

# **Entrepreneurship in the Arab World: A Pathway to Inclusive Prosperity**

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## **Abstract:**

Entrepreneurship is a pivotal force driving prosperity and economic growth, with entrepreneurs serving as catalysts for job creation, innovation, and overall economic development. The Arab region, deeply rooted in entrepreneurial history since the early days of Islam, faces contemporary challenges hindering the full realization of its entrepreneurial potential. Government-controlled economies, limited access to capital, widespread corruption, and bureaucratic hurdles present formidable obstacles to aspiring entrepreneurs. However, the region, characterized by a young and increasingly educated population, possesses substantial untapped human capital that can be harnessed through entrepreneurial endeavors. Overcoming challenges such as corruption, bureaucracy, regulatory and socio-cultural constraints, and limited access to capital is crucial for the region to unlock its entrepreneurial potential. By promoting entrepreneurship and implementing targeted policy reforms, Arab nations can foster economic diversification, job creation, and innovation, paving the way for sustainable economic growth and enhanced global competitiveness.

## **Introduction:**

Entrepreneurship is known to be a key driver of prosperity and economic development. Entrepreneurs play a vital role in the economy by creating new jobs, stimulating innovation, and driving economic growth. What sets entrepreneurs apart is their willingness to embrace risks in pursuit of profit through new approaches to delivering goods or services.

In the Arab region, a rich history of entrepreneurship dates back to the early days of Islam, when entrepreneurs played instrumental roles in developing new trade routes and markets. Today, they continue to play a vital role in the region's economy but still face a number of challenges. Many Arab countries have government-controlled economies, which makes it difficult for entrepreneurs to start and grow businesses. Additionally, there is often a lack of access to capital, widespread corruption, favoritism, and bureaucracy, which makes it difficult for entrepreneurs to get their businesses off the ground.

The Arab region, endowed with a young and increasingly educated population, possesses untapped human capital that can be harnessed through entrepreneurship. Extensive research underscores the correlation between heightened entrepreneurial activity and elevated growth rates, establishing robust foundations for substantial job creation—a pivotal avenue to grow the global middle class.<sup>1</sup> The strategic promotion of entrepreneurship in the Arab world emerges as a catalyst for economic diversification, job creation, and innovation.

Effectively addressing the challenges necessitates a multifaceted approach involving the removal of regulatory barriers, the facilitation of enhanced access to finance, a shift in cultural perceptions, and the proactive promotion of skill development. Through targeted policy reforms, Arab nations have the potential to unlock the latent capabilities of their youth, setting the stage for sustained economic growth and heightened global competitiveness.

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<sup>1</sup> The Arab Competitiveness Report 2018 <https://www.weforum.org/publications/arab-world-competitiveness-report-2018/>

## **Crony Capitalism and Entrepreneurial Stagnation: A Closer Look at Arab Economies**

In the last two decades, the Arab region has experienced below-average economic performance compared to low and middle-income countries. From 2000 to 2019, the annual growth rate of gross domestic product per capita was 1.7 percent on average, significantly lower than the growth rates observed in the East Asia and Pacific and South Asia regions, which were approximately twice as high. Consequently, the Arab region has fallen behind, and the income disparities with other developing regions have widened.

Arab economies, despite their considerable wealth, often face challenges rooted in crony capitalism. Close ties between government officials and a select group of business elites result in preferential treatment, skewing the economic playing field. Crony capitalism is a major problem in many Arab economies. This system can lead to entrepreneurial stagnation because it creates an uneven playing field for businesses and stifles innovation.

In the face of heightened policy emphasis on fostering entrepreneurship and small to medium-sized enterprises (SMEs), the Arab region grapples with a stark reality: domestic policies continuously prioritize large corporations. This preference is reflected in the disproportionate representation of large enterprises, constituting merely 10 to 20 percent of all firms while commanding a staggering 60 to 80 percent of private sector employment across the region.<sup>2</sup> The prevalence of crony capitalism in various Arab nations exacerbates these challenges<sup>3</sup>, as numerous well-established firms exploit political connections to secure advantages such as access to affordable credit, favorable tax conditions, and regulatory measures shielding their market dominance via licenses or quotas. The result is an environment where certain well-connected entities establish monopoly or oligopoly control, suppressing competition, hindering overall economic growth, and impeding productivity. Entrepreneurs attempting to navigate this landscape encounter significant hurdles as politically entrenched larger firms actively impede their market entry or expansion, contributing to the concentration of wealth among a select few and hampering the socio-economic progress of the middle class while eroding income equality.<sup>4</sup>

Furthermore, access to finance remains challenging for entrepreneurs and SMEs across the region, severely impeding their competitiveness. SMEs face obstacles in procurement processes, like large upfront deposits needed to participate in bids for government contracts. A World Bank report shows that SME financing is lacking in the Arab region. Specifically, a meager 8 percent

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<sup>2</sup> Sahar Nasr and Douglas Pearce, *SMEs for Job Creation in the Arab World: SME Access to Financial Services* (Washington, DC: World Bank, 2012)

<sup>3</sup> Friends in High Places: How Cronyism Undermines Growth, Jobs, and Competition, *The Economist*, October 9, 2014

<sup>4</sup> Shahid Yusuf, "Middle East Transitions: The Long, Hard Road," *International Monetary Fund (IMF), Working Paper 14/35*, 2014, 7-8

of bank loans in the Middle East and North Africa (MENA) region are directed towards SMEs, with a notable disparity ranging from 2 percent in the Gulf States to a relatively higher 13 percent in the rest of the region—with Morocco, Lebanon, and Tunisia as the top performers in this regard.<sup>5</sup> This stark reality underscores a stark contrast with middle-income countries, where 16 percent of bank loans support SMEs, and even more so with high-income countries, where 26 percent of bank loans are allocated to SMEs.<sup>6</sup>

Despite estimates indicating a substantial financial requirement of \$180 billion to support the scaling up of SMEs in the MENA region<sup>7</sup>, Arab banks predominantly allocate their resources to the public sector and large private firms. This trend collectively sidelines SMEs and entrepreneurs, creating a financing gap that hampers their growth potential.<sup>8</sup> Notably, a study in Egypt revealed that many entrepreneurs seek capital from friends and family rather than relying on formal banking or microcredit systems, showcasing the limited accessibility of financial support through traditional channels.<sup>9</sup>

Moreover, Entrepreneurs in the region encounter formidable challenges when it comes to expanding and scaling up their ventures. A comprehensive survey of nearly 1000 MENA entrepreneurs unveiled a myriad of obstacles in their path to growth. These challenges encompassed difficulties in marketing their products and services, securing adequate funding, recruiting the right talent, and establishing partnerships for expansion into new countries and markets.<sup>10</sup>

Finally, many Arab countries fall short in essential measures related to enforcing contracts, dealing with construction permits, registering property, and facilitating cross-border trade.<sup>11</sup> The inadequacies in these areas contribute to a challenging business environment in the region. On average, MENA entrepreneurs face formidable hurdles to open a small business; it will cost them approximately 26 percent of their countries' income per capita, compared to a mere 3 percent for entrepreneurs in OECD countries.<sup>12</sup>

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<sup>5</sup> Roberto Rocha, *Financial Access and Stability: A Road Map for the Middle East and North Africa*, with Zsofia Arvai and Subika Farazi (Washington, DC: World Bank, 2011), 104

<sup>6</sup> *Ibid.*, 105.

<sup>7</sup> Qamar Saleem, "Overcoming Constraints to SME Development in MENA Countries and Enhancing Access to Finance," World Bank, 2013,

<sup>8</sup> Rocha, *Financial Access and Stability*, 168-70

<sup>9</sup> Adel Abdel Ghafar, "Educated but Unemployed: The Challenge Facing Egypt's Youth," Brookings Doha Center, Policy Briefing, July 2016,

<sup>10</sup> Jamil Wyne, "The Next Step: Breaking Barriers to Scale for MENA's Entrepreneurs," Wamda Research Lab, March 2014

<sup>11</sup> "Business Reforms Pick Up in Middle East and North Africa, Despite Conflict, Says Doing Business Report," World Bank, October 27, 2015

<sup>12</sup> *Business Reforms Pick Up.*

These disparities underscore the pressing need for substantial improvements in regulatory frameworks and administrative processes to reduce barriers and foster a more conducive environment for entrepreneurship and economic growth in the Arab world.

## **A Stalled Economy: The Price of Failing to Foster Entrepreneurship in the Arab World**

The Arab uprisings of 2011 brought to light the deep-rooted economic and social challenges that the region faces, including high unemployment rates, particularly among youth. Similar issues resurfaced in 2018 protests across multiple Arab countries, driven by frustration with corruption, economic inequality, high unemployment rates, and lack of political freedoms. These protests, known as the "Arab Spring 2.0" or "Arab Awakening 2.0," showed that many of the underlying issues that caused the 2011 Arab Spring remain unresolved in many countries in the Arab region, and only restrictions imposed by the pandemic ended this new uprising.

Over the last three decades, the Arab States have consistently grappled with one of the world's highest unemployment rates, a trend that has intensified over the past decade. Presently, the unemployment rate among individuals aged 15-24 stands at an alarming 23%, surpassing the global average of 13.7%.<sup>13</sup> Furthermore, the region exhibits the lowest female labor force participation rate, clocking in at 19.5%, and the highest youth unemployment rate at 27.9%.<sup>14</sup> Troublingly, these unemployment and labor force participation statistics are compounded by elevated levels of underemployment, as many youth are only employed because they have accepted jobs below their qualifications to earn money.<sup>15</sup>

Furthermore, the private sector contribution to the national output in the Arab world is relatively small compared to other regions in the rest of the world.<sup>16</sup> Over the last several decades, economic development in most Arab countries has been shaped by public expenditures, giving the public sector substantial leverage over economic growth and job creation. Despite an increased societal recognition of the importance of entrepreneurs and SMEs as viable job generators, the public sector remains the largest employer in Arab states.

Historically, the public sector has served as a primary absorber of surplus labor, particularly among the growing ranks of university graduates. This trend persists, constituting 60-80% of total

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<sup>13</sup> Paving the Path to Successful Youth Entrepreneurship in the Arab States with Behavioural Science, YouthPower2, September 17, 2021

<sup>14</sup> Informality and Inclusive Growth in the Middle East and North Africa, World Bank Group, 28 JUL 2023

<sup>15</sup> Underemployment in the MENA Region: Young People in MENA Are in Need of Good Jobs," December 2013

<sup>16</sup> Contribution of Diaspora to Entrepreneurship in the Arab World, European Conference on Innovation and Entrepreneurship, Reading, (Sep 2020). DOI:10.34190/EIE.20.227

formal employment in nations like the Gulf states, Egypt, Iraq, Jordan, and Tunisia.<sup>17</sup> However, this heavy reliance on public sector employment poses a significant challenge. Public finances across the Arab world are under increasing strain<sup>18</sup>, and the expanding public sectors have hindered private sector job opportunities and fostered unproductive work cultures and practices. In numerous Arab countries, individuals often prioritize or patiently await the promised higher wages, benefits, and job security associated with public sector positions rather than actively seeking or accepting opportunities within the private sector.

Given the prevailing circumstances, the policy focus has shifted towards fostering entrepreneurship as a strategic approach to generating private-sector employment in the face of elevated unemployment rates. Entrepreneurship emerges as a viable solution to confront the challenge of unemployment. A comprehensive study spanning 23 OECD countries from 1974 to 2002 revealed a noteworthy correlation: for each 1 percentage point increase in self-employment (a typical measure of entrepreneurship), there was a subsequent reduction of 1.12 percentage points in unemployment eight years later.<sup>19</sup> Moreover, recent trends indicate a growing inclination among youth in the Arab region to pursue self-employment or work within family enterprises, a shift observed since 2019 and potentially influenced by the repercussions of the COVID-19 pandemic.<sup>20</sup>

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<sup>17</sup> Roberta Gatti et al., *Jobs for Shared Prosperity: Time for Action in the Middle East and North Africa* (Washington, DC: World Bank, 2013), 1, <http://dx.doi.org/10.1596/978-0-8213-9719-0>

<sup>18</sup> Lida Bteddini, "Governance and Public Sector Employment in the Middle East and North Africa," World Bank (blog), September 5, 2012

<sup>19</sup> Does Entrepreneurship reduce Unemployment? Tinbergen Institute Discussion, Econstor, Working Paper, Paper, No. 01-074/3

<sup>20</sup> *Global Employment Trends for Youth 2022*, International Labor Organization

## **Policies to Promote Entrepreneurship and Economic Growth in the Arab Region**

The need for inclusive economic growth and job creation in the Arab world has become even more urgent in recent years. The COVID-19 pandemic has had a devastating impact on the region's economies, and the war in Ukraine has further exacerbated the challenges. The global economic slowdown has further heightened these concerns. As a result, Arab governments are facing mounting pressure to find ways to create jobs and improve economic opportunities for their citizens. Thus, the imperative to unlock the job-creating potential of entrepreneurship emerges as a pivotal strategy in addressing the pressing socio-economic issues facing the Arab world. A number of studies have shown that entrepreneurship has a positive impact on economic growth and employment.<sup>21</sup>

There are a number of policies that Arab governments can implement to promote entrepreneurship. These include:

### **❖ Regulatory Reform:**

To foster entrepreneurship, Arab governments must tackle regulatory reforms, liberalize the regulatory environment, and ease entry requirements for new businesses. Reducing costs associated with registering and licensing new ventures is necessary, coupled with streamlined processes to minimize wait times to create a conducive environment for startup initiatives.

Additionally, centralized one-stop shops for accessing information and government services can further enhance the regulatory landscape, promoting a more favorable ecosystem for entrepreneurial endeavors.<sup>22</sup> This regulatory liberalization would substantially diminish the rent-seeking advantages traditionally accorded to crony capitalists. Despite the anticipated initial resistance to such liberalization, the long-term political benefits of increased employment opportunities will outweigh the short-term gains of sustaining relationships with crony entities that contribute progressively less to inclusive growth.

### **❖ Education**

Education plays a pivotal role in promoting entrepreneurship through various avenues. Firstly, it equips individuals with the skills and knowledge essential for initiating and managing a business, like financial literacy, marketing, and business management. Moreover, education helps people

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<sup>21</sup> Entrepreneurship Capital and Economic Performance,” Regional Studies 38, no. 8 (2004): 949-959,

<sup>22</sup> OECD, “Fostering Entrepreneurship and Firm Creation as a Driver of Growth in a Global Economy,” 2nd OECD Conference of Ministers Responsible for SMEs, June 2004, 6

develop the critical thinking and problem-solving skills essential for business success. Unfortunately, there is a notable absence of entrepreneurial programs in many educational institutions, with business-focused curricula often emphasizing skills geared toward employment rather than entrepreneurship. Only 10 percent of universities in the MENA region offer academic programs specifically centered on entrepreneurship. This underscores the pressing need to reshape formal education, creating a more favorable and supportive environment for entrepreneurship.<sup>23</sup>

By providing access to education and resources, governments and other stakeholders can help to promote entrepreneurship and create a more prosperous and inclusive economy.

### ❖ **Access to Credit and Financing**

Entrepreneurs in the Arab world grapple with a significant obstacle: the difficulty in securing funding. Traditional bank loans, a primary source of capital, pose a formidable challenge due to excessive interest rates and strict collateral requirements, particularly disadvantaging newer and younger clients. These loans become even more intricate due to regulatory obstacles, widespread government corruption, and a lack of transparency. This environment not only exposes entrepreneurs to potential harassment and bribery demands from government officials but also creates a daunting financial landscape that hinders the growth and development of businesses in the region.

Here are some specific policies to enhance access to credit and finance:

#### ➤ ***Deregulation and Streamlining of Financial Sector:***

- Reduce regulatory barriers that hinder the entry of new financial institutions, fostering competition and innovation.
- Streamline the approval process for financial products and services to encourage the development of diverse financial instruments.

#### ➤ ***Private Sector-Led Credit Information Systems:***

- Encourage the development of private sector-led credit information systems, allowing credit bureaus to operate independently and compete on the basis of efficiency and reliability.
- Ensure that data protection and privacy regulations strike a balance between consumer protection and the free flow of credit information.

#### ➤ ***Encouraging Fintech Innovation:***

- Foster a regulatory environment that allows and encourages the growth of fintech startups and innovation in financial services.

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<sup>23</sup> World Economic Forum, “Accelerating Entrepreneurship in the Arab World,” 13



- Embrace technologies such as blockchain for secure and transparent financial transactions.
- ***Credit Guarantee Programs with Limited Government Involvement:***
  - Establish credit guarantee programs with limited government involvement, allowing private sector entities to take the lead in providing credit guarantees.
  - Minimize moral hazard by ensuring that guarantees are provided based on sound risk assessments.
- ***Reducing Government Crowding Out:***
  - Minimize government participation in the credit market to avoid crowding out private financial institutions.
- ***Islamic Finance Instruments:***
  - Develop and promote Islamic finance instruments that comply with Sharia principles to meet the specific requirements of entrepreneurs in the Arab region.
  - Encourage the establishment of Islamic banks and financial institutions that can provide Sharia-compliant financing options.

Implementing these policies in a coordinated and sustained manner can contribute to fostering a more favorable environment for entrepreneurs in the Arab region, enabling them to access the credit and financing needed for business growth and economic development.

### ❖ **Greater Regional Access, Integration, and Trade**

Arab governments can further support entrepreneurs by enhancing regional integration and promoting intraregional trade, facilitating business scalability. Despite cultural and linguistic similarities, the MENA region lags as the least integrated globally, hindered by political discord and structural challenges.<sup>24</sup> Similar resource and production structures, income disparities, state-owned enterprises, and high trade barriers impede economic cooperation. Advocates for intraregional cooperation emphasize the need for policy reforms to reduce non-tariff barriers.<sup>25</sup> However, Arab governments' hesitance to challenge existing power dynamics hampers progress. Simplifying access to neighboring markets would significantly benefit entrepreneurs by harmonizing supply chains and enhancing their market position.

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<sup>24</sup> Bessma Momani, "The EU, the Middle East, and Regional Integration," *World Economics* 8, no. 1 (2007): 1-10

<sup>25</sup> Hassan Al-Atrash and Tarik Yousef, "Intra-Arab Trade: Is it too Little?" IMF, Working Paper 00/10, January 2000,

## **Conclusion**

In conclusion, entrepreneurship stands as a transformative force with the potential to reshape the economic landscape of the Arab world, offering a promising pathway to inclusive prosperity. Despite facing significant challenges, from limited access to finance to regulatory hurdles, the region's entrepreneurs embody resilience, innovation, and a determination to contribute to economic growth.

As governments and policymakers recognize the critical role of entrepreneurship in fostering job creation, disrupting crony capitalism, and driving inclusive economic development, there is a growing need for bold and decisive action. Establishing an enabling ecosystem demands political will, commitment to challenging entrenched interests, and proactive policy reforms that address barriers to entry that block entrepreneurs.

The journey towards inclusive prosperity through entrepreneurship is challenging, but the potential rewards for the Arab world are immense, creating a landscape where innovation, job creation, and shared economic success become the cornerstones of a thriving and sustainable future.

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