

**SMES CONTRIBUTION TO THE
CREATION OF THE EURO-
MEDITERRANEAN REGION**

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Working Paper 0106

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Abstract

The paper focuses on the manufacturing sector of 10 Mediterranean Partners, in particular on the industrial structures and their relationship with the market. The Euro-Mediterranean Partnership, and in particular the project of the free trade area, is placing the North-South relationship in a new context. Several studies have demonstrated that the liberalization of the regional markets and increasing competition from European imports will have dramatic effects on the Mediterranean partner countries at both the macro and the micro levels. At the same time, export opportunities and technological spillovers from the forecasted increase in foreign investments can contribute to the upgrading of the Southern Mediterranean production systems, but this depends upon both the type of learning capability and the structure of the Southern Mediterranean countries production system. More than 90% of the total industrial units are family businesses concentrated in traditional sectors utilizing low technology equipment, and supplying to the local markets. They are facing a shrinking purchasing power with changing patterns of consumption. Industrial modernization and export-oriented strategies can have an effect only on a particular type of SME while excluding the majority of the enterprises. The features of the local markets show that development strategies should take increasingly into account the structural characteristics of the production systems and of the markets in which they are embedded.

Introduction

In 1995 the European Union launched a new political and economic partnership with its Mediterranean neighbors based on a three dimensional program of (i) policy and security, (ii) economy and finance, (iii) social, cultural and human affairs¹. In particular, the establishment of a free trade area (FTA) by 2010 to gradually encompass all sectors has given rise to a lively debate among academics and policy makers about the impact that the liberalization process can have on the economies of both shores². Many claim that both groups of countries, the EU and the Mediterranean countries that signed the agreement, will face difficulties in adapting to the new regime³. Specifically, it has been pointed out that: on the EU side, the agricultural sector will suffer most from liberalization because of the comparative advantages enjoyed by the Mediterranean Partner countries (MPCs). On the MPCs side, the free entry of European industrial products in the MPCs markets will undermine the fragile but consistent manufacturing sector of MPCs.

Integration may thus partly reactivate the process of a “natural” specialization in the countries, and agglomeration economies cannot be excluded. Nevertheless, beside the positive effects produced by the growth of two-way trade providing interesting industrial links between the European and the Mediterranean enterprises, a number of problems arise. For example, the OECD estimated that 60 percent of industrial firms in Morocco and Tunisia would not survive against freely imported European products⁴. The study concludes saying that this will not occur if appropriate technological and marketing improvements are made by 2010⁵, however, the types of improvements that should be introduced are not specified.

¹ The author is particularly grateful to the participants of the Workshop on Innovation and Exports from SMEs in Developing Countries, held at the University of Molise, Italy, the 22-24 of March 2001 for their helpful comments, to Sergio Gomez y Paloma for the comments on a previous draft of the paper, and to Bruno Amoroso, director of the Federico Caffè Centre, for his patience in discussing the issues tackled in the paper. The usual disclaimers apply.

² During the transition period MPCs would have a dramatic fiscal loss from lost tariff revenues. For Morocco by the end of the transition, this will total more than 13 percent of the budget revenues, equivalent to more than 3 percent of GDP. For Tunisia it is estimated that as much as 68 percent of trade taxes will be lost, amounting to a loss of total government revenues of nearly a fifth, Economic Research Forum, 1997, p. 38-39; in Holland S. 1999, p. 11.

³ The work of the Femise Network, coordinated by J. Luis Reiffers of the Institut de la Méditerranée and Heba Handoussa of the Economic Research Forum (ERF), is providing a continuous monitoring of the implications of the FTA.

⁴ OECD, 1997.

⁵ *Ib.*, p. 16.

Thus, there are several unanswered questions about what will be the actual welfare gain and loss in the process of market integration, while maintaining the other two objectives of security and social development. If the positive and negative static effects of trade creation and diversion in the short and medium-terms can be assessed with current statistical methods, the dynamic effects on the production systems are not easy to spot. This is also due to the fact that there is a lack of systematic knowledge of the productive structures, particularly of the MPCs and especially of the manufacturing sector. This paper attempts to contribute to the study of the Mediterranean contemporary manufacturing system presenting the results of the surveys carried out in the last three years by the author⁶. The research has focused on ten MPCs⁷ highlighting the needs, challenges, and potentialities for the development of the small and medium sized enterprises (SMEs), and micro and family enterprises (MFEs). In particular, in light of the process of integration with the EU market and production system, the research was driven by the question about what avenues the modernization of the MPCs' production should take to co-evolve and co-develop, given the existing structures. Thus, we first attempted to draw a picture of the organizational and productive structures of the manufacturing sector. Next, we analyzed the needs and potentialities of the firms, looking at their technical and technological capabilities and their relationship with the markets. This was done through in-depth personal interviews with entrepreneurs and with international and local small enterprises' development experts.

Three assumptions placed the research focus on the manufacturing sector. First, in the region's diversified group of economies, traditional consumer goods industries are still dominant. Second, the capacity of the agricultural and petroleum sectors in terms of job creation is very limited, while the manufacturing sector increasingly absorbs jobs. Finally, there is a constant increase in the contribution of the informal sector to GDP and employment⁸.

⁶ The research project on the “Mediterranean Economies: old and new local production systems” has been coordinated by the Federico Caffè Centre at the Department of Social Sciences of Roskilde University, with the financial support of the Italian Economic and Social Committee (CNEL). The research on the Mediterranean manufacturing sector and the Euro-Mediterranean Partnership has produced two reports, one published by the CNEL in 1999 and the other forthcoming by CNEL in 2001.

⁷ The Mediterranean Partners of the Barcelona Conference are, from West to East: Morocco, Algeria, Tunisia, Malta, Egypt, Israel, Jordan, Palestinian Territories, Lebanon, Syrian Arab Republic, Cyprus and Turkey. In the research project, Malta and Cyprus have not been included.

⁸ ERF Economic Trends in the MENA Region 2000.

The paper is organized as follows. Section two presents the theoretical considerations behind market integration and modernization. Next, the analysis of the contemporary manufacturing production systems in the Mediterranean countries and their problems is presented. The paper goes on to discuss the role of innovation in this type of production system as a strategy for co-evolution and co-development. The last section draws some conclusions and proposals for future research.

The Experiences of Market Integration and Modernization

The assumption made by the supporters of free trade that the abolition of trade barriers will enable the automatic integration of markets and productions through higher rates of innovation following the introduction of newer technologies has been proven to be incorrect⁹. The evidence shows that even in highly integrated national or regional markets, the expected process of convergence towards “best practice techniques” and the elimination of regional disparities did not occur. As pointed out by Ernst *et al* (2001) the internationalization of markets has not lead to “the wonderland of a borderless world, where capital, knowledge and other resources move freely around the globe, acting as a powerful force of equalization.”¹⁰ In practice, the situation is more complex, and the structural differences between sectors and countries, on both the technological and infrastructural playgrounds, can play the opposite role of worsening the existing asymmetries in the distribution of welfare. A similar problem is depicted by the differentials in the stages of development between the regions of the European ‘Banana’ and the Southern European regions, despite the enormous amount of structural funds injected for decades, and the existence of a well-functioning common market¹¹.

The discussion on the Euro-Mediterranean meso-regional project generally lacks reference to previous historical experiences of market modernization and integration.

⁹ On a critic on openness and export oriented strategies see Rodrik D., 1999. Even enthusiastic neoclassic economists, conclude after a complex econometric analysis saying “However one should put less faith on the absolute magnitude of the effect of openness on growth derived from the regression model than on the direction of the impact because the robustness of the model requires more thorough examination. In addition, there may be two-way causality between openness and economic growth. Therefore, more detailed study is warranted on the timing of economic policies and the subsequent growth performance of individual countries. Further research is also warranted to examine the effect of openness on the dispersion of income across countries and over time.” Hui Pan, 1999, p. 118.

¹⁰ Ernst *et al*, 2001.

¹¹ As pointed out by Triulzi U., 1999, p. 226, “...despite the important sums invested in these areas, it seems that neither corrective redistribution policies nor efforts to move production activities from north to south or to direct part of the production structure of the south towards the markets of the north have produced significant results”.

A reference would have helped to sort out an attitude that considers market and integration as a technical matter of financing, rules and prices. This lack is even more serious when we are dealing with different markets, and thus not only diversity in market terms but in historical and cultural terms as well.

This has been the case during the process of the formation of national markets in Europe during the last century. Integration has succeeded where cultural differences were small or the resistance to modernization could be brought down by “cultural revolutions.” But these operations were not always successful as shown by the cases of Italy, Spain, Great Britain, etc. After the elapse of more than a century, and despite the many efforts, different market types and regional disparities still exist in these countries.

The European Union should also reflect on its own experiences. Regional and national disparities within the EU remain high, and the strengthening of the EU market competitiveness in the context of globalization has intensified rather than weakened problems like regional disparities and poverty. The case of Germany - where all the “obstacles” to integration were removed and no means were spared in the re-unification effort - is proof indicating that markets might be more than simply numbers and money.

To avoid the deepening of the gap between the EU and the MPCs, transitory measures to achieve liberalization have been introduced in the EMP. However, the time span of ten years during which these measures should produce their effects does not seem consistent with the problems they aim to solve.

It is clear that the problem is neither to work out a self-centered development model based on import substitution and high protective barriers, nor to create a strong export-led sector. The problem is rather to create a sound domestic base for the national economy that is able to achieve a good quality and productivity level and to participate in some sector of the international division of labor. The main export gain must be to extend and improve the domestic market. To imagine the increase of exports on the costs of the domestic market would be to upturn aims and means (Amoroso and Gallina 2000).

The analysis of the “diversities,” in the sense of how production systems are organized, the influence of cultural factors on consumption patterns and institutional set-ups, and the diversities in the social needs of given communities, poses the stress on the need to have a different approach to market integration. The economic policies and measures advocated by the “polycentric model” (Amoroso *et al* 1993: 20-24; Amoroso 1995: 17-33; Amoroso 1998: 130-150) respond to this need. Two main

considerations are at the base of the feasibility of such an approach: on the one hand, integration between areas with marked socioeconomic gaps needs to have transitory regulatory frameworks enabling an appropriate “*mise-a-niveau*” of the economic sectors within which integration will occur. This means that innovation and transformation of production systems, both industrial and agricultural, should be gradual and contextual. On the other hand, social and macroeconomic considerations should be introduced in order to avoid de-stabilizing effects and induce an endogenous growth that is based on the gradual adaptation of society and markets to the different context. This requires an institutional building that overcomes the national boundaries, and is oriented towards a meso-regional dimension. Again, the case of some South-South regional integration agreements, such as for example the Arab Maghreb Union, should be looked at carefully from this perspective.

Markets and productive structure in the Mediterranean

The existing differences within the MPCs could be exploited for the creation of a south-south integrated regional market, which should be complementary to the Euro-Mediterranean FTA. This aspect does not receive much consideration in the Partnership and it represents, in fact, the Achilles’ heel of the project. So far, the Euro-Med Partnership is limited to the liberalization of North-South trade flows, especially due to the technical problems of rules of origin that could emerge if South-South trade is also liberalized. Furthermore, most important is the acknowledgement that, due to the socioeconomic situation in the South, integration policies cannot be limited to trade policies. In fact, the abolition of tariffs can have negative effects if the productive structures are not supported to co-evolve and co-develop taking into account that the construction of local productive systems and markets are a necessary prerequisite to a more independent insertion in the international markets. Considering also that the movement of labor between the EU and the MPCs is increasingly restricted, and that the proportion of the population under fifteen will shrink in the next 10-15 years - meaning that the proportion of the population of working age will grow more rapidly than the total population - job creation is dramatically needed. Over the next forty years, the North African countries will need to create about 100 million jobs just to maintain the present hardly tolerable ratio of unemployment and under-employment¹². With these conditions, it is difficult to imagine that the expected liberalization of trade, and the consequent specialization and technological spillover effects, will be able to face this need. Furthermore, the structural adjustment measures introduced some years ago in many MPCs, have reduced the purchasing power of the population, and increased social inequality and poverty. This has resulted in increased

¹² Amoroso A., 1996, Part IV; Romero, p. 9, in Holland S. (1999).

social tension in several countries of the region, notably Egypt, Morocco and Jordan¹³. The decline in private consumption affected also the volume of local demand, while at the same time the given preference to the upgrading of modern suppliers, generally controlled by foreign capitals, forced production to deflect toward different markets leaving local markets with lower quality products, or without products. This trend is strictly related to the type of economic policy that should be applied within the general process of internationalization of the economy. In addition, the study considers in particular if openness should give priority to imports of capital goods and technology or to the creation of an export-led economy. At present, the analysis of Chevalier and Freudenberg shows that the composition of imports from the EU is increasingly made up of consumption goods, which in turn will put increasing competitive pressures on the local industries during the initial stages of complete liberalization¹⁴. The effect of the adjustments are also shown by the striking increase in employment in the informal sector in MPCs¹⁵. Less institutionalized forms of markets are emerging, despite the attempt of the authorities to reduce the black economy. This phenomenon shows both the existence of increasing demand for goods from lower segments, as well as an enormous number of underemployed labor.

The local demand for goods and services is thus supplied by a network of micro and family enterprises (MFEs), which are basically family-based enterprises with a low ratio of capital investment¹⁶. These represent not only a productive structure but also a social system in which production is based on a fragile interconnection of social practices, cultural values, and power structures. Markets are shaped like the traditional *Souq*, where purchasing, selling, production and consumption are social and socializing functions, strongly influenced by family and interpersonal relationships often based on belonging to ethnic groups. This means that opportunistic behavior is limited and information about prices and quality is general. Thus, demand and production are strongly connected and shape each other.

These elements depict a complex picture of the economies of the Southern Mediterranean countries that is impossible to ignore. Local suppliers and local markets do not represent a romantic vision but an important source of income and stability. The growth of the working population, and thus of migrants, places the stress on the importance of the local production systems and markets. Due to their

¹³ George S., 1996.

¹⁴ Chevalier A. and M. Freudenberg, 1999, p. 4.

¹⁵ Economic Research Forum, 1998, p. 133.

¹⁶ Amoroso B., 1999; Gallina A., 1999.

structural characteristics, the combined effect of the structural adjustments and the uncontrolled liberalization of EU imports will pose a serious obstacle to the endogenous development of MPCs' markets and production systems. Besides, the tools for establishing an incisive inter-industry co-operation, thus enabling a gradual modernization of the manufacturing sector of MPCs, are still weak.

A closer look at the structural characteristics of the sector that will be most exposed to the process of liberalization will enable us to understand the areas in which a sustainable development framework for the north-south cooperation policies can be established.

Contemporary Mediterranean Manufacturing Systems

The choice to study the needs and the role of small enterprises was based on the assumption that in the Mediterranean they represent the production base, upon which social and economic stability depends. In fact, despite the weakness of the statistical indicators, it has been highlighted in various *fora* that the relationship existing between employment and SMEs is so deep that their role can be considered strategic. The statistics available in each country show that the manufacturing firms with less than ten employees account: in Egypt for 95 percent, in Jordan 93 percent, in Lebanon 88 percent, in the Occupied Territories of the West Bank and Gaza 89 percent, in Tunisia 42 percent, and in Morocco and Israel 50 percent of the total industrial units. Their contribution to the employment varies between 20 and 45 percent and to the GDP between 10 to 25 percent.¹⁷

The economic structure of MPCs is characterized by a scarcity of large enterprises. Moreover, these are of a different nature than their European counterparts, due to the fact that the national bourgeoisie has played a modest role in the economic life of Mediterranean countries. This role has been replaced by the military economic apparatus, a heavy public sector and by few large transnational corporations. Today, the reduction of the public sector, with its role as jobs and income creator, has resulted in an increasing amount of self-employment in the region. This, as already pointed out by Pietrobelli and Rabellotti, can be the result of both the fact that there are no better opportunities or because 'own-account' employment is preferred to wage jobs¹⁸. Thus, SMEs are not just a sponge with which to soak up unemployment, they can also be very dynamic; although detailed in-depth research is needed to identify the potentials of the newly established firms. This is to say that the sector in question is very

¹⁷ The figures are taken from Amoroso and Gallina, 2001, p. 42. Data are elaborated by the authors from the national statistics, such as the industrial census, and from the ERF report 1999.

¹⁸ Rabellotti R. and C. Pietrobelli, 1999, p. 17-18.

very heterogeneous and that its growth in terms of capital accumulation and investment is linked not only to its micro dynamic, but also to the evolution of the macroeconomic setting.

Small Enterprises in the MPCs: A Qualitative Study¹⁹

During the field research, qualitative interviews to entrepreneurs, and to other privileged informants in the different ministries and international organizations, have provided the material for the description and analysis of the difficulties and potentialities for the development of the small and medium-sized enterprises sector of the Mediterranean region. From the surveys, it appears that SMEs can be divided into three main categories: retailing, services providers to other enterprises and manufacturing. It is in particular on the latter category that we have concentrated our attention. Within the manufacturing sector the concentration of SMEs is stronger in the traditional sectors, such as textiles, wearing apparel, agro-food, leather and shoes, wooden furniture and articles, etc. The characteristics that they have in common are the low level of capital investment, the use of family manpower, informal credit, use of low technology, a family-based management and low intra-firm division of labor. Very often these enterprises are organized in clusters diffused in the urban and peri-urban areas. At first sight, the level of specialization is very low, firms producing the same finished goods for the same market, but each product is personalized for each different customer. Therefore, competition-with-the-neighbor is not a major threat, and proximity instead means exchange of know-how and information about markets, prices and new technology in a complete "shared environment."²⁰ In Amman Downtown, a small cluster of 12 firms producing furniture purchase wood together in order to obtain a better deal with the importer. Therefore information about the quality and the price of the raw material is shared. A similar thing happens in the cluster of furniture producers in the industrial city of Dawra, Beirut. When not in use, the owner of a particular cutting machine puts it at the disposal of the other producers, teaching them how to use it and thus spreading out technical knowledge in the cluster. The sharing of information and cooperation among producers can also take place in more organized settings. In the Artisan Village of Sale, Rabat, the pottery producers are organized in an association that has the main role of informing about raw material prices, international standards and markets, as well as new technology development, especially about the ovens for cooking the clay. The presence of developed close personal relationships among producers and between them and the customers

¹⁹ This section is based on the documentation and interviews carried out by the author during fieldwork in various countries of the Mediterranean region in the past 3 years.

²⁰ Gallina A., 1999b.

contributes to the creation of “social capital” (in the sense of Putnam, 1993) and to the sharing of specific technical knowledge.

On the employment side, more attention should be paid to the fact that SMEs and MFEs are not only the owner/entrepreneur but they include artisans, wage employees and apprentices as well. For example, the often-neglected fact that they employ children, orphans and students as trainees provides an important opportunity for them to learn a profession and gain some income. The firms’ owners claim that the attempts of the government to regulate the training and the social security of the workers hinder their activities placing other burdens on their already fragile existence.

On the production side, throughout the entire region, the SMEs and the MFE is a workshop of limited dimension, localized on the streets or inside apartments with crowded production chains and little and old equipment. The machines being used are in fact simple, even though some of them have been used for more than fifty years, they still provide the necessary service. Most of the production in the traditional sectors is labor intensive and the specific operations for which the machines are used, such as cutting wood and metal or sewing, are very simple. According to the sector and the type of firm the output obtained can be either that typical of the craft production (with a lower level of standardization), or mass-produced for a contractor.

This important type of heterogeneity is not reflected in the statistical classification of the industrial structure. Artisan micro-enterprises, with only one or two workers and without machines, are classified in the official statistics together with small enterprises with some investments in fixed capital, and with small enterprises with higher level of mechanization. Some of them work only as subcontractors for importers of finished goods, or perform both tasks for other enterprises and for the final market. Other enterprises despite their size are oriented towards the international markets, even though not directly but always through an intermediary. In some cases the specialized output of the craft production can be so high that they can be classified as “niche” products.

An attempt to summarize the main type of SMEs and MSEs in the region and their productive and organizational characteristics is provided in the following table. The categories and indicators in the table are elaborated following the information gathered during the field work. The table takes into account many factors: the number of employees, the registration, the technological level, the internal division of tasks, and the relationship with the markets and with the employees.

It is important to emphasize that, clearly, firms can belong simultaneously to different categories due to the presence of similar characteristics in the type of production and

organization. This means that a craft industry can be small and internationalized, and in addition may be specialized in a product that can be considered as a niche.

The common characteristics of these firms are the flexible organizational and productive structure as well as the presence of special ties with similar and close firms. In theory, all the pre-conditions for developing a production system as such into a well-organized group of enterprises able to enjoy economies of scale and technological externalities exist. However, the situation is more complex and the SMEs and MFEs sector faces many problems in the daily activities that hinder the possibility to develop into a more dynamic and prosperous sector.

Mediterranean Small Enterprises Structural and Operational Problems

This section is also based on the information obtained from the surveys carried out during the field works. It also benefits from the participation to the activities of the working-group on “Quality and Commercialization Problems in Mediterranean SMEs” established within a network of Mediterranean non-governmental organizations working for micro-enterprise development²¹. The list of problems faced by the Mediterranean SMEs is not, generally speaking, much different from that of other developing countries. As has emerged in the various debates, the problems must be seen from both the demand and the supply sides, but also on the infrastructural playground.

On the demand side the factors identified are: the change in the consumption pattern of the population, the change in the requisite on the production imposed by the local norms, the weakening of the purchasing power of the population and the imposition of international standards.

On the supply side, the problems are related to the quality of the products, the absence of continuous product innovation, the lack of raw material of good quality, the use of obsolete technology, as well as the poor design, poor packaging and presentation of the products. Looking at the supply side, little attention is generally paid to the fact that in the Mediterranean the owner of an SME is not necessarily a risk-taking entrepreneur, but is only a craftsman/producer, and thus is not prepared to grasp the opportunities offered by the market. The obstacle presented by the lack of marketing capacities is overcome by using intermediaries. However, this reduces the margin of profit and easily results in creating a situation of dependency and exploitation.

²¹ The Network has been established within the framework of a project financed by the EU DG Development.

It emerged also that many of the problems faced by SMEs in their daily productive routine are related to a lack of infrastructure, roads and communications and provisions such as electricity, water and telephone, especially in Lebanon, Palestine and Algeria, or to a lack of adequate spaces. The concentration of all production phases in a limited place determines losses in the value added due to the difficulty in organizing the production line in a more rational way. The lack of an internal division of labor is often linked to the lack of machinery, which in turn produces competition among workers paid on a piece by piece basis and thus a less friendly working environment. The absence of qualified manpower is another problem that is diffused especially in textile and clothing firms, which utilize young and cheap labor. Furthermore, these small producers have few marketing skills, however they can survive only because they do not need to go to the market; it is the customer, be it a final buyer or another firm, that comes to their workshops to buy.

Learning for Innovating in the SMEs and MFEs sectors

The intangible factors, such as personal relations and tacit technical knowledge (the “know how” and “know who” of Lundvall’s taxonomy)²² emphasized in the description of the SMEs and MFEs production system are the main sources of change in the products and production processes. Innovation consists mainly of incremental adaptation to new materials, to new techniques and design. Therefore, it is easy to find firms working with the same technology for more than fifty years. This can be also explained by the fact that in mature sectors, technology is subject to a discontinuous process of innovation, and therefore, it is not necessary for the firm to replace its capital stocks through the intense acquisition of new machinery²³. This does not pose any problem to their capacity and the product supplied can still be sold on the local market.

Product innovation is of an incremental nature, and it depends very much upon the ability of the producer to imitate. But it is easily foreseeable that, due to the lack of good raw material and of marketing skills, such production is not sufficient to match the standards of the international markets. Although it should be recognized that a central asset for the innovation process is the stock of tacit knowledge owned by the producers and by the workers employed, the negative attitude towards external sources of information and knowledge can create situations of “lock-in.” In this

direction the presence of “*shared local environment*” in many clusters of enterprises, in which resources and information are shared and competition is replaced in many cases by co-operation, needs to be emphasized. The “absorption attitude” of the firm should thus increase if the unity of the community of producers must be maintained instead of being fragmented by process of exclusion. To make these factors available for the firms of that specific production system means to integrate social informal networks and the community of producers. Learning about each other and about each other’s activity becomes an important aspect of the process of innovation. The same applies to vocational and professional training schemes. The professional training schemes and the “infra-mural” informal system should interact with each other. The first system can supply the second providing the skills related to newer development in design and materials. Greater emphasis should be given to the importance of the “infra-mural” informal training for its role for the young unemployed. The resistance of the firms to the introduction of measures that affect their production directly, such as training schemes, social security schemes and support schemes, is due not only to their attitude, but also to the large gap existing between them and the institutions working for industrial development. Different levels of integration between local public authorities and private groups of interest should be supported in order to contribute to the cohesion and solidarity between the environment’s different elements, as well as to enhance collective values and rules. The importance of this sector for the socio-economic stability of the region and for the process of Euro-Mediterranean co-development, once acknowledged, will lead to greater efforts for further research in this sector.

Innovation activities, although hidden and difficult to measure, are routine activities for the SMEs and MFEs if we consider the special relationship that exists between the firm and its production and the customer. The capacity of the “practical man” (Hansen and Serin 1997) to adapt to new demand and to new design gives the small firms an important advantage, and shows the existence of a knowledge base that should not be neglected by industrial and innovation policies within the Euro-Mediterranean Partnership. It should also be stressed that the process of innovation, as an accompanying measure of the more general process of modernization, in order to be sustainable with the existing stock of localized knowledge needs to focus on the learning capacity of the workers and entrepreneurs. It is therefore important that, beside the solution to the obstacles which emerged during the field study, an institutional set-up reinforcing and stimulating the learning capacity according to the needs and the structure of the local production systems and markets be properly developed.

²² Similar conclusions have been reached by North and Smallbone, 2000, when analysing the innovation dynamic in British printing industries. On the different types of knowledge see Lundvall B. Å. and B. Johnson, 1994; Ernst D. and Lundvall B. Å., 1997.

²³ See also Sterlacchini 1999 on innovation in mature industries.

Conclusions and Implications for Future Research

The paper has attempted to link the analysis of a macro process, the creation of a political and economic partnership between the EU and 12 Mediterranean countries, with the dynamic at the micro level represented by the SMEs and MFEs sectors. Although the risk of remaining superficial in the analysis of each aspect of the processes occurring at the macro and micro levels, the paper has contributed to a better knowledge of the Mediterranean contemporary manufacturing system, and highlighted some important conditions to be taken into account in the future implementation of the Partnership.

The loss of fiscal earnings and the dismantling of public monopolies will continue to reduce the role of the state in the economy of MPCs, and its possibility to keep the welfare improvements that were achieved over many years. At the same time, the increasing demand for jobs and the decline of the purchasing power cannot be met only by export-oriented strategies or technological innovation. The transition from import substitution to export promotion has been even in the most successful cases very painful despite the strong intervention of the state as in the Asian countries. Furthermore, as demonstrated in the cases in Ariff and Hill (1985) export-oriented strategies can lead to specialization in production which make little contribution to indigenous technology and human capital development²⁴. On the other hand, although the infant industry argument is very appealing, the reduction of tariff on imports of capital goods, which represents an important share of total imports, can produce important technological advances if appropriate technological training measures are supported.

The upgrading of the industrial sectors, as demonstrated also by the number of measures undertaken by the single countries, is a priority issue on the agenda. But due to the structure of the sector and the varieties in the type of firms existing, the risk of creating incurable fractures, only concentrating the efforts on specific segments of the productive systems, namely medium-high and high-tech sectors and medium-sized firms, is very high²⁵. Furthermore, the importance given to the creation of special economic zones does not take into account previous experiences in other countries, as for example in Asia, showing the risk that protected zones as such serve basically the

²⁴ In a study by Ariff and Hill, 1985, on the development strategies of South East Asian countries is showed that in export promotion zones trade unions are virtually excluded, work norms are so high that workers develop physical and mental disorders, p. 49

²⁵ See also the Note of the European Union Economic and Social Committee "Le politiche di innovazione delle PMI e dell'artigianato (VI Vertice Euromed), Bruxelles 3 Agosto 2000. See also Chourou (2001) for evidences on the Industrial Modernisation Programme effects in Tunisia.

interests of large international firms investing in unskilled and labor intensive activities²⁶. Finally, an entry in the international production chain through sub-contracting can be dangerous if it aims only at cost reduction instead of at enhancing the technical capabilities and the technological confidence of the entrepreneurs, workers and apprentices.

With the progress towards the establishment of a completely free trade area, to take advantage of the new regime depends also on a set of accompanying measures, both fiscal and monetary, such as for example the exchange rate policy, tax holidays, and export incentives²⁷.

The analysis of the productive structures has shown the difficulties in considering the SMEs and MFEs as a homogenous sector to which blueprint solutions apply. Even in the policy discussion, very little reference is made to this problem, and the discussion is mainly based on the problem of formalization/regulation of the informal sector. In the field study it has emerged that these firms are not a backward, immobile and impermeable form of organization. Instead, they are receptive to changes, both on the demand and supply sides, but lack a dynamic macro-economic setting enabling to stimulate production as well as a learning capacity enabling to mobilize a process of innovation that is sustainable with the stock of competencies possessed.

It is impossible to imagine that these entrepreneurs can be transformed, in a span of time like the one envisaged for the establishment of the free trade area, into the multi-skilled and dynamic craftsmen/managers of Piore and Sabel's books²⁸. The increase of the human value added must be on the agenda, but cannot be separated from the contextual factors and from the macro-economic setting. In this direction, a better knowledge of the technological and technical capabilities possessed by the entrepreneurs and the workers, the types of innovation processes that take place, the various elements that characterize the local environment, the socio-economic context and the markets represents a priority for both theoretical and policy-oriented research.

To conclude, due to the fact that in the region there is:

- An increasing demand from a growing population with a pattern of consumption different from those supplied by global firms; and,

²⁶ Ariff and Hill, 1985, p. 48.

²⁷ For example, through a strong devaluation Tunisia during the mid-1980s managed to export in the EU labour intensive goods, such as textile and garments, in which for example Italy and Spain enjoy a strong competitive advantage.

²⁸ Similar conclusions can be found in McGrath S. and K. King.

- A manufacturing sector strongly tied to the local markets and local commodity chains;

The SMEs and MFEs sectors in the Mediterranean countries can contribute to the establishment of a more balanced Euro-Mediterranean market if the co-evolution and co-development of the production system is able to move production toward higher quality and new forms of production and consumption. This can be done by exploiting the current intra-industrial complementarities and creating new ones. In this direction, necessary to complement the other objectives of the EMP, a North-South inter-firms cooperation, able to avoid the bottlenecks at the origin of the losses, because of production inefficiencies or because of the monopolistic position of other enterprises or institutions, is desired.

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Table 1: Towards A New Taxonomy of Manufacturing Firms in the MPCs

Type	Micro	Small	Medium
Artisan-artistic	One-few workers Not registered Labor intensive Low division of labor Local customers Flexible form of payments Both workers paid by piece produced or wagers	About 5-10 workers Registered Labor intensive High division of labor Local customers and other firms More regulated forms of payments Wagers	10-50 workers Registered Labor intensive High division of labor Local customers and other firms More regulated forms of payments Wagers
Subcontractors	Less than 5 workers Not registered Labor intensive High division of labor Local or international customers Flexible form of payments Workers paid by piece produced	5-10 workers Registered Good ratio capital/labor High division of Labor International customers Formal management Workers paid by piece produced	Up to 50 workers Registered Good ratio capital/labor High division of Labor International customers Formal management Workers paid by piece produced
Specialized in niche products	Less than 5 workers Not registered Labor intensive and/or specialized technology High division of labor Local and national customers Unregulated form of payments Specialized workers	5 to 10 workers Registered Labor intensive and/or specialized technology High division of labor Local, National and international customers Regulated forms of payments Specialized workers	Up to 50 workers Registered Capital intensive High division of labor National and international customers Regulated forms of payments Highly skilled workers
Internationalized	Less than 5 workers Family oriented management Not registered Low-medium use of technology Little division of labor International customers or local intermediaries Unregulated forms of payments Specialized workers	Up to 10 workers Family oriented management (with external managers) Registered Capital intensive High division of labor National and international customers Regulated forms of payments Highly specialized workers Quality control (ISO)	Up to 50 workers Non family management Registered Capital intensive High division of labor International customers Regulated forms of payments Highly specialized workers Quality control (ISO)

Source: Author's elaboration