Chapter 5
Private Sector Development

Richard Woodward and Mehdi Safavi

5.1 Introduction

This chapter deals with the larger issues of private sector development in the SEMC, and starts with an overview of relevant developments in the region, including a look at the business climate. It then reviews the recent record with respect to FDI before turning to an examination of a number of cultural factors that may influence the development of the private sector, and concludes with a discussion of possible future developments.[1]

Although in all SEMC, governments have passed rules and regulations to ease and accelerate private sector development in 2000s, there have been differences with regard to the pace of change. Additionally, popular uprisings that started in the area in December 2010 in Tunisia and subsequently affected Egypt, Libya, and Syria have changed the countries' priorities, which have shifted to establishing a new political order or stabilizing the current one, with economic reform having to take a back seat at least in a short term horizon. As Table 5.1 demonstrates, the legacy of past policies, combined with the meanderings of more recent ones, has left the SEMC with quite a wide range of private sector shares in GDP.

Among them, Israel has not only the most business-friendly policy environment but also the most developed (in terms of private sector GDP per capita) private sector, accounting for almost 80 % of employment, while the least developed one is in Palestine where, although the share of the private sector is above 60 % of GDP,

[1] In preparing this chapter the Authors have had to rely on ten country background reports (Hatem 2011; IMRI 2011a, b, c; ITCEQ 2011; MAS 2011a, b, c, d, e; hereinafter referred to as 'country reports') and the accuracy of the findings contained therein. Both this chapter and country background reports consist of desk research.

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R. Ayadi et al. (eds.), *Economic and Social Development of the Southern and Eastern Mediterranean Countries*, DOI 10.1007/978-3-319-11122-3_5

Table 5.1 Private sector share of GDP, % in SEMC (From country reports)

Country	Share of GDP
Algeria	35[a]
Egypt	na
Israel	74
Jordan	85
Lebanon	79
Libya	na
Morocco	88
Palestine	62
Syria	59
Tunisia	na
Turkey	na

[a]Note: Share of industrial production

that share has actually been falling since 2000. (Moreover, the fragility and dependency of its economy on outside forces – both the Israeli occupation and foreign aid – raise doubts about how meaningful the discussion about that share is). Israel's private sector has attained such a high level of development despite the fact that, like several other countries in the region (including Algeria, Egypt, Libya and Syria), the country followed a socialist, state-led development path for several decades.

Indeed, countries in which private sector development is lagging, such as Algeria, Libya and Syria, continue to follow this course. In the case of Algeria and Libya, this is due largely to the extreme degree in which the state-owned gas and oil industry dominates these countries' economies, and although all three of them have introduced certain reform and liberalization measures, they remain very modest in scope. The Syrian government made some market-friendly reforms in the 2000s, and although the country's business environment remained a very unfriendly one for private sector development, the private sector share in the economy showed impressive growth in that period. The environment for private sector development in Algeria and Libya is not at all favorable. In Algeria private sector development has lagged behind that observed in almost all the SEMC, and in Libya, the other major oil country in the region, some degree of liberalization (accompanied by a privatization program of limited extent) only began in 2003. However, just as in the case of Algeria, the dominance of the state-owned oil sector ensures that the private sector share of the economy remains small.

Developments have been more positive in Tunisia, Lebanon, and Turkey. Tunisia experienced rapid economic growth in 1990s and 2000s; however, the private sector investment has slowed since the 1990s, with development in that period being largely state-led. In Morocco, while the post-colonial period beginning in 1956 saw the creation of a large number of state-owned corporations in many sectors of the economy, since the introduction in 1990 of a policy of economic liberalization and privatization, the public sector share of GDP has been reduced significantly. The private sector dominates the economy of historically conflict-torn

Table 5.2 The ease of doing business ranking for SEMC, 2009 and 2013 (From World Bank 2010, 2013)

Countries	2009	2013
Israel	30	35
Tunisia	58	51
Turkey	60	69
Egypt	99	128
Jordan	107	119
Lebanon	109	111
Morocco	114	87
Palestine	133	138
Algeria	136	153
Syria	144	165
Libya	na	187

Lebanon, but since the mid-2000s subsidies to state-owned entities have been increasing rather than decreasing. Policies implemented in Turkey since 1985 have promoted the privatization of public enterprises, with a sharp increase in the number of privatizations since 2005 – the date of the beginning of Turkey's negotiations on accession to the EU, which necessitates a withdrawal of the Turkish state, in full or in part, from economic activity and also substantially increased investor interest in the country. Summing up, for several countries in the region, the private sector remains rather underdeveloped.

According to the 2011 WB DB report (World Bank 2010), the SEMC are very diverse with respect to the business climate (see Table 5.2). Israel is by far the best-performing country in the region in this respect and ranks 35th in the world. In particular, the Israeli economy excels in the categories of 'getting credit' and 'protecting investors', where it placed 13th and 6th respectively. Tunisia and Turkey are in second and third place in the region, ranking 51st and 69th in the world, respectively. The poorest performing countries are Palestine, Algeria, Syria, and Libya. Table 5.2 also shows how the situation in the SEMC has evolved over the course of 4 years. In eight of the eleven countries we can see a relative decline, which has been particularly dramatic in Egypt, Algeria, Syria, and Jordan. Surprisingly, despite being one of the countries affected by the Arab Spring, the situation has improved in Tunisia, and the most dramatic improvement has come in Morocco.

5.2 Foreign Direct Investment

Recent years have seen a great deal of effort to attract FDI in the SEMC. Figure 5.1 shows the total net inflow of declared FDI into the SEMC along with the number of announced projects between 2003 and 2010, based on data from the most recent ANIMA-MIPO report (unfortunately growing somewhat dated). The global economic crisis negatively affected FDI flows to the region in 2009, and the Arab

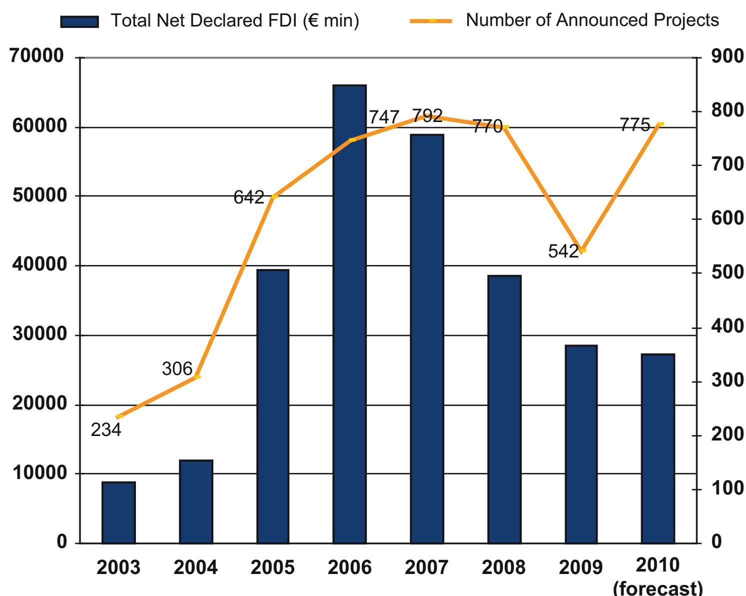

Fig. 5.1 Inward FDI into SEMC (From ANIMA-MIPO 2010)

Table 5.3 SEMC FDI stocks, 2011 (From CIA World Factbook 2012)

Country	FDI stock, USD bn	Country rank in the world	FDI stock per capita (USD)
Turkey	99.0	36	1307.7
Israel	82.8	43	10,927.8
Egypt	75.7	45	896.1
Morocco	45.0	56	1389.7
Tunisia	32.5	60	3084.9
Algeria	24.5	65	691.6
Jordan	22.6	66	3709.2
Libya	19.6	69	2994.4

Spring that followed in 2011 also did not help matters. Although the region recovered in terms of the number of FDI projects at the end of the decade, it had not yet recuperated in terms of the amounts invested (while in 2010 43 % growth in the number of announced projects was forecasted, the amount was forecasted to decline by 8 % in comparison with 2009). Table 5.3 takes us beyond the year-by-year perspective of FDI inflows, showing accumulated FDI stocks (according to CIA estimates) as of 2011 (data were not available for all SEMC; Lebanon, Syria and Palestine are missing). The table shows that countries with the most diversified economies (such as Turkey and Israel) tend to attract more investment than those whose economies are more concentrated in a single sector, even if that sector is very attractive to investor (as in the case of hydrocarbons).

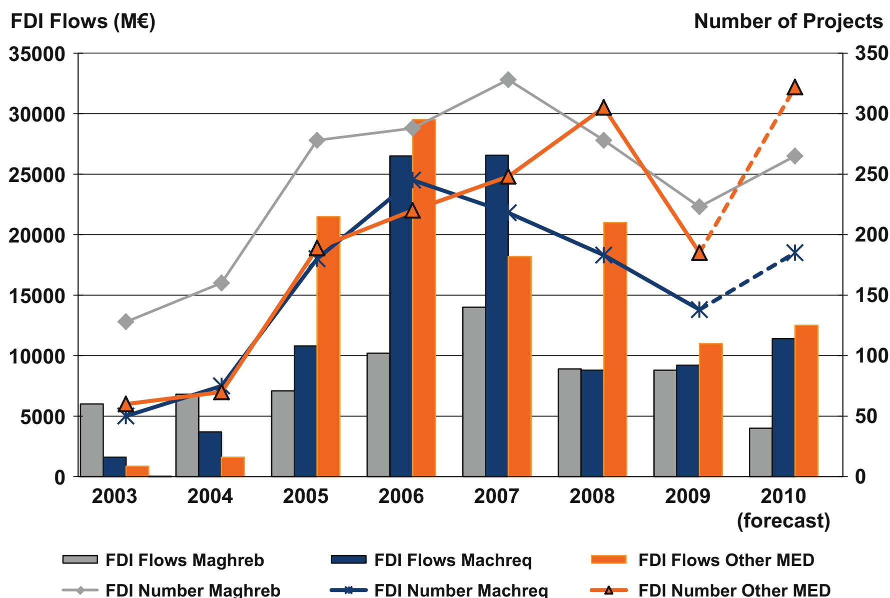

Fig. 5.2 FDI into three different regions of SEMC (From ANIMA-MIPO 2010) (Note: Other MED means Turkey and Israel)

Comparison among the countries in different sub-regions can give us a better understanding of FDI inflows into the area. The Maghreb, consisting of five North African countries (Algeria, Libya, Morocco, Mauritania and Tunisia), is still awaiting recovery from the worldwide credit crunch, while the Machreq[2] and other SEMC (Israel and Turkey) have already recovered and show signs of growth (Fig. 5.2).[3]

Figure 5.3 shows that foreign investors are counting more and more on partnerships with domestic businesses. For example, in the three quarters of 2010, 362 partnership projects (local representatives, franchises, joint production and R&D projects, etc.) were announced, which represented 59 % growth over 303 for the whole of 2009.

While we have seen that overall FDI in the Maghreb has been slower to revive than elsewhere, Table 5.4 shows the strong appetite of European businesses for

[2] Sometimes spelled Mashregh, Machreq, or Machreck, the term refers to a large area in the Middle East bounded by the Mediterranean Sea and Iran. It is the companion term to Maghreb. Although there is no clear definition, it commonly includes Egypt, Sudan, Jordan, Lebanon, Syria, Palestine, Iraq, and the countries of the Arabian Peninsula.

[3] The data used in Figs. 5.2 and 5.3 and Table 5.4 come from the ANIMA-MIPO (Mediterranean Investment & Partnership) Observatory, which, since 2003, has monitored more than 5,000 announcements of FDI and partnerships. The latter are defined by ANIMA-MIPO as projects where a foreign corporation enters a domestic market either through an identified partner or by opening local representation (see ANIMA-MIPO 2011).

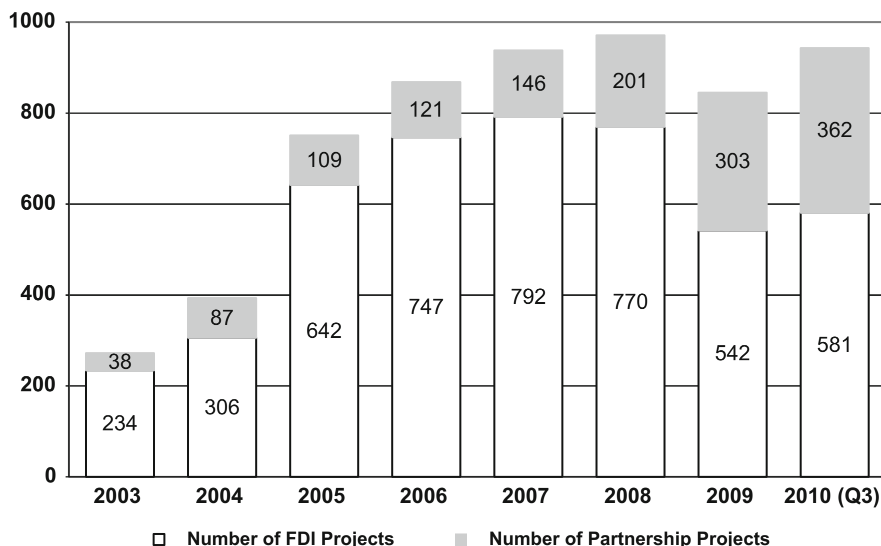

Fig. 5.3 Inward FDI into three different sub-regions of SEMC (From ANIMA-MIPO 2010)

Table 5.4 Total number of detected partnership projects, per region of origin and region of destination (From ANIMA-MIPO 2010)

Origin/target	Machreq	Maghreb	Other SEMC	% of total
Europe	142	392	171	52
Gulf countries	72	40	9	9
SEMC	31	31	16	6
Other countries	56	62	26	11
US and Canada	90	101	128	23
% of total	29	46	26	100

partnerships with Maghreb-based counterparts in terms of the number of detected partnership projects.

As we see in Fig. 5.4, in the Maghreb sub-region, Tunisia and Morocco both show recoveries after initial downturns due to the global crisis in terms of the number of FDI projects, while Algeria continued to show a steady decline in 2012. Mauritania has had some particularly spectacular years, in the mid-2000s and again more recently.

Finally, in Table 5.5 we present data on FDI as a % of GDP for all SEMC since 1997 (inward FDI into the region was very low before the second half of the 1990s – see Chap. 4). The table also shows that the region as a whole was affected by the global downturn toward the end of the 2000s, and that the Arab Spring had a particularly strong effect on Egypt and Tunisia (data are not available for Syria and Libya, the other two countries affected). For two countries, Algeria and Syria,

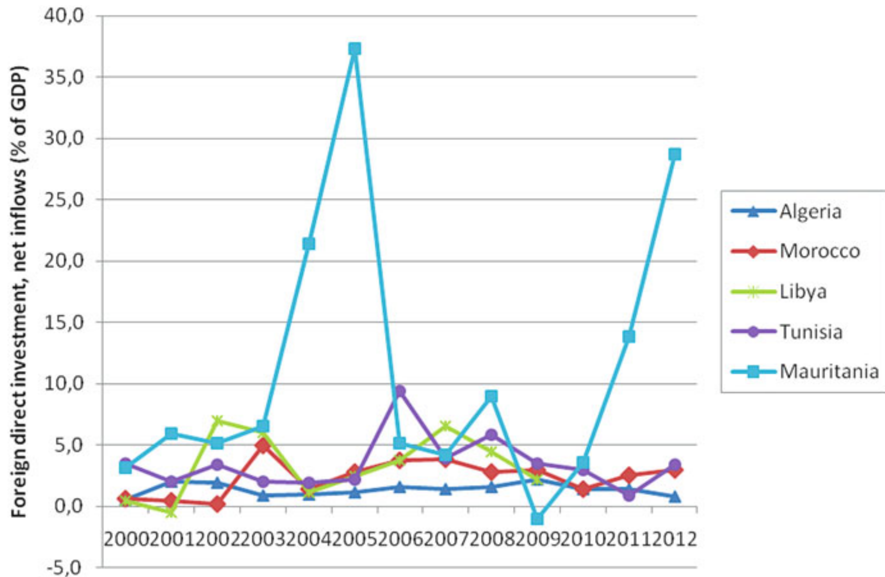

Fig. 5.4 Net Inflow of FDI for the Maghreb Countries, % of GDP (From WB WDI, 2000–2012)

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

5.3 The Informal Sector

De Soto (1989, 2000) has shown how the barriers bureaucrats place in the way of recognition of the property rights of entrepreneurs (especially poor and middle-class ones) in developing countries force them into the informal sector and impede the growth of firms in that sector. He has also argued that the formalization of the property rights of informals and 'squatters' could lead to the unleashing of enormous potential for growth and entrepreneurship. All too often, however, governments take exactly the opposite route; instead of recognizing squatters' rights, they take away the land and property that tribal peoples have had for hundreds of years (see, for example, Roy 2002, 2010). For these reasons, it is worth briefly considering the role of informal entrepreneurship in SEMC.

Table 5.5 Inward FDI flows, annual, 1997–2012, % of GDP (From UNCTADstat, http://unctadstat.unctad.org)

Country	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Algeria	0.54	1.26	0.60	0.51	2.01	1.87	0.93	1.03	1.05	1.53	1.24	1.52	1.96	1.43	2.57	1.48
Egypt	1.04	1.19	1.11	1.24	0.54	0.72	0.31	2.62	5.47	8.95	8.76	5.76	3.57	2.98	−0.48	2.80
Israel	1.85	1.79	3.78	5.58	1.44	1.40	2.79	2.32	3.59	10.49	5.27	5.38	2.29	2.39	11.08	10.41
Jordan	4.98	3.92	1.92	10.79	3.05	2.49	5.36	8.21	15.76	24.21	15.42	12.46	9.68	6.19	1.47	1.40
Lebanon	11.54	6.71	5.12	5.78	8.50	7.14	14.44	11.57	15.19	13.96	13.47	14.48	13.91	12.77	3.49	3.79
Libya	−0.20	−0.50	−0.38	0.37	−0.33	0.66	0.55	1.07	2.28	3.65	7.48	5.05	4.55	5.35	na	na
Morocco	3.23	1.00	3.43	1.14	7.44	1.19	4.65	1.57	2.78	3.73	3.73	2.80	2.15	1.43	2.57	2.83
Palestine	4.40	5.53	4.51	1.48	0.49	0.27	0.47	1.16	1.00	0.40	0.61	0.87	4.52	na	na	na
Syria	0.49	0.47	1.48	1.37	0.52	0.53	0.77	1.30	2.05	2.02	3.09	2.98	2.66	2.32	na	na
Tunisia	1.93	3.37	1.77	4.01	2.44	3.90	2.34	2.26	2.69	10.64	4.54	6.74	4.27	3.76	1.92	0.35
Turkey	0.32	0.35	0.31	0.37	1.71	0.47	0.56	0.71	2.08	3.80	3.41	2.67	1.37	1.21	12.42	0.72

Information on the individual countries indicates that shares of the informal sector in GDP are generally high in the region, ranging between 20 % and 40 % for the countries on which we have data., Lebanese statistics show a share of 25.3 % (Lebanon Central Administration of Statistics 2007). The situation in Egypt appears to be much more serious. According to Hatem (2011):

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

In Syria, the informal sector is growing and is represents about 30 % of employment and 40 % of GDP. It employed about 48 % of the rural poor and 31 % of the urban poor as of 2003–2004 (Bureau for Gender Equality 2010). While some efforts have been made in countries such as Lebanon and Morocco to improve the situation by making it easier to operate small businesses and microenterprises, other countries have adopted a more repressive approach. An example of this can be found in the case of Algeria, which has attempted to combat the growth of informal activity by restrictive regulations on the use of cash in transactions.

5.4 Cultural Factors That May Influence Private Sector Development

In this section we will consider the role of two cultural factors that may influence private sector development: entrepreneurship and the role of Islamic finance and Islamic rules on interest.

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

The entrepreneurship literature often makes a distinction between necessity-based entrepreneurship, in which individuals are self-employed due to a lack of employment opportunities, and opportunity-based entrepreneurship; i.e., the entrepreneurship described in the work of Schumpeter (1934) and Kirzner (1997), in which a firm is founded as a result of a conscious choice to take advantage of a perceived business opportunity. Typically, it is the latter type that is responsible for employment growth and innovation, whereas the former is oriented exclusively to survival. We expect to see relatively higher shares of necessity-based entrepreneurship in lower-income countries. What is the situation in the SEMC?

Table 5.6 presents the situation in all the countries for which GEM data exist for at least one of the years 2008–2010. In the case of Egypt there is an inexplicable and huge shift from opportunity-based to necessity-based entrepreneurship in the space

Table 5.6 Necessity- and opportunity-based entrepreneurship, % of adults in the economy engaged in relevant activity (From GEM Database)

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

of just 2 years (such a jump raises questions about the measurement of the phenomenon; however, fortunately we do not observe such discontinuities for the other four countries for which there are data for two or more years – Israel, Palestine, Tunisia, and Turkey). In Palestine, Jordan, Syria, and Turkey, necessity- and opportunity-based entrepreneurship seem to be roughly balanced. In all other countries (i.e., Algeria, Israel, Lebanon, Morocco, and Tunisia), opportunity-based entrepreneurship clearly dominates necessity-based entrepreneurship.

Islam and finance. Finally, we turn to one factor that might be hypothesized to affect the region's private sector development in the future. Do regulations compliant with Islamic law (shariah), which prohibits the taking of interest, impede the development of private sector capital? In most of the countries (excluding Israel for obvious reasons), shariah-compliant investment and business operate alongside conventional banking. However, solely Islamic banks are increasingly using shariah-compliant financial instrument in business.

Although in some countries Islamic banks are refused licenses on account of perceived political affiliation, in other countries like Jordan, Tunisia, and Sudan, the general population has been receptive to Islamic finance as an alternative means of accessing capital and growing businesses (Ilias 2010). Although there have been clashes in recent years between Islamic fundamentalist groups and government loyalists in which protesters demand shariah law rule in Jordan, the predominant business climate is open to a mix of conventional and shariah-compliant businesses (International Business Times 2011).

Another example can be seen in Egypt, where, after the 2011 uprising, Islamic fundamentalist groups have called for implementing shariah rules in Egypt, while the military authorities resist this. As for Lebanon, the government has started a process of reforming the 2004 shariah-compliant banking law to boost shariah-compliant banks' ability to compete with conventional banks (El Baltaji and Hall 2010). Islamic banking represents less than 1 % of USD251 mn of the total assets of banks in Lebanon. Nevertheless, the central bank of Lebanon is attempting to

access a perceived large demand for Islamic banking that, according to the central bank's first vice governor, can be divided into two groups:

> customers who for religious reasons want to deal with a bank that has an Islamic dimension and customers who benefit from using such a system. (Halawi 2010, p. 3)

In Syria, the establishment of Islamic banks comes as an attempt to diversify the investment sector, and to conform to Shariah laws. In a nationwide survey conducted by Bankakademie International, it was reported that some 34 % of Syrian companies that had not requested a bank loan refused to do so for religious reasons. The size of the Islamic banking market has been steadily increasing year after year. It is estimated that the assets of Islamic banks in Syria were worth over USD265 bn in 2006, with an annual growth rate of 20 %, providing a boost to the Syrian economy (CGAP 2008). In Morocco, to meet hitherto marginal needs, the State has put in place alternative products (with an Islamic reference framework) which banks have recently started using (IMRI 2011a).

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

5.5 Conclusions

Table 5.7 summarizes some of the key variables for the SEMC.

Looking ahead to what the next two decades may have in store for the SEMC in the area of private sector development, we can consider a number of possible scenarios, which we will now characterize briefly. The decade of the 2000s, as we have seen, brought rapid development in terms of GDP per capita even to the poorer countries of the region. However, the recent political instability in the region, coupled with its general resistance to the democratization trends observed in Latin America and the post-Communist countries of CEE (Woodward et al. 2012), makes the future exceptionally uncertain.

One of the possible political scenarios emerging as a result of the upheaval currently underway in many SEMC is a turn to a more Islamist policy. However, there is no evidence that this would result in policies harmful to the development of the private sector. On the contrary, the experience of Turkey under the relatively moderate Islamist Justice and Development Party (Turkish acronym: AKP) shows that rule by such a party can be pro-developmental in economic terms. The AKP model, in which institutional reform has been driven by the EU accession process, is currently the one that Islamist movements such as the Muslim Brotherhood in Egypt and Hamas in Palestine seek to emulate (Sayigh 2010; Daly 2011; Yezdani 2011). We therefore see no reason to view an Islamist turn in politics as necessarily constituting a threat to private sector development (providing such a turn takes the

Table 5.7 Summary of key variables for private sector development in SEMC (From background reports for private sector share of GDP and employment and share of informal sector in employment, GEM Database for necessity-based entrepreneurship, World Bank 2013 for WB DB rank, WB WDI database for domestic credit to private sector)

Country	Private sector share of GDP (%)	Ease of Doing Business rank (2010)	Share of informal sector in employment	Necessity-based entrepreneurship as share of total entrepreneurial activity
Algeria	35[a]	136	22	18
Egypt	na	94	40	53
Israel	74	29	na	24
Jordan	85	111	na	28
Lebanon	79	113	25	18
Libya	na	na	na	na
Morocco	88	114	37	25
Palestine	62	135	na	32
Syria	59	144	30	37
Tunisia	na	55	na	24
Turkey	na	65	40	37

[a]Share of industrial production

relatively moderate form of Egypt's Muslim Brotherhood rather than the more extreme form of the Salafi/Wahhabi or similar movements), and will ignore this factor in the ensuing discussion of possible scenarios, while noting the importance of EU engagement (as in the case of the Turkish developments).

Rapid development scenario. If peaceful democratic development takes place, with a decrease in corruption and the regulatory burden, then private sector development could take off in an explosive way. This would be signaled by significant increases in the Ease of Doing Business scores, significant progress in privatizing remaining state-owned enterprises, and a fall in the share of the informal sector in GDP, and could entail high rates of entry for new firms, dramatically improved performance of the banking sector in terms of lending to private firms, and diversification of the relevant countries' economies and exports. It would involve dramatically increased FDI, and presumably greater integration with the EU and other world markets as well. It is important to remember, however, that rapid GDP development and rapid private sector development are by no means synonymous (particularly in the case of economies based on oil and natural gas reserves that remain state-owned).

Inertial scenario. Under this scenario, the Ease of Doing Business scores would remain essentially unchanged, further progress in privatization would be stalled, and FDI flows would also remain fairly stable. Such an outcome could be driven by economic policy inertia, which might result from the inability to generate a consensus around a clear political direction in the case of countries which have recently undergone revolutionary uprisings.

Regression scenario. Regression appears to be relatively unlikely for the region as a whole, though we have seen areas of regression for individual countries in

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

Acknowledgments The Authors would like to thank Luc De Wulf, Rym Ayadi and Marek Dabrowski for their extremely helpful comments. All the usual disclaimers apply.

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