

The Need to Strengthen the Private Sector in Southern Mediterranean Countries for Development. Rethinking Private Sector Development in the Southern Mediterranean

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A Private Sector Trapped in Survival Mode

The private sector has long been viewed as the engine of economic transformation across the southern Mediterranean. Governments, international financial institutions and development partners have promoted entrepreneurship, access to finance, vocational training and support for small and medium-sized enterprises (SMEs) as pathways to job creation and inclusive growth. Yet despite decades of reform efforts and substantial external assistance, the region continues to exhibit low levels of private investment, widespread informality, weak productivity growth and persistent unemployment, particularly among young people (ILO, 2023; UNESCWA, 2024).

The conventional explanation attributes these outcomes to limited access to finance, insufficient entrepreneurial capacity or burdensome regulation. While these factors matter, they overlook a more fundamental constraint: firms operate in environments where the costs and risks of formal business activity are sys-

tematically high. Unreliable infrastructure, volatile macroeconomic conditions, opaque regulatory systems and weak institutional governance create incentives for businesses to remain small, informal and flexible rather than invest, innovate and grow. Under such conditions, survival becomes a rational business strategy. Informality is therefore not merely a symptom of underdevelopment but an adaptive response to an economic environment that rewards short-term resilience over long-term productivity (ILO, 2023). Business environment assessments across the region similarly show that deficiencies in regulatory quality, public services, market competition and institutional effectiveness continue to constrain private sector development (World Bank, 2025).¹

This article examines these dynamics across six southern Mediterranean countries: Algeria, Egypt, Lebanon, Morocco, Syria and Tunisia. Although these countries differ in their political systems, levels of economic development and recent reform trajectories, they share structural constraints that shape firm behaviour in remarkably similar ways. Morocco has pursued more sustained institutional and business climate reforms, while Lebanon and Syria represent cases of profound institutional fragility. Egypt, Algeria and Tunisia occupy positions between these two extremes, each facing distinct combinations of state dominance, regulatory complexity and macroeconomic instability. Together, they provide a useful comparative lens through which to understand the common barriers preventing private sector transformation across the region (EBRD, 2024; IMF, 2024).

The central argument of this article is that strengthening the private sector requires moving beyond firm-

¹ Evidence presented throughout this article draws, where relevant, on the World Bank Enterprise Surveys, a standardized firm-level survey covering business environment constraints across developing economies. Available at: www.enterprisesurveys.org/en/enterprisesurveys.

level interventions toward addressing the institutional and structural conditions that determine how businesses operate. Sustainable private sector development depends not only on improving access to capital or supporting entrepreneurship, but also on reducing the hidden costs of doing business, encouraging formalization and rebuilding institutions that provide predictability, transparency and fair competition. Without tackling these deeper constraints, policy interventions will continue to improve firms' capacity to survive rather than their ability to grow, innovate and contribute to long-term economic development across the southern Mediterranean.

Informality as a Development Constraint

Informality remains one of the defining characteristics of private sector activity across the southern Mediterranean. Although its scale varies across countries, a substantial share of firms and workers operate wholly or partially outside formal regulatory frameworks, limiting productivity, fiscal capacity and economic resilience (ILO, 2023). Informality is often portrayed as a temporary stage of development or a consequence of weak enforcement. However, this perspective overlooks a more fundamental reality: for many firms, operating informally is a rational economic response to institutional weaknesses and an unfavourable business environment. When formalization entails high administrative costs, unpredictable regulation, limited access to public services and uncertain returns, remaining informal becomes a strategy for reducing risk rather than merely avoiding compliance.

Informality should therefore be understood as a continuum rather than a binary distinction between formal and informal firms. Many enterprises operate in a grey area, complying with some regulations while remaining outside others. A business may possess a municipal license but not register employees for social security, pay certain taxes while avoiding others or maintain partial financial records while operating largely in cash. Such hybrid arrangements reflect firms' efforts to balance the benefits of formal participation with the costs imposed by weak institutions and burdensome administrative systems. Rather than indicating an unwillingness to contribute to the economy, they demonstrate the adaptive behav-

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iour of firms seeking to survive in environments characterized by uncertainty and limited state capacity. Several interconnected factors reinforce this equilibrium. Registration procedures are often lengthy and fragmented across multiple agencies, while compliance requirements can be disproportionately costly for micro and small enterprises. Weak contract enforcement, inconsistent implementation of regulations and limited access to affordable finance further reduce the perceived value of operating formally. Equally important, firms frequently lack confidence that taxes and regulatory compliance will translate into better infrastructure, public services or legal protection. The result is a weak social contract between the state and the private sector, in which entrepreneurs often conclude that the immediate costs of formalization outweigh its uncertain long-term benefits.

Why Informality Persists

The persistence of informality carries significant economic and social costs that extend well beyond the firms themselves. Governments lose tax revenues needed to finance public services and infrastructure, while social protection systems remain underfunded as workers stay outside formal labour and pension schemes (UNESCWA, 2024). Informal firms typically face restricted access to bank credit, government support programmes, export markets and new technologies, limiting investment and productivity growth. They are also more vulnerable to economic shocks because they lack legal protections and formal financing channels. At the macroeconomic level, widespread informality distorts competition by placing compliant firms at a disadvantage, discourages productive investment and contributes to persistently low productivity across the region. Rather than functioning as a reservoir of entrepreneurship, a large informal sector often reflects deeper structural weaknesses that undermine long-term economic development. The experience of Lebanon illustrates these dynamics. Recent research finds that institutional complex-

ity, procedural delays, weak incentives and low trust in public institutions discourage micro, small and medium-sized enterprises (MSMEs) from formalizing, despite the potential benefits of legal status, including improved access to finance, markets and business support services. The study argues that gradual, incentive-based approaches, including simplified procedures, phased registration, digital platforms and stronger local institutional engagement, are likely to be more effective than enforcement-led strategies alone (Nassar et al., 2026). While Lebanon represents one of the region's most acute cases of institutional fragility, its experience highlights broader challenges that are also evident, to varying degrees, across the southern Mediterranean.

Although the underlying drivers are similar, the manifestations of informality differ across the six countries examined in this article. Lebanon and Syria have experienced severe institutional erosion, prolonged conflict and macroeconomic instability, making informality an essential survival strategy for both firms and workers. Egypt, Algeria and Tunisia continue to grapple with large informal sectors despite relatively stronger state institutions, reflecting persistent bureaucratic complexity, uneven enforcement and limited private sector dynamism. Morocco has made greater progress in simplifying business registration, expanding digital public services and improving the investment climate, yet informality remains widespread among micro-enterprises and self-employed workers, illustrating that regulatory reforms alone are insufficient without broader improvements in governance, productivity and market opportunities (EBRD, 2024). Ultimately, reducing informality requires shifting the policy objective from increasing compliance to improving the incentives for participation in the formal economy. Firms formalize when the benefits of legality (including access to finance, legal protection, reliable public services and stable market conditions) clearly outweigh the associated costs. Without addressing these underlying incentives, governments risk treating informality as a regulatory failure rather than recognizing it as a symptom of deeper institutional and structural constraints. This perspective provides the foundation for the next section, which examines how the high and often hidden costs of

doing business reinforce this equilibrium and constrain private sector development across the southern Mediterranean.

The Cost of Doing Business Problem

The central obstacle to private sector development across the southern Mediterranean is not a lack of entrepreneurial talent or market opportunity, but the underlying cost structure of operating a business. Even when firms are willing to formalize, invest and expand, they often face operating conditions that make competitiveness exceptionally difficult. These constraints extend well beyond visible policy burdens such as taxation or business registration. Instead, firms confront a complex system of hidden and structural costs that accumulate across multiple dimensions of the business environment. The result is an economy in which remaining operational is itself a challenge, and where survival frequently takes precedence over expansion, productivity and innovation. Recent assessments of the region consistently show that weaknesses in the business environment continue to constrain firm growth despite ongoing reform efforts (World Bank, 2025).²

Informality should therefore be understood as a continuum rather than a binary distinction between formal and informal firms. Many enterprises operate in a grey area

Infrastructure and Energy Constraints

These hidden costs are most visible in the provision of infrastructure and energy, which form the foundation of productive economic activity. Reliable electricity remains elusive in several southern Mediterranean countries, particularly Lebanon and Syria, while firms in Egypt and other economies also report fre-

² World Bank Enterprise Surveys, www.enterprisesurveys.org/en/enterprisesurveys.

quent service interruptions and infrastructure bottlenecks. Unreliable electricity forces businesses to invest in costly self-generation through private generators, increasing fuel, maintenance and operating expenses while diverting scarce capital away from productive investment. Rising fuel prices further expose firms to unpredictable cost fluctuations, reducing their ability to plan and compete.

Transport and logistics impose additional burdens. Congested roads, inefficient ports, inadequate transport infrastructure and unreliable logistics increase the cost of moving goods within countries and across borders. Delivery delays reduce productivity, disrupt production schedules and make it more difficult for firms to participate in regional and global value chains. These constraints disproportionately affect MSMEs, which often lack the financial resources needed to absorb such costs or develop alternative supply arrangements. As the EBRD (2024) argues, deficiencies in infrastructure and industrial ecosystems continue to undermine private investment and competitiveness across many emerging economies.

Regulatory and Administrative Costs

Beyond physical infrastructure, firms must navigate administrative and regulatory systems that significantly increase transaction costs. Obtaining permits, securing licenses, complying with inspections and completing customs procedures frequently involve lengthy and unpredictable processes. The challenge lies not only in the existence of regulation but also in its implementation. Procedures may be fragmented across multiple agencies, inconsistently applied or subject to discretionary interpretation, creating uncertainty that discourages long-term investment.

Firms confront a complex system of hidden and structural costs that accumulate across multiple dimensions of the business environment

Time itself becomes an economic cost. Resources are diverted towards administrative compliance rath-

er than productive activities, while delays in approvals postpone investment decisions and increase operating expenses. Customs delays, for example, compound already high transportation costs, particularly for firms dependent on imported inputs or export markets. Administrative complexity therefore interacts with infrastructure deficiencies, creating cumulative rather than isolated obstacles. Although many governments have introduced reforms to simplify business procedures, implementation has often lagged behind policy ambitions, limiting their impact on firms' day-to-day operations (World Bank, 2025).

Macroeconomic and Financial Pressures

These structural constraints are further amplified by macroeconomic instability and limited access to finance. High inflation erodes purchasing power, complicates pricing decisions and increases the cost of raw materials. Exchange-rate volatility introduces additional uncertainty, particularly for firms reliant on imported intermediate goods or engaged in export activities. In countries such as Lebanon and, more recently, Egypt, currency instability has made long-term planning exceptionally difficult, forcing businesses to operate under conditions of continuous uncertainty (IMF, 2024).

Access to affordable credit remains another major constraint. Financial systems across much of the region often struggle to provide long-term financing for productive investment, particularly for MSMEs. Businesses therefore rely heavily on retained earnings or informal sources of finance, limiting their ability to invest in technology, innovation or expansion. These financial constraints reinforce the effects of poor infrastructure and regulatory inefficiencies. A firm already burdened by high energy costs and administrative delays faces even greater challenges when credit is expensive or unavailable. Similarly, exchange-rate depreciation raises the cost of imported fuel, spare parts and machinery, compounding the impact of unreliable infrastructure.

A System of Interconnected Constraints

Taken individually, each of these constraints presents a significant challenge. Together, they create a business environment in which firms must simultaneously absorb high operating costs, regulatory uncer-

tainty and macroeconomic risk. Competitiveness therefore becomes less a function of innovation or productivity than of an enterprise's ability to survive adverse operating conditions. Rather than investing in expansion, research and development, or workforce upgrading, businesses often limit their scale, postpone investment and avoid unnecessary exposure to risk.

This perspective reinforces the central argument of this article. The principal barrier to private sector development in the southern Mediterranean is not a shortage of entrepreneurial capacity but an environment in which the hidden costs of doing business systematically discourage growth. Policies focused solely on promoting entrepreneurship or expanding access to finance are therefore unlikely to succeed unless they are accompanied by broader efforts to reduce these structural costs and improve the quality of the business environment. This, in turn, requires institutional reforms that increase predictability, improve public service delivery and strengthen the relationship between the state and the private sector.

Institutional Repair as Economic Reform

Addressing the high cost of doing business requires more than isolated policy adjustments or additional support for entrepreneurs. It requires strengthening the institutions that shape how markets function. Institutional repair refers to restoring the conditions under which firms can operate predictably, efficiently and transparently. In practical terms, this means improving policy consistency, reducing arbitrary implementation of regulations, strengthening contract enforcement, promoting fair competition and making state-business relations more transparent and rules based. Institutional reform therefore extends well beyond anti-corruption campaigns or administrative modernization. It concerns the practical functioning of the rules, incentives and organizations that determine how economic decisions are made and implemented.

Private sector development is often discussed as a technical issue of finance, training or entrepreneurship support. Yet across much of the southern Mediterranean, institutional quality is one of the principal determinants of whether firms remain informal, stagnant or growth oriented. Businesses invest not only in response to market opportunities but also accord-

ing to their expectations regarding policy stability, legal protection and government credibility. Where these conditions are absent, firms rationally limit their exposure to risk, reducing investment and favouring short-term survival over long-term growth (World Bank, 2025).

Institutional weaknesses magnify the costs of doing business by creating uncertainty over how rules will be applied and whether public institutions can provide a stable environment for investment

Institutional weakness should therefore not be viewed as a background condition within which firms operate. It is itself an economic constraint that directly influences private sector performance. As the previous section demonstrated, infrastructure deficiencies, regulatory burdens and macroeconomic instability increase the cost of doing business. Institutional weaknesses magnify these costs by creating uncertainty over how rules will be applied and whether public institutions can provide a stable environment for investment.

Institutions Shape Firm Behaviour

The importance of institutional repair becomes evident when examining how firms respond to weak or inconsistent governance. Businesses do not simply endure institutional shortcomings; they adapt their behaviour to the incentives and uncertainties they face. When policies change frequently or regulations are applied inconsistently, firms become less willing to undertake investments that depend on stable operating conditions. Instead, they prioritize flexibility, maintain smaller operations, postpone expansion and avoid commitments that increase their exposure to regulatory or political risk.

This behavioural response also helps explain the persistence of informality discussed in the previous section. While formalization offers potential benefits, (including improved access to finance, legal protection and larger markets) it can simultaneously increase

firms' exposure to inconsistent enforcement, administrative discretion and changing regulatory requirements. Under such circumstances, remaining informal or semi-formal becomes an economically rational strategy rather than simply an attempt to evade regulation. Likewise, uncertainty surrounding contract enforcement discourages long-term commercial relationships, limiting opportunities for specialization, investment and economies of scale. Institutional quality therefore shapes not only what firms produce, but also how they organize themselves, how much they invest and whether they choose to grow. The cumulative effect is a low-investment equilibrium in which firms continuously adapt to uncertainty rather than pursue productivity-enhancing activities. Resources that could finance innovation, technology adoption, workforce development or export expansion are instead devoted to managing administrative complexity, mitigating regulatory risks or building operational flexibility. Institutional weaknesses therefore impose costs that extend well beyond compliance, reducing the overall dynamism and competitiveness of the private sector.

Institutional Variation across the Southern Mediterranean

The six countries examined in this article illustrate different manifestations of the same institutional challenge. Lebanon and Syria represent the most severe cases, where prolonged crises and conflict have weakened the state's ability to provide reliable public services, enforce contracts and maintain predictable economic policies. Under these conditions, firms operate in environments characterized by extreme uncertainty, making short-term survival a rational business strategy.

Egypt, Algeria and Tunisia present a different, though still challenging, institutional landscape. Public institutions remain more functional, yet businesses continue to face opaque administrative procedures, uneven regulatory enforcement and significant state involvement in economic activity. Regulatory frameworks generally exist, but their implementation is not always predictable or consistent. These conditions create uncertainty that discourages investment and distorts competition, as firms must navigate both formal regulations and informal practices in order to operate efficiently. Such institutional frictions continue

to constrain private sector development despite ongoing reform efforts (EBRD, 2024).

Morocco offers an important point of comparison rather than an exception. Over the past decade, it has undertaken more sustained efforts to improve the business environment through administrative simplification, digitalization and institutional reforms that have strengthened policy predictability. These reforms have contributed to a more supportive environment for private investment. Nevertheless, informality remains widespread and businesses continue to face structural challenges, demonstrating that institutional reform is a necessary but not sufficient condition for sustained private sector transformation.

Sustainable private sector development ultimately depends on creating an institutional environment in which firms can confidently move beyond survival strategies toward investment, innovation and long-term growth

Governance as Economic Policy

The experiences of these six countries underscore a broader political economy lesson: governance and private sector development cannot be treated as separate policy agendas. Institutional weaknesses do not merely coexist with economic constraints; they actively generate and reinforce them. They influence firms' costs, shape their expectations, determine their willingness to invest and ultimately define the boundaries of what businesses consider economically feasible.

Institutional repair should therefore be viewed as economic reform rather than simply governance reform. Strengthening contract enforcement, improving regulatory consistency, increasing transparency and building more predictable state-business relations reduce uncertainty in much the same way as lowering taxes or expanding access to finance. Without these institutional foundations, efforts to encourage entrepreneurship, promote formalization or attract private investment are likely to produce only

limited and short-lived results. Sustainable private sector development ultimately depends on creating an institutional environment in which firms can confidently move beyond survival strategies toward investment, innovation and long-term growth.

Policy Priorities and Mediterranean Implications

The analysis presented in this article suggests that strengthening the private sector in the southern Mediterranean requires a shift in policy thinking. Traditional approaches have largely focused on expanding access to finance, supporting entrepreneurship or simplifying individual regulations. While these measures remain important, they are unlikely to generate lasting improvements if the broader institutional environment continues to impose high costs and uncertainty on businesses. The challenge is therefore not simply to help firms perform better within existing systems, but to improve the systems within which firms operate.

Moving Beyond Firm-Level Support

A first priority is to reduce the structural costs of formal economic activity. Governments should continue simplifying business registration and licensing procedures, expanding digital public services and reducing unnecessary administrative burdens. However, these reforms should be accompanied by greater regulatory predictability and consistent implementation. Businesses are more likely to invest when rules remain stable over time and are applied transparently rather than selectively. Similarly, improving infrastructure, particularly reliable electricity, transport networks and digital connectivity, should be viewed not only as infrastructure policy but also as

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private sector policy because these investments directly reduce firms' operating costs.

Formalization strategies should also move away from enforcement-led approaches towards incentive-based reforms. Many MSMEs remain informal because the immediate costs of formalization exceed its perceived benefits. Governments should therefore emphasize gradual transition mechanisms, simplified compliance procedures, digital registration platforms and improved access to finance and business support services. Rather than treating informal firms as regulatory failures, policy should recognize them as potential contributors to economic growth once institutional barriers are reduced. This perspective is particularly relevant for fragile and conflict-affected economies, where rebuilding trust between governments and the private sector is essential for encouraging investment and expanding the formal economy.

Institutional Capacity as a Development Priority

The findings of this article also suggest that institutional capacity should be viewed as productive economic infrastructure. Predictable regulations, effective contract enforcement, transparent public administration and competitive markets reduce uncertainty in much the same way that roads, ports and electricity reduce production costs. Institutional reform should therefore be integrated into broader economic development strategies rather than treated as a separate governance agenda.

Equally important is improving the quality of state-business relations. The objective should not be a larger or smaller state, but a more capable and predictable one. Governments that provide consistent policies, transparent decision-making and reliable public services create conditions in which firms can plan, invest and innovate with greater confidence. This institutional credibility is particularly important in countries emerging from conflict or prolonged economic crises, where rebuilding investor confidence may be as valuable as providing financial incentives.

A Mediterranean Partnership for Private Sector Development

These priorities also carry important implications for Euro-Mediterranean cooperation. Discussions

on the southern Mediterranean have traditionally focused on migration management, humanitarian assistance and macroeconomic stabilization. While these remain important, long-term regional stability ultimately depends on creating productive private sectors capable of generating employment, attracting investment and expanding economic opportunities. A stronger private sector reduces the economic pressures that contribute to outward migration, social vulnerability and political instability, while creating more resilient and integrated regional economies.

For the European Union and other Mediterranean partners, this implies moving beyond project-based assistance toward longer-term institutional partnerships. Technical cooperation should increasingly support regulatory modernization, judicial efficiency, digital government, customs reform and business climate improvements alongside investments in infrastructure and entrepreneurship. Supporting institutional capacity is not separate from supporting private investment; it is one of its principal enabling conditions. Regional initiatives should also encourage knowledge exchange among southern Mediterranean countries, allowing successful reforms in areas such as digital public services, business registration and investment facilitation to be adapted across different national contexts.

Ultimately, private sector development should be understood not simply as an economic objective but as a cornerstone of regional resilience. Firms invest, innovate and create employment when institutions lower uncertainty rather than amplify it. The experience of the southern Mediterranean demonstrates that entrepreneurship alone cannot overcome persistent structural constraints. Sustainable growth requires institutions that reward productive investment, encourage formalization and provide businesses with the confidence to move beyond survival. Strengthening these institutional foundations offers one of the clearest pathways toward more competitive economies and a more

prosperous, stable and interconnected Mediterranean region.

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