
Industrial Policies and SME Competitiveness

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Introductory Remarks

- An industrial policy is neither limited to industries nor is it synonymous to a state “master plan” with a top-down approach
 - Industrial policy should be a discovery process where public and private agents learn about costs, opportunities, externalities & devise remedies
 - Information & coordination imperfections (by both sectors) require an inter-active approach in policy-making at all levels
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More on Industrial Policies

- An industrial policy is any policy, measure, initiative; it could be sector or activity-specific
- Industrial policies include: Regulatory, business environment-related, technology, or employment
- Govt. Policies to support SMEs generally focus on:
 - The legal & regulatory framework (*e.g., rule of law*)
 - The incentives framework for business (*e.g., tax, subsidies*)
 - The institutional & organizational framework

Industrial Policy in the Region: GCC

- GCC states adopted an industrial policy in **1985**
- The policy (focused on industry only) was revised in 2000 adopting a more sustainable development approach; its objectives included:
 - Promote the establishment of industries in less developed areas
 - Develop and increase the efficient utilization of natural resources
 - Set up industry-related research and applied science
 - Promote integration of the industrial sector with other sectors
 - Increase the growth rate (and the share of nationals) in manufacturing sectors

SMEs in Developing Countries

- Classification of SME varies by country, but in relative terms (to GDP), opportunities & challenges are about the same
- Classification criteria: # of workers, fixed assets, turnover (in region, often use # workers)
- SMEs dominate developing & ESCWA countries: Egypt (98% of firms, 80% of GDP are SMEs < 100 workers), Jordan (99% are SME < 249 workers), Lebanon (~ 95% of firms < 50 workers), Morocco (SMEs are < 250 workers), ...
- But SMEs faces numerous challenges and market failures, which necessitate measures and policies to ensure their sustainable growth

Micro & Small Enterprises in Lebanon

- Characteristics of the Surveyed Firms (<50 employees)
 - 45% are one-person enterprises (entrepreneurial spirit)
 - 35% of firms were established after 2000, 58% after 1995 (relatively young but still operational)
 - The smaller the firm the more likelihood it is located in deprived areas
 - 8% of firms are headed by females, often widowed or divorced
 - 73% are in trade (e.g., small shops), industry (9%)
 - 8% have a current loan and 4.2% received a formal loan in the start-up phase
 - Survey validates the 1996 Official Census which showed that 97% of firms employed less than 10 workers
(Issue of under-reporting in the sampling, note that 45% not commercially registered, 20% only registered with NSSF)

Source: Hamdan, ERF 2006 Survey

Importance of SMEs in the Economy

SMEs ...

- Are an engine for job creation;
- Have a positive role in poverty alleviation
- Cover almost all (productive) sectors;
- Are a main source for new products (thanks to the innovators & risk-takers who head these SMEs);
- Diversify the economy and introduce flexibility;
- And often bridge the development gap within an economy.

Often Cited Constraints to SME Growth

- Access to credit (collateral & cost, initial capital)
- Difficulty to obtain inputs (skilled labor, technologies, market & industry info)
- High cost to build local capacities
- Inadequate legal & regulatory environment
- Lack or inappropriate Govt. promotion policies
- Lack of economies of scale & limited ability to sustain external shocks
- Difficulty to adhere to IPR & quality control measures
- Registration, set-up cost & other admin. burden

FDI Inflows to SMEs in the Region

- FDI is a source of new technologies and new discoveries
- Although SMEs are considered an engine of growth & employment, FDI does not target them but instead large scale industries
- Aside from petroleum, industries that attract FDI include petroleum-related, cement, steel, aluminum, and services such as tourism, banking, telecom
- There is a shift from traditional small scale-scale family-owned to large scale conglomerates
- *If trend continues => Lebanon can attract FDI to large-scale services & heavy industries (e.g., Cement). Need policies that channels FDI to SMEs*

Doing Business 2006 (World Bank):

Lebanon vs. Non-GCC Arab Countries

| | Tunisia | Jordan | Lebanon | Syria | Algeria | Egypt |
|--------------------------------|------------|-------------|------------|-------------|------------|-------------|
| Overall rank | 58 | 74 | 95 | 121 | 128 | 141 |
| Getting credit | 102 | 65 | 66 | 124 | 138 | 142 |
| Export: # days (trade rank) | 25 (53) | 28 (61) | 22 (94) | 49 (146) | 29 (84) | 27 (70) |
| Start business: days (rank) | 14 (40) | 36 (119) | 46 (99) | 47 (135) | 26 (109) | 34 (115) |
| Close business: yrs (rank) | 1 (31) | 4 (70) | 4 (98) | 4 (65) | 4 (46) | 5 (106) |
| Protect investor | 133 | 124 | 102 | 105 | 97 | 114 |

Doing Business 2006:

Upper Middle Income Country Comparison

| | Chile | Latvia | Poland | Panama | C. Rica | Turkey | Lebanon |
|--------------------------------|------------|------------|------------|------------|------------|------------|------------|
| <i>GNI per capita</i> | 4,910 | 5,460 | 6,090 | 4,450 | 4,670 | 3,750 | 4,980 |
| Overall rank | 25 | 26 | 54 | 57 | 89 | 93 | 95 |
| Getting credit | 32 | 26 | 88 | 19 | 33 | 103 | 66 |
| Export: # days (trade rank) | 23 (42) | 18 (62) | 19 (34) | 30 (93) | 36 (88) | 20 (95) | 22 (94) |
| Start business: days (rank) | 27 (23) | 18 (26) | 31 (92) | 19 (21) | 77 (83) | 9 (46) | 46 (99) |
| Close business: yrs (rank) | 6 (82) | 1(11) | 1 (23) | 2 (74) | 4 (99) | 6 (125) | 4 (98) |
| Protect investor | 36 | 40 | 22 | 92 | 134 | 75 | 102 |

Initial Observations On Business Climate

- Compared to non-GCC (doing average) but when comparing to upper middle income countries (*same GNI per capita*), Lebanon performs worst
- No incentives for new SME or start ups (Lebanon performs badly with respect to typical SME constraints: finance, close or start business, export)
- Risk is very high to innovate & export,
- Bankruptcy laws, commercial disputes, and the unfavorable business climate in general does not encourage risk-taking & entrepreneurship, and hence SME development

Entrepreneurships in Developing Countries

There are demand-side limitations behind the lack of innovations and new discoveries in developing countries. Spending more on laboratories and equipment is not sufficient if entrepreneurs do not foresee a return and do not take the risk of discovering.

- ⇒ Reduce the risk (partly by improving business climate) to innovate faced by entrepreneurs
- ⇒ Do not focus on picking winners, mistakes are part of the discovery process. Otherwise there is little risk-taking, and less innovations and fewer products

Imperfect Information & Setting Policies

Public & private sectors have imperfect information:

- Government commits two types of errors: omission (fails to intervene) and commission errors (wrong or excessive interventions like trade restrictions).
- Private sector also does not have full information (information externality => high cost of discovery for entrepreneur) and lacks full picture on related sectors/policies, (coordination externalities => stand alone project not profitable).
- Because of the imperfect information, there is need to jointly (with private sector) & inter-actively set industrial policies by eliciting information on business opportunities and constraints and in response, generate policy initiatives.

An Inter-active Sustainable Approach

- Lebanese officials engage often (some of) the private sector in the process of drafting legislations but rarely there is a policy impact assessment
- The adoption of policies with a more sustainable development approach must *not* lead to over-regulation and through the inter-active dynamic process of developing & implementing policies we can achieve this objective.
 - ERF/Hamdan 2006 Survey showed that 69% of surveyed micro & small firms do not consider (at all) environmental regulations as a constraint; only 11% view these regulations as a major constraint and 20% as a moderate constraint.
 - Regulation and SD do not necessarily imply higher cost. An ESCWA 2001 survey showed that cost of health, environmental, and safety policies are minimal or bearable. Study covered Lebanon, Syria, Jordan, and Egypt and covered textile/garment, agro-food, and pharmaceuticals

Industrial Policy's Desired Principles

- Provide clear benchmarks & criteria for success and failures & sunset clauses in case of failures
- Provide incentives to new activities (i.e., new products or new technologies to produce existing products) and not to sectors. Activities include training, venture capital funds, adaptation of new technologies, etc.
- Subsidize activities with spillover effects (positive linkages)
- Ensure authority in charge of implementation is competent, has the mandate, and is monitored by a top official (e.g., minister, PM) with vested interest in the success of a policy
- Maintain communication channels with the private sector (not just big firms)
- Minimize cost of mistakes but do not minimize chances of mistakes (i.e., promote risk-taking)
- Renew and update promotional activities and instruments

Source: D. Rodrik "Industrial Policy for the 21st Century," Discussion Paper, Nov 2004 Harvard

Five Pillars for SMEs Development

| Med-Best Pillar | Existing initiatives/ measures |
|---|---|
| Simplification of administrative rules | IDAL, Omsar, E-govt, Projects (ELCIM) |
| Access to finance & taxation (policies) | Commercial banking, Kafalat (1 & 2), BDL subsidies, NGOs, Micro-finance (<i>SMEs still on margin, high cost & collateral, no VC culture</i>) |
| Access to information & business support (development services) | Syndicates, Chambers, IDAL, ELCIM, MoET incubators & Berytech (<i>Lots of work remains</i>) |
| Access to education & training | Some initiatives to promote entrepreneurship & training (e.g., AUB, CNRS, MoET incubators) |
| Promotion of R&D, Innovation, and entrepreneurship | Few initiatives (LIRA, IRI) but no business R&D. Clustering is promoted by chambers or incubators; and IDAL tries to attract FDI (carrier of new technologies) but flows target big firms |

Source: ESCWA *Med Best* Mapping Study for Lebanon

Indicative List of Policies

- Subsidize self discovery (early phases)
- Develop mechanisms for higher risk finance (post discovery requires often large investments)
- Internalize coordination externalities through councils and public-private partnerships
- Provide Public R&D since most developing and especially SMEs do not possess the means
- Subsidize general technical training activities