Arab SMEs, highlights the vital role they play in Arab economies, accounting for 96 per cent of GDP growth in Yemen (2005) and 59 and 25 per cent in Palestine and Saudi Arabia respectively.<sup>22</sup>

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<sup>20</sup> Stevenson (2010), p. 76.

<sup>21</sup> World Bank (2005), p. 158.

<sup>22</sup> Al-Asrag (2010), pp. 20-22.

According to Alasrag (2006), the potential impact of small and medium businesses on the development of the Arab region includes:

1. Supporting socio-economic growth, prosperity and economic revitalization.
2. Providing job opportunities.
3. Doubling the value added to the GDP of the economy.
4. Promoting policies to combat unemployment and poverty reduction.
5. Promoting forward and backward linkages in the national economy through supply networks, distribution, maintenance and complementarity to large enterprises by providing a large array of services.
6. Encouraging the spirit of innovation, creativity and invention.
7. Attracting foreign investment and encouraging the exploitation of local resources and market expansion.
8. Developing human capacity through technical assistance, among others.
9. Enhancing the competitiveness of the country.
10. Creating groupings or competitive production (clusters), which work to deepen the capital formation through reciprocal link networks, which seek to deepen the added value generated by these industries.

SMEs can be the main players in domestic economic activities, as providers of employment opportunities, and hence generators of primary or secondary sources of income for many households. For low income or poor farm households in rural areas, these enterprises, especially the smaller ones, i.e. microenterprises with less than five workers and small enterprises (with 5 to 20 workers), are crucial in providing alternative livelihood. These SMEs play an important role as engines of growth for rural economies and communities in most countries.<sup>23</sup> Table 2 provides data showing the importance of SMEs and the manufacturing sector in selected countries of the region.

TABLE 2. CONTRIBUTION OF SMEs TO THE ECONOMY IN SOME ESCWA MEMBER COUNTRIES

Country	Size (# employees)	Contribution to employment (%)	Contribution to output (%)	Contribution to value-added (%)	SMEs in total enterprises (%)
Bahrain	<50	73	28	--	88
Egypt	10-49	75	25	80	99
Jordan	5-49	70	40	--	95
Lebanon	<50	90	67	68	95
Palestine	<25	61	64	67	98

Source: Al-asrag (2010); Nicola (2009).

<sup>23</sup> Tambunan (2008), p. 125.

## II. SMES COMPETITIVENESS AND INFRASTRUCTURE NEEDS

### *Competitiveness and the role of Governments*

Competitiveness is a wide-ranging term, not firmly tied down in economic theory. At a national level, a country's competitiveness has been defined as "its ability to attract and maintain activity which increases economic prosperity"<sup>24</sup> or "the capacity of a state which is in an international competition to generate a high level of income and placement for the labour force on a sustainable basis".<sup>25</sup> At the SME level competition determines "the appropriateness of a firm's activities that can contribute to its performance".<sup>26</sup> Put simply, a competitive SME is the one that produces goods and/or services of a higher quality or at a lower price than its competitors, thus growing its business and market share. Competitiveness relies on the ability to innovate and the ability to bring about a price advantage.

A country's first source of competitiveness is in its SMEs: this is where added value is created. Governments however have a key role in putting place the conditions that favour competitiveness, for example through low taxation or high support services for research and innovation. Globalisation and the acceleration of technological advances bring significant transition costs and new challenges to SMEs, but they also create opportunities. Indeed, it is because of their flexibility and ability to adapt easily to changing circumstances that SMEs are key to countries' responses to globalisation. While this flexibility and adaptability indicates the potential for success in global trade, SMEs can achieve this only if they are competitive in terms of price, quality of goods, are able to meet delivery requirements and are backed by supportive Government policies.

Because no one issue can determine SME competitiveness, economists tend to examine trends in terms of 'competitive bunches'. Some examples are as follows:<sup>27</sup>

- Competitive advantage relative to the structure of domestic market;
- Competitive advantage relative to the access to raw materials;
- Competitive advantage relative to the technology;
- Competitive advantage relative to the quality of human resources;
- Competitive advantage relative to the demand on the market.

The World Economic Forum *Global Competitiveness Report*<sup>28</sup> is a good source on the competitiveness of countries in various areas. The above mentioned report is an example of an economic report that considers competitor bunches for selected countries. It examines competitiveness under twelve pillars, as follows: institutional environment; infrastructure; macroeconomic environment; health and primary education; higher education and training; goods market efficiency; labour market efficiency; financial market development; technological readiness; market size; business sophistication; and innovation. Under each of these pillars there are twenty or so subheadings that are examined to give an average country ranking. While these are macro level considerations regarding countries, they can also be applied at the micro level to SMEs competitiveness.

Competitiveness is therefore a relative term because it is dependent both on multiple selected variables, and on others' performances.

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<sup>24</sup> Porter (1990), p. 65.

<sup>25</sup> Organization for Economic Cooperation and Development (1996), p. 3.

<sup>26</sup> Porter (2004), p. 124.

<sup>27</sup> Ibid.

<sup>28</sup> Schwab (2010).

According to the World Bank's 2010 Logistics Performance Index (LPI), the Gulf countries and Lebanon are the most competitive ESCWA member countries in terms of logistics, based on a bundle of six competitiveness indicators as outlined in table 3.

TABLE 3. ESCWA MEMBER COUNTRIES LOGISTICS PERFORMANCE INDEX 2010

Country	LPI	Customs	Infrastructure	International shipments	Logistics competence	Tracking & tracing	Timeliness
Bahrain	3.37	3.05	3.36	3.05	3.36	3.63	3.85
Egypt	2.61	2.11	2.22	2.56	2.87	2.56	3.31
Iraq	2.11	2.07	1.73	2.20	2.10	1.96	2.49
Jordan	2.74	2.31	2.69	3.11	2.49	2.33	3.39
Kuwait	3.28	3.03	3.33	3.12	3.11	3.44	3.70
Lebanon	3.34	3.27	3.05	2.87	3.73	3.16	3.97
Oman	2.84	3.38	3.06	2.31	2.37	2.04	3.94
Qatar	2.95	2.25	2.75	2.92	2.57	3.09	4.09
Saudi Arabia	3.22	2.91	3.27	2.80	3.33	3.32	3.78
Syrian Arab Republic	2.74	2.37	2.45	2.87	2.59	2.63	3.45
The Sudan	2.21	2.02	1.78	2.11	2.15	2.02	3.09
United Arab Emirates	3.63	3.49	3.81	3.48	3.53	3.58	3.94
Yemen	2.58	2.46	2.35	2.24	2.35	2.63	3.48

Source: World Bank Logistics Performance Index (2010)

Note: Palestine not included.

The remoteness and terrain of rural areas often means that rural areas would have much lower logistics rankings than the national scores above would indicate. For example, an SME operating in upper Mount Lebanon or an oasis of Egypt may face considerably more difficult logistical challenges compared to an SME based in Beirut, Cairo or Alexandria.

It is apparent from the continuing economic difficulties of most rural areas of the region that SMEs have been unable to provide enough jobs to achieve high levels of income (or supplementary income) to make the livelihoods of rural dwellers more secure.

Fostering rural development is not easy, but the advantages of rural areas over urban areas for SME development must also be considered. These include for example the availability of resources; a cleaner environment than cities; relatively good supply of land at lower prices; generally, a ready low skilled labour supply willing to work for less; a willingness to work on a part time and flexible basis; an alternative and in many ways more positive lifestyle which can attract investors; opportunities to develop eco-brands; and being closer to selected raw materials such as agricultural produces.

In a report on competitiveness policy in Egypt,<sup>29</sup> it is argued that fundamentally, competitiveness consists in upgrading a company's position in the value chain through research, development and innovation; technological development; continuous product improvement; high skill base; technical capacity; systemic factors; and good financial systems.

None of these factors is location-specific so, in theory and given a level playing field, rural enterprises can have as good a chance as any at being competitive.

<sup>29</sup> El-Meeny (2004) p. 12.

Finally, there is a need for policy and institutional mechanisms favouring large, often state-owned or city-based enterprises over rural SMEs to be eliminated. The simple requirement to go to a Government office to get a registration form or a tender document will disadvantage rural SMEs.

### *Infrastructure deficiencies in rural areas*

According to the International Labour Organization, the Arab world has one of the highest rates of youth unemployment in the world and will need to create an additional 74 million jobs in the next fifteen years in order to absorb new entrants to its job market. This is equivalent to a 75 per cent increase in its workforce, or to the total growth of its workforce between 1950 and 2000.<sup>30</sup> Most of these new jobs are expected to be created by SMEs. However, these SMEs are still facing numerous challenges, as listed below:

- *Transport:* Poor transport and logistics infrastructure results in higher direct costs and longer times of delivery, leading to higher domestic production and trading costs. An improvement of the infrastructure can have an impact on SMEs as it would open them new markets. It is estimated that a 10 per cent increase in transport cost may reduce trade volume by more than 20 per cent.<sup>31</sup> Inefficiencies associated with infrastructure are a major binding constraint to SME competitiveness in many rural areas of the ESCWA region. Although the region generally has quite a good network of major routes with further upgrades planned, not all rural areas are well serviced. Rail networks have largely been abandoned in the Levant, but are being revived in other areas, in particular in Saudi Arabia where they are mostly inter-city, but do provide some rural linkages where rural stations operate. Routes into and out of rural areas are critical to improving competitiveness. Moreover, until very recently, the region did not fully recognize the economic and social implications of its demographic transition. However, it is now becoming clear that there will be a need to build much more infrastructure for the next ten to fifteen years and at a pace much faster than the United States of America or Europe achieved over forty years;
- *Logistics:* The extent of complementary services, such as cold chain infrastructure, warehousing, scale consolidation, licensing services, border crossing procedures, and so on are very variable in the region, adding to logistic costs and hampering competitiveness. The region's strict border controls can still hamper trade corridors despite the initiation of the Great Arab Free Trade Area;<sup>32</sup>
- *Energy:* Not all parts of the region have a reliable electricity supply, or even connection to a national grid. ESCWA has identified opportunities for SMEs to engage in providing additional energy (especially renewable energy) in rural areas.<sup>33</sup> Electricity supply is however a clear obstacle to the operation of rural SMEs, if a reliable and cost-effective source is not available. Alternative sources of energy should be sought, such as investments in small energy generation sources including small solar and wind generation units that could be affordable to SMEs but also exploring potential investments in mini-hydroelectric power projects;
- *Communication:* The development of information super-highways using cable, and ensuring good satellite and mobile phone access, are also key infrastructure issues affecting the competitiveness of rural SMEs. A number of countries in the region have identified this issue and are putting in

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<sup>30</sup> International Labour Organization (2009), p. 4.

<sup>31</sup> World Bank (2007) p. 91.

<sup>32</sup> The Great Arab Free Trade Area (GAFTA) was declared within the Social and Economic Council of the Arab League as an executive program to activate the Trade Facilitation and Development Agreement that has been in force since January 1st, 1998. GAFTA includes in its membership all ESCWA member countries and also the Arab Maghreb.

<sup>33</sup> ESCWA (2011a), pp. 20-21.

place upgrade programmes. Training for SMEs in rural areas regarding information technology will also increase competitiveness;

- *Support services:* The existing infrastructure of business support centres and services in the region that facilitate knowledge is growing (for example ESCWA recently established a South-South facility based in Amman, Jordan), however this is largely an urban-based network. There is a need to develop more outreach centres to rural areas to help rural competitiveness and assist them in identifying appropriate value chain linkages. Designing more effective innovation programmes, particularly to assist knowledge transfer, increases in funding/tax incentives for SME research, innovation and quality, and improving the governance and capacity in corresponding government institutions should be considered by Governments. Input from SMEs themselves in the formation of policies and programmes will help to ensure their relevance. The infrastructure of educational institutions in rural areas is also a competitiveness issue;
- *Financial services:* A good financial services infrastructure is needed in rural areas. Effective access to financial services is essential. Seed, working and development capital is needed including innovative financial ways of mitigating the risks and transaction costs of lending to rural SMEs. With the advent of internet and mobile phone banking, and the growth of micro-finance schemes, this is an area where rural SMEs are gradually becoming more competitive. However, SMEs from the region are still among the least financed in the world. Access to financing is one of the most significant and persistent barriers with a very small percentage of SMEs being able to secure adequate financing from commercial banks. The situation is even worse in countries where there is limited competition in the banking sector (for example, in Yemen and the Syrian Arab Republic) and where banks have little experience lending to SMEs. Although microfinance schemes exist, the demand far exceeds the supply;
- *Labour force:* With a labour force of around 80 million people, the region can easily accommodate a great number of SMEs. Currently, much of the labour force is under-employed. However, labour productivity is low and uneven with countries such as Iraq, Jordan and the United Arab Emirates, witnessing a loss of labour productivity compared with the early 2000s, while others recorded substantial growth particularly in agriculture, such as Yemen (3 per cent), Egypt (4 per cent) and Saudi Arabia (10 per cent).<sup>34</sup>

#### *Other challenges facing rural SMEs in the region*

Other challenges facing SMEs in rural areas of the region are as follows:<sup>35</sup>

- *Small number of SMEs:* In many countries of the region, the SMEs sector is insufficiently developed and thus is unable to achieve economies of scale so that it could compete with other enterprises and businesses (suppliers, buyers, intermediaries) or to face international markets, let alone to compete against them;
- *Lack of high impact SMEs:* Most jobs are usually created by a minority of high growth firms. Such innovative firms tend to account for less than 10 per cent of firms but do create more than 50 per cent of new jobs every year. Yet for various reasons, the region does not only have enough SMEs, but more importantly lacks high growth SMEs which could create many more jobs for the Arab youth;

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<sup>34</sup> Economic and Social Data Service (2008), p. 10.

<sup>35</sup> ILO (2009), pp. 3-8.

- *Management expertise:* SMEs from the region lack the necessary management expertise to grow. The region does not yet have the right infrastructure to provide the needed expertise for SMEs creation and growth. There are very few SME investment vehicles with the right expertise and focus, particularly for start ups, small enterprises, and women owned or managed SMEs;
- *Bureaucracy:* SMEs from the region are also burdened by cumbersome regulatory and administrative procedures and largely unattractive tax regimes. Complicated, costly and time-consuming procedures to register a business, securing operating licenses, registering property and complying with complex taxation and other reporting requirements are significant barriers, which are within the power of governments to address;
- *Processing capacities:* The region might have a comparative advantage in the production of a number of processed products including vegetables (*mouloukchieh, humus, couscous*, etc.), olive oil, fruits (juices, dates, raisins, jelly, etc.) or milk-derived products, which are already well known and well appreciated throughout the population. To the extent the combined production, processing and transport costs for these products out of their areas of production can match or undercut regional benchmarks, there may be market-oriented and import substitution opportunities for rural areas of the region;
- *Research and development:* The ESCWA region is not well served by adequate research and development institutions particularly those that could support the development of SMEs. Most countries have relatively good research institutes in various areas including agriculture but they are still lacking adequate applied research and development services aimed at supporting the efforts of the private sector and particularly that of small and medium enterprises, which usually lack the capacity to develop their own internal research and development programs;
- *Export barriers:* The quality of manufactured products is also a critical SME constraint especially with the increasing opening of markets through free trade agreements. Local SMEs will have to meet international production and quality standards if they want to sustainably develop and compete;<sup>36</sup>
- *Conflict:* There are major conflict and post-conflict issues affecting the majority of ESCWA countries at present: In Bahrain, Egypt, Iraq, Lebanon, Palestine, the Sudan, the Syrian Arab Republic and Yemen, political instability and/or the legacy of war are major issues, which are not conducive to greater investments and risk-taking. In addition to the key competitiveness issue of accessible roads and highways in rural areas, security can also be an issue affecting competitiveness;
- *Others:* Reports and studies reveal other challenges facing the SMEs sector in the region. Common among them are: a low level of education and inadequate access to information, skill development and training; a lack of appropriate management skills and systems required to compete effectively in today's markets; non-adapted production systems; a lack of the knowledge and experience required for exporting; a lack of broad-based and strategic linkages with larger firms and global supply chains; limited access to markets and distribution channels; poor access to adequately priced inputs due to their size limitations and inability to obtain price discounts through volume purchases; inadequate supply of educated and skilled workers; low utilization of and access to up-to-date technologies; low product quality and competitiveness; and low level of innovation. In some countries, access to land and physical premises is also a challenge particularly near major cities.

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<sup>36</sup> Ibid., p. 7.

### *SME and rural development support policies*

With the advent of world trade agreements and increasing globalisation, there is a realisation that trade barriers and isolation are no longer an effective means of SME development. Historically, the Arab region thrived on international trade, and the introduction of national boundaries in the 20th century has not served the interests of trade in the long-term. Looking inwards and outwards, many Arab Governments and industry bodies are introducing SME development policies, but these are not rural-specific. SME development is being supported, but not in rural areas specifically. Examples include the following: *Business-friendly Bahrain* initiatives; Bank Muscat seminar on SME development in Oman;<sup>37</sup> Egypt's Small and Medium Enterprise Policy Development pilot project<sup>38</sup> the development of an SME Unit within the Ministry of Finance; and the SME Development Policy for Jordan.

However obstacles remain significant. The World Bank has suggested that there are three main reasons for the low productivity of investments in the region:

*“First is the dominance of production by the state, which typically uses resources less efficiently than the private sector. Second, the region’s tariff barriers are among the highest in the world. For countries with limited domestic markets, import substitution policies quickly outlive their usefulness. In the early 1980s, the region’s tariffs were quite low compared with those in other developing regions. But they have remained at these levels, while those in other regions have now been dramatically reduced. Third, Middle Eastern and North African countries maintain domestic restrictions on private investments. Domestic restrictions on private investments are not always explicit and the lack of a vibrant and developing private sector is not always the result of state monopolies. Red tape, the inefficiency of the judiciary, corruption, and state capture of government regulation all work to deter private investment. And the absence of clear directions on the future evolution of policy creates uncertainty, which further limits private investment”*.<sup>39</sup>

In addition, the fact that the region has seen regular wars and continued political unrest remains a potent factor that hinders SME development.

#### *Rural development policies in selected countries*

*Egypt:* With its population forecast to grow to 95 million by 2025, Egypt account for a very substantial percentage of the region’s rural poor in the years to come. Planning rural development has a long history going back to the nineteenth century in Egypt. The 1952 revolution awarded more importance to the rural *fallahin*, providing support for integration of departments and the strengthening of liaison with rural communities. Community development associations were founded but the approach remained sectoral and centralized. The first attempts at setting up an integrated approach to rural development were made from 1973 to 2005, with the creation of a national rural development agency. At the same time, the cooperative movement lost ground while a development structure for Egyptian villages became dominant. National and local non-governmental organizations (NGOs) work on participatory, local rural development operations, but there is a very complex institutional structure for rural development, which has limited real effects in the face of continuing population growth. Attempts are being made to strengthen the role of municipalities in local government. The unemployment of young persons with qualifications, especially in Upper Egypt, as well as land pollution, have become very serious problems for the sustainability of rural development.

Rural development in Egypt has thus been characterized by two types of strategy: community strategy and that of integrated development. It has recently sought to incorporate the notion of sustainable development but on an experimental, limited scale. Human development is becoming the pivot of the present

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<sup>37</sup> See: <http://www.omaninfo.com/news/bankmuscat-seminar-highlights-global-perspective-sme-development.asp>.

<sup>38</sup> See: <http://www.sme.gov.eg/English/smepol.htm>.

<sup>39</sup> World Bank (2005), p. 162.

strategy with the desire to build up a legislative framework, in particular for supporting municipal initiatives.<sup>40</sup> Looking to the future, Kruseman and Vullings suggest an income support programme for rural areas.<sup>41</sup>

*Jordan:* Jordan is also a highly centralized country, both in economic and political terms. Amman dominates the economy and royal prerogative dominates the Government. Rural transformation has seen previously largely nomadic populations and agriculture moving away from subsistence to a market orientation. Modern agriculture has a heavy dependence on subsidised water. Rural Jordan is quite well served with social facilities, clinics and schools, but lacking in economic growth and has a very limited SME base. NGOs, such as the Royal Society for the Conservation of Nature (RSCN) have helped to establish arts- and food-based SMEs in its Dana Nature Reserve,<sup>42</sup> and the Jordan River Foundation is encouraging enterprise by rural women.<sup>43</sup>

Most rural communities in Jordan have access to electricity and other elements of infrastructure but lack economic opportunities.<sup>44</sup> In recent years, the Royal Court has pioneered the development of Special Economic Zones (SEZ) in rural areas, in an attempt to attract investment and create jobs. These have been set up in rural areas, such as Petra and the Jordan Valley where they have largely replaced the role of central and local government with an (additional) unitary authority run by appointed commissioners charged with creating enterprise and employment. They are envisaged as a 'one-stop-shop' for investors and were originally envisaged as 'slimmed own government'. However, they have increased the size of the public sector as the existing government institutions remain largely in place. The concept does however, clearly seek to make it easier for the investor to start a business.

*Lebanon:* A very different system pertains in Lebanon due to the country's unique system of government based on confessional representation and its challenges in terms of local constituency interests. Rural innovations are often quite localised and many involve NGOs and donors working with the Ministry of Agriculture or other ministries on various programmes. Examples include the United Nations Development Programme's (UNDP) initiative on hemp, the Young Men's Christian Association (YMCA) Integrated Rural Programme supported by the United States Agency for International Development (USAID). A current example is in the Shouf region where a local NGO, the Shouf Biosphere Reserve, has been encouraging the establishment of food processing based on the area's organic agricultural output. Organic preserves and honeys are sold to the local market, to tourists and to the coastal cities. Many rural areas in Lebanon have seen increasing suburbanisation and ribbon development, as city dwellers and overseas Lebanese nationals invest in second homes. This has substantially changed the rural dynamic away from agriculture to commuter lifestyles and tourism, mostly domestic. It has also had a significant negative effect on the environment and, in particular, water quality. In these circumstances however many SMEs have developed in rural areas, sometimes on a seasonal basis. Nonetheless there remain areas of extreme rural poverty in Lebanon, particularly in areas where political representation is not strong. Rural (and urban) areas of the south have been heavily affected by war and, in particular, the deadly legacy of the deployment of cluster munitions in 2006, which significantly increased rural poverty.

*Gulf Cooperation Council:* In the Gulf there is an emphasis on providing rural dwellers with the same facilities as urban dwellers. This is articulated in Abu Dhabi's *Vision 2030*, which aims to channel investments to rural areas to provide better roads and access to airports, as well as improve recreational facilities, such as cinemas, sports facilities, museums and shopping malls. Finally, and perhaps more importantly, job opportunities need to be created to ensure the long-term prosperity and sustainability of

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<sup>40</sup> Nawar (2006), p. 50.

<sup>41</sup> Kruseman and Vullings (2007)

<sup>42</sup> [www.rscn.org.jo](http://www.rscn.org.jo).

<sup>43</sup> [www.jordanriver.jo/](http://www.jordanriver.jo/).

<sup>44</sup> Honey and Abu Kharmeh (1989), p. 75.

regional communities. This will stem the trend of rural depopulation as young people move to the main cities in search of better jobs. It will also provide greater incomes to households, mainly through maximised female participation in the workforce in these regions, which will also fuel greater economic activity.<sup>45</sup>

#### *Opportunities for SMEs in the region*

The region has various opportunities to generate a thriving SMEs sector:

- It has potentially a large market for its products as a result of the similarities of countries of the region (language, culture, among others);
- Proximity to developed countries markets and signing of various free trades agreements with various European countries;
- Availability of cheap energy sources;
- Availability of vast sovereign funds willing to invest in the development of local enterprises.

### **III. RESPONDING TO THE CHALLENGE**

#### *Improving performance*

Improving the performance of the region's rural SMEs and increasing their participation in local and global markets will have positive social, economic and environmental consequences, and address poverty; which are also key issues for growing a green economy. If rural SMEs can be integrated into realistic value chains they can generate employment, raise incomes, and reduce poverty; they can also contribute to slowing the trend towards urbanisation and unsustainable patterns of consumption

A World Bank report, drawing on data from thirty countries including six countries of the Middle East and North Africa region during the period 1990/2004, shows that the impact of liberalizing the provision of services has a great impact on SME performance and as such improves greatly per capita income growth, trade and foreign direct investment.<sup>46</sup> The report notes that the liberalization of services can lead to a doubling of average per capita annual growth of GDP, to an average increase in stock of around eight times and a one-to-one average increase in annual export growth.

Therefore, the potential impact of a greater liberalization of services in MENA economies, in terms of export growth, foreign direct investment, and overall growth, is considerable.<sup>47</sup>

#### *Rural development funds*

The recent financial and economic crisis has induced a return to 'the fundamentals' among a large variety of countries: Among these fundamentals is the need to support and reinforce the role of SMEs in the overall national development and recovery strategies. To implement this policy in other regions, higher budget allocations and external aid have been provided to the SMEs sector, including sizeable resources made available through specially designated rural development funds (for example, the Mizayawa Initiative to extend credit to SMEs in Malaysia with the assistance of the Japanese government). Such initiatives help not just to underpin socio-economic recovery for SMEs which were affected by recent crises, but also promote growth and the creation and strengthening of up and coming SMEs. These funds support also job creation with a view to accommodate an expanding pool of millions of job-seekers (especially young graduates) and, at the same time, widen available opportunities for current as well as potential SMEs entrepreneurs. In the ESCWA region, a similar initiative is being implemented in Oman with relative success.

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<sup>45</sup> Emirate of Abu Dhabi Executive Council (2008), pp. 46-100.

<sup>46</sup> World Bank (2007), pp. 94-95.

<sup>47</sup> World Bank (2007), p. 82.

### **Oman: Self-employment and National Autonomous Development Programme**

This programme was launched in 2001. Its objectives were as follows:

- (i) To promote entrepreneurship;
- (ii) To provide job opportunities to Omanis, especially the youth;
- (iii) To expand the private sector;
- (iv) To promote sustainable development.

The programme advocates for a culture of initiative and self-employment among Omani nationals with the support of innovative financial mechanisms, provision of entrepreneurial training and implementation of follow-up projects. Loans are given through the Oman Development Bank at an interest rate of 2 per cent. Repayment starts after one year of operation and extend over a six-year period. Skill training is delivered by public vocational training centres (VTCs) and/or private training institutes. Mentoring and consultancy services are also provided to beneficiaries of the programme. All these services are provided free of charge to Omanis aged 18-40 years and to the unemployed. In the first five years of the programme's operation (2002-2007), more than 17,000 job opportunities were created and 8,000 entrepreneurs were assisted to start their own businesses, while the repayment rate of loans ranged between 70 and 80 per cent. More than 3,000 men and women were trained in specialized technical skill programmes.

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*Adapted from International Labour Organization (2009), p. 9.*

#### *Legislation and incentives*

In order to spur the development of rural SMEs, there will be a need to enact and implement innovative and aggressive sectoral industrial policies that will include both direct and indirect measures. Some of these might include the following:

- Direct subsidies for production or promotion of exports;
- Tax policies and off-budget finance to encourage internal investment and growth;
- Subsidized credit, including channelling capital to selected sectors, supplemented by research and development incentives;
- Control on international trade, investment, technology imports and attraction and channelling of FDI into specific sectors;
- Tolerance of anti-competitive behaviours (particularly towards imports);
- Strong policy guidance to encourage the advent of champions.

Such innovative and aggressive policies would have to be combined or complemented with policies that promote a rapid accumulation of human capital, through the provision of adequate and well-targeted training and other capacity building programmes, and the control of credit or selective distribution of subsidized credit to focus sectors and industries.

It is usually recognized that there are three tiers of policies that support the development of SMEs.<sup>48</sup>

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<sup>48</sup> Stevenson (2010), pp. 151-170.

1. *Macrolevel policies*: which promote fiscal stability and develop efficient financial markets among others. Macrolevel policies build confidence in the government and the economy; foster more diverse and sustainable patterns, reduce budgetary and administrative burdens imposed on the public sector; and promote social investments in health, education and housing. Macroeconomic policies include those to promote low inflation, deregulation, fiscal and monetary stability and instituting rational factor prices, and those that promote structural changes in areas such as competition and trade policies and the creation of a well-functioning financial system.
2. *Mid-level policies*: which stimulate entrepreneurship, initiative and risk-taking. Actions at this level aim to assist in improving the institutional environment that frames business decisions, such as promoting the rule of law and its enforcement, reducing the scope for corruption and establishing institutions through which public and private sector dialogue can be fostered.
3. *Microlevel policies*: which replace controls and prohibitions with incentives, promotional measures and supportive public interventions. Actions in this area aim to support facilitative activities, such as business training and consulting services, micro and small enterprise development, privatization, public enterprise reform and foreign direct investment.

Thus, Governments have a central role to play in creating an enabling environment for SME development. Success is achieved by strengthening the banking and financial services, providing economic incentives, establishing effective import and export facilities, reducing red tape, upholding the effective rule of law, ensuring well-functioning legal systems and an efficient and effective judiciaries, and instituting fair and transparent regulatory systems, among others. However, key questions remain about whether macrolevel investment climate and business environment reforms are sufficient to produce a vibrant private sector, and concerning which specific mix of policies, actions and interventions will produce the desired effects.

#### *Rural priority setting*

Governments have to set clear priorities with regards to development, taking into account the country or region's comparative advantage, such as local production, labour availability, and proximity of suppliers or buyers and so on. Gaps, risks and opportunities should be detected and analysed through monitoring and in-depth assessments, and solutions should be prioritized so as to ease strategy formulation and implementation for maximum effectiveness and efficiency. The highest priority needs to be given to areas which will have the most impact in the short-, medium- and long-term, without neglecting the feasibility aspect, since some actions might not be feasible in a given socio-economic and political context. The priority-setting exercise could be carried out in five steps as follows:<sup>49</sup>

- Narrowing the focus by identifying a few priority sectors or areas, i.e. identification of no more than 5 major priority sectors for SME development;
- Promoting mutually beneficial linkages among small and large firms, which could be done through industrial-subcontracting exchange schemes, strengthening SME associations, establishment of linkages and cooperation between small, medium and large firms;
- Strengthening technology and research and development initiatives that would benefit SMEs, promote use of quality standards, among others;
- Bolstering human resource development by creating, expanding and improving curricular training programs in entrepreneurship, management;
- Improving access to finance by developing innovative financing schemes using non-traditional sources and schemes such as cooperatives and associations, and, equity financing and venture capital.

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<sup>49</sup> Stevenson (2010), p. 36.

### *Institution building and giving leverage to rural actors*

Rural communities and rural actors have to be brought into the mainstream of development in order to achieve long-term economic growth. However, most rural communities and actors are not usually given sufficient prominence. In most cases, formal institutions avoid or fail to offer sustainable services in rural areas (e.g. rural financial services, skill development, enterprise support, etc.) and as a result informal or semi-formal institutions as well as alternative providers such as traders or input suppliers become major providers of services without having the proper knowledge to do so, and in most cases with clear conflict of interest as they are more interested in promoting their products or services. These informal providers often have weak institutional and managerial capacity; and tend to operate in isolation from formal systems thereby acting more like rent-seekers rather than genuine development agents. However, it is important to avoid dismantling informal or semi-formal institutions as they are more accustomed to working in their rural communities, but instead encourage them to strengthen ties with formal and public institutions.

### *Clusters and specialisation*

There is much to be gained by clustering priority areas for SME development. This can happen organically, as in a village in the Fayoum Oasis of Egypt, where craft-based projects and potteries have developed; or it can be induced through planning. The process enables the development of specialisations and innovation, making SMEs more competitiveness. In Asia for example, projects to develop 'one village, one product' have been popular. The role of government is crucial in ensuring the creation of these clusters and promoting the various inter-linkages through both direct and indirect policies and other measures, as the case presented below from Indonesia demonstrates.<sup>50</sup> Such cluster agglomerations are not just the policy goal of developing countries. Industrial nations have complex forms of clustering where different sectors or sub-sectors depend on or benefit from each other. Prominent examples of SME and mainstream industry cluster agglomerations are found in north-central Italy (tourism, food, fashion, furniture and machinery industries), southern Germany (vehicle, electronics, machinery and software industries), Greater London (banking, insurance, software, publishing, film, music, tourism, fashion, advertisement and other service industries) or Silicon Valley in the United States (software, electronics, computers, etc.).<sup>51</sup>

It is usually easy to advocate for a uniform kind of development in rural areas through experience sharing, replication or outright implementation of a unique development programme over several communities. Farmers, governments, business and industry are quick to jump on these imported models as they see them as the right answer, which has been successful elsewhere. However, rural communities differ markedly in terms of endowments and settings, which unravel all well-thought pre-established plans and programmes. It is therefore better to bring together all concerned stakeholders in the concerned community in order to brainstorm beyond the suggested plan or programme in order to identify local specificities that could favour or hinder the project, and to address them. These could provide alternative ways of doing business and thus provide multiple benefits, including a more sustainable solution for the concerned rural community economically, environmentally and socially.

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<sup>50</sup> Tambunan (2008), p. 128.

<sup>51</sup> Ibid., p. 133.

### **Indonesia: Rural development through SME clusters**

The development of manufacturing SMEs has been seen as a key engine to promote development of rural economy in Indonesia, as was the case in several other developing countries particularly in South East Asia. The Indonesian government adopted clustering – whereby firms producing similar products concentrate in certain areas or regions – as the main element in its rural development strategy, with a view to promote rural industries. These rural SME clusters were established along traditional activities of local communities whose production of specific goods was made with respect to the abundance of local raw materials and labour with the necessary skills in making such products. This allowed these clusters to have enough ground for growth.

Although the Government provided the impetus for clustering, the success of the strategy was due mainly to the ability of these clusters to build strong inter-firm linkages within the clusters but also with firms and institutions outside the network, such as large enterprises, which provided subcontracting, and/or traders and trading companies in rural areas, which acquired their goods or supplied them the raw materials. Through these linkages, firms in clusters were able to achieve economies of scale, which ensured access to a wider market and/or the ability to obtain better prices for their products than would have been possible otherwise, due to their small individual size (of each SME) and reach.

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*Source: Tambunan (2008):pp. 123-146.*

#### *Capacity development*

There is a need to develop capacity in rural areas and to provide an enabling environment through the following:

- Strengthening managerial capacity and governance of informal and semi-formal institutions in rural areas through appropriate training;
- Link informal to formal institutions, to enhance flexibility (more services) and accountability (building trust), particularly to the most isolated institutions;
- Develop alliances among various types of institutions and sectors, for instance training and health care, etc. and strengthening or building on existing rural value chain (i.e. via rural trader shops, or agricultural processing firms);
- Mitigate risk by encouraging diversification (agricultural production, processing, financial, etc.);
- Assess supply and demand to minimize the discrepancy between both;
- Improve the technical skills of local officials to encourage the necessary political independence required to manage local development schemes;
- Increasing literacy in rural communities (i.e. not only reading-writing but also on such issues as financing, management enterprises, assessing markets, etc.) as this would empower them to make informed decisions both in their households and in their businesses;
- Increase knowledge of the information society, the Internet and facilitate electronic commerce;
- Promote a culture for development and entrepreneurship among rural populations through awareness campaigns, training or the sharing of experience/testimony;
- Provide accurate data and information to make the market more transparent.

### **MSMEs policies: The case of Tunisia during the period 1986-2006**

In order to promote economic development, the Government of Tunisia implemented wide ranging operations of enterprise restructuring and privatization with the effective involvement of the private sector. The restructuring efforts were conducted along with other reforms such as a reduction in the number and weight of taxes, the enactment of new laws (competition law, consumer prices law and consumer protection law) and a unification of systems for enterprise creation and development by regrouping all laws and regulations in one investment code. Specific incentives were also provided in some cases, including grants of 70 per cent of the cost of preliminary and feasibility studies for micro and small and medium enterprise (MSMEs), contributions to the capital of the MSMEs, subsidies for the employer's share of social security, contributions grants of 30 per cent of the cost of the land and premises, grants of up to 6 per cent of the investment cost and the provision of loans reimbursable over 11 years without interest.

A special programme was launched with a view to create 70,000 MSMEs during the period 2004-2009 with a target of 1.4 enterprises for every 1,000 citizens, compared with 0.8 during the previous period. The National Council for Enterprise Creation and Innovative Projects was also created as a one-stop shop for entrepreneurs and it was expanded through a one-stop website to encourage MSMEs creation. Other supporting programmes included the reduction of the minimum capital required to less than US\$1,000; the waiving of 70 per cent of the procedures for enterprise creation with the ultimate aim of waiving of 90 per cent by 2009); the creation of support institutions all over the country; the creation of business centers delivering information and providing technical support to new small entrepreneurs; the creation of two fully-fledged banks specialized in the delivery of credit and microcredit for MSMEs; the implementation of programmes for the benefit of MSMEs including capacity-building, enterprise restructuring, product quality, vocational training, competitiveness and economic information, all funded up to 70 per cent by the government; on-site provision of technical assistance to MSMEs in their respective fields; the creation of the National Investment Portal which provides information to existing and potential entrepreneurs and foreign investors; and the creation of six technopoles in collaboration with universities, research centers and technical and engineering institutes in the areas of innovative energies, biotechnology, chemicals and medicines, information technology, multimedia, mechanics, electronics, media, textiles and food processing.

As a result of these efforts and the effectiveness of measures taken, law enforcement, continuous monitoring and evaluation of national programmes, wide participation of the private sector and all concerned stakeholders, various indicators of the national economy started to rise pointing to an effective enabling environment for the MSMEs sector. World Bank reports such as *Doing Business*, as well as the World Economic Forum's Competitiveness Report, all ranked Tunisia high among developing countries and especially among African and Arab countries in the area of economic and social development.

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*Source:* Adapted from International Labour Organization (2009)

## **IV. CONCLUSION**

Each country of the ESCWA region has its own peculiarity in terms of history, politics, economics and socio-cultural background, but all of them share the same willingness to transition to a more liberalized and market-oriented economy. They are at various stages of making that transition notwithstanding the recent sociopolitical upheavals, which emphasise the need for action in job creation and delivering more open societies.

It is beginning to be accepted by governments that SMEs rather than government need to be the main player in domestic economic activity, especially as providers of employment opportunities, and hence generators of primary or secondary sources of income for many households. However, populations are looking to governments to address their concerns, so there is a danger of more interventionism and State-controlled enterprise, rather than less. Low income or poor farm households in rural areas have often been neglected in the past and may expect little from their government. However, their need for poverty alleviation is often great.

There are many interlinked factors affecting the livelihoods of rural communities in the region and there is a need for a comprehensive country-by-country approach to rural development which would enable a comprehensive understanding of the social, economic and natural factors within the rural communities in each economy. Rural communities also need to be empowered to make their own decisions regarding natural resource use and livelihood strategies, in order to protect both their natural resource base and their chosen ways of life. Rural communities and rural actors have to be brought in the mainstream of development in order to achieve long-term sustainable growth.

In order to ensure development in rural areas, substantial reforms will be needed. These include the following:

- Redefine the role of government to make it more responsive to the needs of rural dwellers, but also more creative in the means it uses to address their needs;
- Delegate power downwards, give local communities more responsibility and resources to assist the development of their areas;
- Improve the competitiveness of rural enterprises through infrastructure, education and support mechanisms;
- Prioritize clusters (existing and embryonic) and improve their access to communications and transport infrastructure;
- Encourage a stronger role for the civil society, facilitate partnerships involving NGOs and local clusters and joint development strategies.
- Facilitate private investment in rural areas with public incentives;
- Facilitate seed funding in rural areas and monitor the results of network initiatives;
- Create a better climate for foreign direct investments in rural areas;
- Make better use of the Internet in government and local government interactions with SMEs and promote electronic public procurement initiatives that provide equal access to rural SMEs.
- Create more resource and demonstration centres, training initiatives and pilot SME-support projects in rural areas;
- Target promising economic sectors based on market research, to ensure viability and sustainability such as agribusiness, forestry and wood processing, and ecotourism.

To foster SME development, both urban and rural, it is generally recognised that reforms are needed in most ESCWA member countries in order to bring about a more globally-competitive and business-friendly environment. The following are needed:

- Downsize the government's direct involvement in economic activity and empower the private sector;

- Open the regional economy to trade so that countries are internationally competitive, not relying on import barriers;
- Enable a business-friendly environment for the emergence and growth of more domestic SMEs;
- Strengthen the rule of law, transparency and accountability;
- Enhance electronic networks to disseminate technological and market information and provide related assistance and remove paper-based legal barriers to commercial electronic transactions and administrative impediments;
- Provide financial support for innovation in SMEs, especially for start-ups;
- Create cohesion and communication between the representative organizations and bodies responsible for the development of SMEs in Arab countries (such as the Social Fund for Development in Egypt, the Aga Khan Foundation, and other NGOs): This is an area where ESCWA may have a greater role to play.

Countries of the region are still at differing stages of progress in their efforts to promote the development of their SME sectors. All countries are far behind when it comes to the provision of the full range of support services, particularly with regards to research and development, technology acquisition, capacity-building and training and adequate infrastructure, particularly in rural areas. The benefits of a more locally-focused rural SME development approach will include the following:

- Ensure local ownership;
- Develop industries and businesses that create sustainable local jobs;
- Allow community members to benefit and profit from projects;
- Provide incentives for people to remain in their community;
- Manage the local environment in a diversified and sustainable manner;
- Utilize local products for value-added processing;
- Create and utilize local expertise;
- Build stable and consistent local leadership;
- Receive support from communities as they identify with the project;
- Maintain a safe, healthy and attractive social environment;
- Respect local values.

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