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Aftercare Strategy for Investors in the Occupied Palestinian Territory

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Executive summary

Attracting private investment is considered a central element for sustainable growth and economic modernization in developing countries. In the case of the war-torn Palestinian economy, the challenge is how to retain existing investments and attract new local and foreign direct investment (FDI) that could revitalize sluggish growth and the economy's devastated productive capacity. This is essential to arrest the accelerated rates of divestment and reverse the substantial erosion of the economy's capital base over the past eight years due to the destruction and deterioration of private and public physical infrastructures.

This paper proposes a tailor-made aftercare strategy to support Palestinian efforts to set the economy on the path of sustained recovery. The strategy focuses on local and foreign enterprises benefiting from the 1998 Palestinian Investment Law No. 1, which together constitute the client base of the Palestinian Investment Promotion Agency (PIPA). It is based on a comprehensive field survey of these enterprises and their business development needs, implemented by PIPA in cooperation with the United Nations Conference on Trade and Development (UNCTAD).

Retaining and expanding investments in the Occupied Palestinian Territory will require assistance to firms to enhance their competitiveness, including through the development of their technological capabilities and mitigating existing constraints to their growth. Such an approach should also seek to create synergies between public services and interventions that address the enterprises' immediate needs and long-term interventions that aim at strategic, development objectives. This necessitates investment retention and aftercare efforts to proceed at four levels: enterprise, industry, institutional and macroeconomic. This integrated approach is at the heart of the proposed aftercare strategy, which emphasizes PIPA aftercare services with a view to:

(a) Generating additional capital investments from existing enterprises;

(b) Bringing local enterprises up to international standards in terms of product quality;

(c) Ensuring the widest possible spin-off benefits from FDI.

As the lead agency in dealing with investors and formulating investment policy in the Occupied Palestinian Territory, the strategy involves each of the core functions of PIPA, as follows:

(a) Investor aftercare services: PIPA could launch new services that involve information dissemination, sectoral-geographical clustering, networking among enterprises, integrating Palestinian enterprises into regional and global value chains and developing enterprise skills in the areas of strategic management and industrial organization;

(b) Policy advocacy: PIPA could expand the scope of its lobbying efforts to promote streamlining of investment procedures, updating of the legal framework for investment, skills development, creative solutions for financial intermediation and a more favourable tax system;

(c) Investment attraction: PIPA may consider refocusing its investment attraction function from FDI inflows generally towards those firms and sectors that will complement existing firms through the stimulation of markets and linkages. In particular, the agency should target particular FDI source countries and transnational corporations (TNCs).

Strategy implementation will have to take into consideration the limited policy space available to the Palestinian Authority, as well as the prevailing security and political conditions. These are likely to affect policy prioritization and the strategy implementation schedule. At the same time, the fullest implementation of the proposed aftercare strategy requires greater capacities than what is now available to PIPA and market support institutions. Donor assistance is required not only to support the implementation of the proposed strategy, but also to enable PIPA to sustain it and capitalize on its benefits.

Moreover, even if PIPA were endowed with sufficient resources and government support, it would be difficult to launch all the proposed activities in a single undertaking. This paper proposes an implementation plan for sequencing the recommended strategy components by priority in two interrelated phases. The aim is to allow for proper prioritization of activities in a manner that is conducive to addressing existing investors' immediate and long-term strategic business development needs and to leveraging the required partnerships between PIPA and relevant public and private sector institutions. The choice of the activities that will form the focus of each phase can be decided through focus groups that bring together the main stakeholders from the different priority sectors.

Contents

Preface

This paper was prepared by the UNCTAD Assistance to the Palestinian People Unit of the Division on Globalization and Development Strategies and the UNCTAD Investment Facilitation Section of the Division on Investment and Enterprise. Prepared in response to a request by the Palestinian Authority, this report proposes *An Aftercare Strategy for the Palestinian Economy*. The strategy outlines practical steps for retaining existing investments and increasing their contribution to Palestinian economic growth, based on a comprehensive needs assessment survey of local and foreign investors operating in the Occupied Palestinian Territory, the secretariat's rich experience in supporting Palestinian economic development efforts and its work in the area of investment promotion and facilitation.

The strategy was presented at a workshop in the West Bank city of Ramallah on 29 October 2008, under the patronage of the Palestinian Authority Minister of National Economy, with the participation of 65 representatives from the Palestinian government, businesses and leading enterprise support institutions. The proposed strategy received positive feedback from participants and Palestinian officials requested technical assistance and guidance from UNCTAD in implementing the strategy.

Implementation of the strategy will depend largely on PIPA in its capacity as the focal point for dealing with investors and formulating and implementing investment policies in the Occupied Palestinian Territory. It will also depend on the extent of policymaking space available to the Palestinian Authority, prevailing political and security conditions and the ability to strengthen the capacity of PIPA and existing market support institutions. The current capacity shortfall renders financial and technical support critical for implementing and sustaining the strategy through the medium term.

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Abbreviations

FDI	foreign direct investment
GDP	gross domestic product
ICSID	International Centre for the Settlement of Investment Disputes
ICT	information and communication technology
IFC	International Finance Corporation
IPA	investment promotion agency
IPR	intellectual property right
JETRO	Japan External Trade Organization
MFI	microfinance institution
MIGA	Multilateral Investment Guarantee Agency
NBFI	non-banking financial institution
NGO	non-governmental organization
OCHA	United Nations Office for the Coordination of Humanitarian Affairs
PCBS	Palestinian Central Bureau of Statistics
PIPA	Palestinian Investment Promotion Agency
PITA	Palestinian Information Technology Association
PLC	Palestinian Legislative Council
PMA	Palestinian Monetary Authority
PSE	Palestinian Security Exchange
SME	small and medium-sized enterprise
TNC	transnational corporation
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization
UNSCO	Office of the United Nations Special Coordinator for the Middle East Peace Process
WAIPA	World Association of Investment Promotion Agencies

Introduction

Private investment, especially targeted FDI, is considered a key element of sustainable growth in developing and least developed countries. In addition to standing as an important source of external finance, FDI facilitates the structural transformation of the economy's industrial base towards higher value added production. Not only can FDI accelerate capital formation, it also serves as a vehicle for transferring modern production technology, skills and state-of-the-art organizational and managerial practices.

In the case of the Occupied Palestinian Territory, investment promotion is rendered particularly challenging by adverse political and economic conditions. The intensification of the protracted conflict since October 2000 and the resulting widespread economic crisis have created profound changes in the structure and functioning of the Palestinian economy. These changes will not be easily reversed once political stability is attained. The economy has witnessed the depletion of its productive capacity, manifested in enterprises' escalating closure rates. Enterprises that have managed to survive are operating under precarious conditions aggravated by dwindling demand in view of the soaring unemployment and poverty rates. These enterprises have exhausted their savings and are being forced to scale down their activities.

These adverse conditions have pushed long-term development objectives down the Palestinian Authority's priority list to allow for more attention to the essential emergency humanitarian needs generated by the crisis. Thus far, interventions targeting the enterprise sector have involved partial compensation for conflict-induced damages, along with microcredit schemes to address enterprises' liquidity crunch. Meanwhile, investment retention and attraction have been relegated to secondary importance. Foreign enterprises have been receiving little attention and FDI has been declining.

Such a limited focus on emergency needs risks further loss of investment and further weakening of the economy's productive capacity. The immediate task should therefore be to focus on retaining and developing existing local and foreign enterprises, while at the same time attracting targeted investments to revitalize the economy's capital base. There is therefore an urgent need for an integrated approach that targets both local and foreign investors and goes beyond cushioning the impact of the economic crisis to develop the enterprises' technological capabilities. Such an approach will allow for the creation of a minimum level of industrial development to ensure successful investment attraction and broad economic modernization in a post-conflict situation.

This approach forms the broad conceptual framework of the proposed aftercare strategy. As a starting point, the strategy targets enterprises benefiting from the Palestinian Investment Law No. 1 of 1998 in the West Bank and the Gaza Strip. This group comprises 400 mostly local medium and large enterprises, which together constitute the clients of PIPA. The strategy is to be executed primarily by PIPA, given its leading role in dealing with investors and formulating investment policy. The Palestinian Investment Law mandates PIPA to propose changes to laws and regulations in conflict with the investment law, recommend changes to the law for the improvement of the Occupied Palestinian Territory's investment climate, and create a "one-stop shop" to facilitate all procedures for investors, attract investors and maintain a registry of investments.

This paper proposes a tailor-made aftercare strategy for PIPA based on a comprehensive needs assessment survey of the agency's clients. Chapter I highlights the particular challenges facing investment retention efforts in the Occupied Palestinian Territory, as an occupied, war-torn territory. Chapter II provides an overview of existing investors' business development needs, leading to a proposed aftercare strategy in chapter III.

I. Challenges to Investment Retention in the Occupied Palestinian Territory

This chapter provides an overview of the key external factors negatively influencing the growth of local and foreign investors operating in the Occupied Palestinian Territory. These factors arise from the Occupied Palestinian Territory's political and economic conditions, overall legal framework and market support institutions.

A. A war-torn economy with chronic structural problems

The intensification of the Israeli security measures imposed on the Occupied Palestinian Territory since October 2000 has brought a tightening of the already strict Israeli closure policy and restrictions on the movement of Palestinian goods and labour. Israeli security measures have also been tightened at the Occupied Palestinian Territory's main commercial crossing points with Egypt, Israel and Jordan.[1] Compounding the impact of these measures is the Israeli Separation Barrier, which intrudes into the territories of the West Bank. Approximately 86 per cent of the barrier has been constructed, effectively reshaping the 1949 Occupied Palestinian Territory border and involving the confiscation of almost one fifth of the West Bank's most fertile land.[2]

Movement restrictions coupled with the continued construction of the barrier have fragmented the Occupied Palestinian Territory and effectively isolated Palestinian enterprises from the rest of the world (Office of the United Nations Special Coordinator for the Middle East Peace Process (UNSCO), 2005). According to UNCTAD (2007a), the economy has lost an estimated $8.4 billion in potential gross domestic product (GDP) between 2000 and 2005, almost twice the size of the 2006 GDP.[3] More critical is the estimated loss of one third of the economy's 1998 productive capacity as a result of the Israeli destruction of physical infrastructure, overuse and poor maintenance. Official Palestinian statistics also show high enterprise closure rates and a declining share of paid workers in the labour force (PCBS, 2004c; 2000; and 2007, respectively).

These setbacks have aggravated the effect of ongoing deindustrialization since the Israeli occupation of the Palestinian territory in 1967. This has further pushed the Palestinian economy towards low productivity activities. Between 1996 and 2006, the manufacturing sector lost importance as a source of income with a 7 per cent decline in output. During the same period, this sector increased its employment by 3 per cent, implying a significant reduction in labour productivity as enterprises shifted their production toward low-skill, low-wage processes. This pattern is more pronounced in the agricultural sector, which has become a refuge for low-wage, low-skill employment. While this sector's added value decreased by about 19 per cent during the same period, its contribution to employment increased by 80 per cent (UNCTAD, 2007a). Furthermore, Palestinian trade remains heavily concentrated with Israel, accounting for more than 60 per cent of the Palestinian trade deficit in 2006 (UNCTAD, 2007a). This highlights a salient feature of the Palestinian economy, namely, its vulnerability to external shocks from Israel.

The situation in the Gaza Strip, where 40 per cent of the Occupied Palestinian Territory's population lives, is much worse. Already impoverished by an almost complete economic blockade since July 2007, Gaza has witnessed the effective collapse of its economy as a result of the Israeli military offensive that lasted from 27 December 2008 to 17 January 2009. In addition

[1] For a detailed discussion of the Israeli closure policy and system of movement restrictions, see B'TSELEM (2005), Office for the Coordination of Humanitarian Affairs (OCHA) (2005a and 2005b). Details on the movement restrictions at commercial crossing points can be found in OCHA (2005c) and Palestine Trade Center (PalTrade) (2007).

[2] Details on the Separation Barrier and its impact on the Palestinian economy can be found in OCHA (2008 and 2005d), and Palestinian Central Bureau of Statistics (PCBS) (2004a and 2004b).

[3] UNCTAD (2008) provides a more recent review of the economy of the Occupied Palestinian Territory.

to paralyzing economic activities, the military offensive led to massive demolition of private and public properties, basic utilities and agriculture lands. Initial conservative estimates by the PCBS put direct economic losses resulting from infrastructure and property destruction at around $1.9 billion, more than 135 per cent of the value of the GDP produced by the Gaza Strip in 2006 (PCBS, 2009). The situation in Gaza is a telling example of escalating "complex humanitarian emergencies", where vulnerability is great, and the impact on the future livelihood of the Palestinian people and their productive capacity, institutional infrastructure and the economy is severe and could have a long lasting impact. The full magnitude of Gaza's deepening economic and humanitarian crisis on the Occupied Palestinian Territory's economy as a whole has yet to unfold, rendering bleak prospects for investment and growth, at least for the short term. Hence, immediate action is urgently needed to offset further income losses and pave the way for sustained development.

The performance of the Palestinian economy as a whole since 2000 points to the critical role of the agricultural sector and small and medium-sized enterprises (SMEs) in mitigating the negative impact of the widespread economic crisis. The agriculture sector and SMEs in other sectors have managed to absorb newcomers to the labour force and a significant proportion of those who lost jobs in Israel, thereby acting as a shock absorber for the economy and curbing further increases in unemployment rates (UNCTAD, 2007a; 2004). However, this has come at the cost of labour productivity and wage levels, with negative consequences for the overall welfare of the population. The challenge, therefore, is to develop and implement a strategy to enable Palestinian enterprises to revitalize and develop their productive capacity.

B. Weak legal framework

The legal framework for investment is mainly based on the 1995 investment promotion law, which was revised in the 1998 law. A second revision has been recently prepared for the consideration of the Palestinian Legislative Council (PLC). The new revision provides a wider range of incentives to local and foreign investors, including tax and customs exemptions. It also deals with such issues as business licensing, bankruptcy and liquidation, and certain aspects of tax administration for national and foreign investors. Another bill related to investment is the 1998 Industrial Estates and Free Zones Law, which provides customs, tax and other exemptions to enterprises operating in industrial estates.[4]

The Palestinian Authority has also passed several laws to regulate economic and trade activity with a direct bearing on the investment climate, such as the 2005 Capital Market Authority Law that regulates the non-banking financial sector (insurance, securities, mortgages and leasing).[5] More recently, the Ministry of National Economy has taken concrete steps to speed up the reduction of bureaucratic requirements for business registration. Licensing, issuance of permits and taxation are also judged well in regional comparison (World Bank, 2007).

Despite Palestinian Authority efforts to improve the investment climate under adverse political conditions, thorough reform is still needed to support investment retention, most notably in relation to the fragmented legal system. The system is a patchwork of inconsistent, at times contradictory, business regulations originating from the British mandate, the Jordanian and

[4] These enterprises are part of the Industrial Estates Programme, which was launched in 1999 to attract new export-oriented local and foreign investments, and is managed by the Palestinian Industrial and Free Zones Authority.

[5] The following laws with a direct bearing on economic and trade activity have been published in the Official Gazette: Public Works and Bidding Law, Public Procurement Law, Natural Resources Law, Amendment of Money Changers Law, Supervision and Stamp of Gold and Precious Metals Law, Labour Law, Environment Law, Law for the Formation of the Insurance and Pensions Fund, Commercial Agency Law, Apartments Condominiums and Stores Ownership Law, Communication and Telecommunication Law, Animal Husbandry Law, and Public Budget and Financial Affairs Law.

Egyptian administrations and Israeli military orders. Moreover, several important business laws are still waiting to be passed or amended by the PLC such as the Competition Law, Commercial Law, Companies Law, Leasing Law and Insurance Law.

At the same time, judicial reform in the Occupied Palestinian Territory remains slow, due to overlapping institutional responsibilities and a paucity of enforcement capacity. The lack of business confidence in the judiciary system is best exemplified by the problems inherent in commercial dispute resolution. Commercial disputes mechanisms, detailed in Law No. 3 (2000), specify the basis for court recognition, enforcement and arbitral awards. Specialized services for arbitration and mediation to the business community are offered by the Centre for Settlement of Commercial Disputes established in 2002. Nevertheless, concerns regarding neutrality, procedures and enforcement have discouraged all but a few businessmen from relying on the courts to settle disputes. Instead, they are often settled informally, based on socially established norms.

C. Evolving financial sector

The financial sector is regulated by the Palestinian Monetary Authority (PMA), as defined under the terms of the 1995 economic agreement between the Palestine Liberation Organization and Israel known as the Paris Protocol. The PMA is endowed with regulatory authority similar to that enjoyed by most central banks. It is entrusted with the tasks of licensing all banks operating in the Occupied Palestinian Territory, holding their reserves and regulating their operations with regard to solvency, liquidity and stability. The PMA also acts as the Palestinian Authority’s official economic and financial advisor and sole financial agent, both locally and internationally, and holds and manages foreign currency reserves of all public sector entities. However, with no national currency and three main currencies (Jordanian Dinar, New Israeli Shekel and United States dollar) in circulation, the effective power of the PMA is very limited and its ability to ensure the system’s safety and stability and to control foreign exchange is undermined.

As of mid-2008, the Palestinian financial sector consisted mainly of the 21 commercial banks, with 178 branches (World Bank, 2008a). Although the commercial banks possess excess liquidity, they exercise conservative credit policy for a range of reasons that are common to banks in developed and developing countries. These include: (a) the general impression that the enterprises are high risk borrowers due to insufficient assets and low capitalization, vulnerability to market fluctuations and high death rates; (b) information asymmetry arising from enterprises’ lack of accounting records and inadequate financial statements and business plans, which make it difficult to assess the creditworthiness of requests made; and (c) high administrative/transaction costs involved in dealing with small amounts, which render such financing unprofitable for banks.

In principle, banks take three types of collateral: mortgages, pledges of movable assets and guarantees to reduce risks. They are also kept abreast of enterprises with significant debt levels by the PMA, which regularly circulates information on borrowers with loans exceeding $10,000 and a black list of those with bounced checks. However, due to the scarcity of titled land and the lack of a computerized system for registering pledges of moveable assets, the bulk of loans is secured by guarantees (either by the income of the borrower or a personal guarantor) (Consultative Group to Assist the Poorest (CGAP), 2006). Moreover, Palestinian enterprises have consistently reported failure meeting what they consider high bank collateral requirements (World Bank, 2007).

Yet another important financial institution is the Palestinian Security Exchange (PSE), which commenced activities in 1997. It is jointly regulated by the PSE Chairman and Board of Directors and the Palestinian Capital Market Authority, which was established in 2005 pursuant to the 2005 Capital Market Authority Law. The PSE remains a thin market, with only 35 listed companies in 2008 and small trading volumes generated by five companies. It is also characterized by extreme volatility and vulnerability to speculations and price manipulation, particularly in view of the adverse political and economic conditions.

The Palestinian financial sector also features a limited number of specialized lending institutions, leasing and mortgage finance companies, operating alongside a handful of insurance companies that offer life, property and car insurance. In addition, there are approximately 300 money changers, through which the bulk of the remittances from abroad are channelled. Money changers do not participate in the payment system but instead use their bank accounts to receive clients' funds. Although licensed money changers are not permitted to engage in lending, some of them provide loans, mostly against post-dated checks (CGAP, 2006).

Given such conditions, microfinance institutions (MFIs) have been assuming an increasing role in financing enterprises and their number has steadily increased over the past years (Palestine Network for Small and Micro Finance (PNSMF), 2005). These include non-governmental organizations (NGOs), for-profit and not-for-profit companies, in addition to savings and credit cooperatives. However, their financial resources are limited and can only meet a fraction of the demand for medium- and long-term loans. Moreover, the sustainability of these institutions and their ability to continue providing services is hampered by low and declining repayment rates. The operations of microfinance institutions continue to depend primarily on donor assistance (CGAP, 2006).

The Palestinian Authority has implemented important measures to promote the efficiency, soundness and stability of the banking system, including: (a) the adoption of modern techniques to supervise banks, along with new regulations to mitigate risks associated with lending and investment activities (e.g. liquidity, operations contingency plans and foreign exchange risk); (b) the conclusion of a memorandum of understanding with the Jordanian Central Bank to foster cooperation and joint supervision; and (c) the establishment of a credit bureau with automated information systems to facilitate wide access to information on borrowers by banks and financial institutions. The PMA has also taken concrete steps to broaden the range of financial products available to businesses and investors, with the launching of two loan guarantee programmes in 2006–2007 to facilitate access to credit for SMEs without collateral securities (World Bank, 2008a).

Recent initiatives with direct bearing on investment include the World Bank's West Bank and Gaza Investment Guarantee Fund, launched in late 2008 (World Bank, 2008b). The fund is administered by the Multilateral Investment Guarantee Agency (MIGA) that will issue political risk insurance (i.e. guarantees) for both national and foreign investors against losses arising from transfer restrictions, expropriation, war and civil disturbance and breach of contract. MIGA guarantees cover new investments as well as expansions and privatizations of existing businesses, with a special emphasis on projects with high employment generation capacity.

Nonetheless, there remains much room for improvement. The Palestinian Authority and the PMA should accelerate efforts to further develop the financial sector's legal framework and promote new products and services, including the adoption of a corporate governance code and passing a law on secured transaction to establish the range of collateral to be accepted by banks. The PMA also needs to move faster towards bringing the 2002 banking law more in line with the Basle core principles, and consider allowing MFIs to take deposits. In addition, the Capital Market Authority should develop the required rules and regulations to address the problem of share price manipulation.

D. Narrow range of support services

As explained by UNCTAD (2004), the Occupied Palestinian Territory's enterprise support system features a narrow focus on training activities, particularly in the areas of strategic management, trade promotion and finance. It is also a donor-dependent system, with the majority of the enterprise support institutions lacking adequate internal sources of funds to develop and maintain their services. The widespread economic crisis has further aggravated these institutions' precarious financial position, effectively undermining their ability to respond to the enterprise sector's emerging needs. Problems such as high staff turnover and delayed/non-payment of membership fees are becoming acute for all of these institutions. Moreover, donor interventions remain inadequately coordinated, causing duplication of efforts and undermining overall impact. Nonetheless, these institutions could play an important role in spearheading economic modernization. They have acquired first-hand knowledge of the existing enterprises' problems and the majority are actively involved in promoting and defending the interests of their members.

II. Existing Investors and Their Business Development Needs

This chapter analyses existing investors' business development needs emerging from survey results (detailed in annexes I and II). The survey sought to ascertain enterprises' immediate and long-term needs in light of the ongoing crisis. The questions cover issues related to enterprises' growth and performance, including their entrepreneurial profiles, competitiveness, backward and forward linkages, and adaptability to shocks and crises.

Respondents to the survey conducted by PIPA in September 2004 include 278 enterprises representing 70 per cent of PIPA clients. Of these, 28 are foreign enterprises, a number which mirrors their limited share of the PIPA client base. The survey results only allow for a broad-brush analysis that needs to be substantiated by follow-up surveys. There is a need for more primary data on foreign investors as well as on the production capacity of PIPA clients, particularly concerning the relative importance of capital, financial solvency and profitability.

As shown in annex 1, the PIPA client base consists of mostly local enterprises that were founded following the establishment of the Palestinian Authority in 1994. These are heavily concentrated in the industrial sector, with manufacturing and mining/quarrying constituting the two largest segments. This skewed sectoral distribution mirrors that of the enterprise sector, reflecting the modest success of PIPA in attracting investments in new areas.

PIPA clients also share features that are common to Palestinian SMEs. They are dominated by small enterprises, have weak backward and forward linkages with other sectors and focus on local markets. Those engaged in export activities exhibit a narrow export mix and are heavily dependent on Israel as the main outlet for their products. However, in contrast to the sole proprietorship management structure of most of the SMEs, PIPA clients are mainly limited liability companies and exhibit more formal management structures. Moreover, the majority reported specialization in capital-intensive activities.

Among PIPA clients, there are several crucial differences between local and foreign investors. Most foreign enterprises provide information and communication technology (ICT) and business services. They are more capital-intensive and tend to be larger firms. Whereas the majority of local enterprises are in Hebron, foreign enterprises are mostly in Ramallah. In terms of industrial location, foreign enterprises are located in residential areas, while local enterprises are concentrated in industrial areas.

The survey also reveals locational differences along the lines of economic activity and target markets. First, there is regional variation in the relative intensity of labour, with enterprises in Khan Younis, Rafah and Deir El-Balah having higher labour intensity. Second, enterprises producing final goods are concentrated in Qualqilya, Hebron, Tulkarem, Northern Gaza and Rafah. Enterprises based in Tulkarem, Hebron, Nablus and Rafah also stand out as mainly engaged in the production of semi-final goods. Third, export-oriented enterprises are mainly concentrated in the West Bank, with Bethlehem-based enterprises driving exports to non-Israeli partners, particularly Europe and the United States.

To allow for a thorough understanding of the existing business development needs, this chapter starts with an overview of the external constraints on growth reported by the surveyed enterprises. An account of enterprises' business development needs comes next, leading to a conceptualization of enterprises' growth dynamics.

A. External constraints reported by investors

The survey respondents were asked to assess the extent to which the overall business environment is conducive to the operation and growth of their enterprises in relation to a set of factors. These factors, rated by the surveyed enterprises on a three-point scale, are detailed in annex II (tables AII.1 and AII.2). Key constraints reported by most of the respondents include the high cost of and limited access to raw materials, in addition to prohibitive overland transport costs and complex customs and overland transport procedures.

Paradoxically, a majority of the surveyed enterprises assess positively the availability of external finance at reasonable terms. This rather testifies to the weight of other factors constraining business expansion, notably political uncertainty, and the enterprises' predominant concern with maintaining existing production levels, even if these are below capacity. In other words, enterprises are more focused on adapting to survive and are less interested in expanding their activities, creating a limited demand for long-term loans. As a result, investment levels have remained below capital depreciation rate. Thus, improving enterprises' access to finance and related services has to play an important role in aftercare and business expansion support programmes.

Ratings by foreign investors

The survey results reveal the Occupied Palestinian Territory's geographical location as the main factor driving foreign investors' location decisions. Proximity to main markets was ranked as a positive factor by the 59 per cent of the respondents, followed by the Palestinian Authority's favourable tax treatment and the availability of relatively cheap labour (46 per cent and 41 per cent of the respondents, respectively). Other factors of influence on foreign investors' location decisions include access to regional markets (35 per cent) and cheap raw materials (35 per cent). In addition, a limited percentage of foreign investors identified the availability of industrial zones as an influencing factor (31 per cent), along with the Palestinian Authority's trade agreements (30 per cent) and the availability of skilled labour (30 per cent).

As for foreign investors' assessment of the investment environment, as shown in annex II (table AII.1), the respondents identified obtaining and renewing business licenses as major factors working in their advantage. Other factors include renting and purchasing premises, the availability of local skilled staff and telecommunications services at reasonable prices. However, the list of factors working to the disadvantage of these investors is a long one. Key constraints identified by the majority include:

(a) Cost of raw materials (identified by 73 per cent of the respondents);

(b) Access to raw materials (50 per cent);

(c) Dispute settlement mechanisms (39 per cent);

(d) Availability of overland transport services at reasonable prices (32 per cent).

Ratings by local investors

Factors that seem to work to the advantage of local enterprises include existing development policies and business support programmes at the national level and the availability of workers with adequate skills (annex II, table AII.2). Factors working to the disadvantage of local investors include:

(a) Cost of raw materials (identified by 72 per cent of the respondents);

(b) Access to raw materials (57 per cent);

(c) Availability of overland transport services at reasonable prices (38 per cent);

(d) Customs and overland transport procedures (30 per cent);

(e) Dispute settlement mechanisms (29 per cent).

Rating differences by enterprise activity

The costs of raw materials received the lowest ratings by the majority of the enterprises, irrespective of their activity. Sector-specific rating differences are outlined below:

(a) Agricultural and crafts enterprises identified access to raw materials as a major constraint, in addition to the existing customs and overland transport procedures and finding business partners;

(b) Enterprises involved in industrial activities (mining, quarrying and manufacturing) and the provision of education and health services emphasized the high cost of overland transport services as particularly problematic;

(c) Providers of ICT and business services took issue with existing dispute settlement mechanisms;

(d) Tourism enterprises find obtaining licenses to establish a business problematic.

Rating differences by enterprise location

The majority of both West Bank- and Gaza-based enterprises emphasized access to, and cost of, raw materials as problematic, in addition to the existing overland and customs procedures. West Bank-based enterprises also described existing overland transport services as problematic. Factors that were negatively rated by Gaza-based enterprises include existing dispute settlement mechanisms as well as renting and purchasing premises.[6]

B. The investors' business development needs

Around 92 per cent of the surveyed enterprises are members of enterprise support institutions, particularly of semi-governmental institutions such as chambers of commerce and agricultural and industrial federations (annex II, table AII.3). However, only 29 per cent of the respondents reported seeking advice from these institutions on a regular basis, and only 34 per cent said that they are satisfied with available enterprise support services.

Table AII.4 (annex II) shows market information and support services to participate in international trade as the main types of services requested by PIPA clients. Among the strategic business development needs mentioned below, improving/adapting products, training local staff and financing are the most prominent.

Foreign enterprise business development needs

Table AII.5 (annex II) provides a detailed account of foreign investor business development needs. The following is a list of the needs reported by over 50 per cent of the respondents:

(a) External finance (65 per cent of the respondents);

(b) Training of local staff (62 per cent);

(c) Receiving FDI (58 per cent);

(d) Improving product quality (56 per cent);

(e) Adapting products to target markets (56 per cent).

[6] It was not possible to discern rating discrepancies at the district level, given the limited number of observations.

Local enterprise business development needs

Table AII.6 provides a detailed account of local investor business development needs. The following is a list of the needs reported by over 50 per cent of the respondents:

(a) Improving product quality (79 per cent of the respondents);

(b) Training of local staff (73 per cent);

(c) Adapting products to target markets (67 per cent);

(d) External finance (62 per cent);

(e) Receiving FDI (54 per cent);

(f) Good relations with government (54 per cent);

(g) Increased use of local suppliers (52 per cent);

(h) Linkages with TNCs (51 per cent).

Local enterprises seem to attach great importance to establishing linkages with TNCs to improve their competitiveness. This is particularly the case for those involved in tourism, mining and quarrying, and ICT and business services (annex II, table AII.7). As shown in annex II (tables AII.8 and AII.9), the majority of the respondents believe that such linkages will facilitate their access to technology and external finance, in addition to exposing them to best practices in strategic management. New growth opportunities appear to be the last thing on the respondents' minds, suggesting an awareness of their enterprises' weaknesses and the need to tackle these weaknesses before entering into new markets.

C. The investors' growth dynamics

The analysis suggests that existing enterprises are held back by deep-seated internal and external constraints. Internal factors include the enterprises' physical, financial and human resources. External factors with direct bearing on enterprise-level competitiveness can be divided into three categories: (a) the overall country-level determinants, including the level of demand, the structure of factor markets and geographical location; (b) the institutional level, including market support institutions, the legal framework and economic policies; (c) industry-specific determinants, particularly backward and forward linkages within the sector and its stage of development.

At the macro level, enterprises' development prospects are limited by the absence of a well-articulated development strategy, a weak legal framework and the absence of adequate trade-related infrastructure. To these factors should be added the dwindling demand for the enterprises' products and their increased isolation from regional and global markets under the ever-tightening Israeli movement restrictions and closure policy. Thus enterprises' limited participation in international trade does not reflect the work of free, unregulated market forces. Rather, it reflects the prohibitive transaction costs facing Palestinian traders in view of the restrictive Israeli security measures, which also involve cumbersome customs and overland transport procedures at the main borders (UNCTAD, 2003a). These measures coupled with the existing trade regime have rendered Palestinian enterprises inward-looking.

At the industry level, the growth prospects of enterprises are influenced by the technological intensity of their sector, their level of innovation and technology transfer opportunities. Successful enterprise development experiences show that enterprises belonging to developed sectors are more likely to experience higher growth rates than those in less developed sectors (Liedholm, 2001). In the Palestinian case, the survey results reveal that the majority of enterprises are constrained by limited growth-inducing inter- and intra-industry production and trade linkages, since they operate within sectors with poor technological capabilities (UNCTAD, 2004).

At the micro level, perhaps the most binding impediment to Palestinian enterprise development is their preoccupation with daily problems arising from the Israeli tight mobility restrictions and, therefore, little attention to long-term improvement opportunities. Palestinian enterprises are forced to focus on survival mechanisms to cope with the adverse political and economic conditions, rather than on strategic business development and expansion.

The adverse political and economic conditions aside, enterprises lack the required institutional support to help them shift their focus away from crisis management. UNCTAD experience with technical assistance projects shows that provided with such support, Palestinian enterprises are quick to reconsider their focus. A case in point is the UNCTAD capacity-building programme for promoting SME development (EMPRETEC), which focuses on developing enterprises' organizational and managerial capacities. Despite the prevailing adverse conditions in the Occupied Palestinian Territory, out of the 130 EMPRETEC graduates of the programme, 10 started their own businesses, 13 expanded existing operations or re-opened their closed businesses and three succeeded in obtaining bank loans. Most of the remaining graduates reported higher sales, strengthened abilities to manage adversity and achieving long-term strategic objectives. These achievements attest to the need to adopt an approach similar to that of the programme, which focuses on building on the enterprises' actual strengths as opposed to a preoccupation with exposing them to international best practices in strategic management.

III. A Proposed Aftercare Strategy

The retention of investments in the Occupied Palestinian Territory would be most helped by a political settlement and lifting of the Israeli movement restrictions and closure policy. However, with or without such developments, the Occupied Palestinian Territory can still improve its attractiveness as an investment location by addressing the aforementioned structural problems. Despite its awkward position, the Palestinian Authority, with the support of the international community, continues its reform and development efforts to improve the investment environment through the efficient use and expansion of the existing policy tools at its disposal.

This chapter proposes a strategy to retain and expand investment in the Occupied Palestinian Territory by focusing on investor needs to improve competitiveness, including through the development of their technological capabilities and mitigating their constraints on growth. The strategy also highlights opportunities for synergy between public services and interventions that address the immediate needs of enterprises as well as long-term interventions that aim at strategic, development objectives. The strategy responds to needs at four levels: enterprise, industry, institutional and macroeconomic.

A. An integrated approach

Retaining existing investments is rendered difficult by an institutional framework that is not tuned to the economic realities generated by the protracted conflict. It is important to keep in mind that the systemic deindustrialization of the Palestinian economy is at the heart of its widespread economic regression. Furthermore, the period since October 2000 has witnessed a shift in Palestinian Authority and donor community attention away from development efforts towards addressing emergency humanitarian needs, through food aid and employment generation, along with financial schemes to compensate local enterprises for physical losses and to address their liquidity crunch.

Efforts to address the economy's long-term development needs have thus far focused mainly on future needs under a more conducive (non-conflict) environment. Priority has been given to developing sophisticated services and liberal laws similar to those of developed economies, with a view to creating a more attractive investment climate. There is a need to complement this wide top-down approach with a PIPA-led bottom-up approach that focuses on the enterprise sector's existing needs.

The immediate challenge of investment retention, therefore, is to reverse the ongoing disinvestment of the industrial capital base. Development experiences elsewhere point to this direction, showing that countries that have succeeded in attracting FDI have combined investment attraction efforts with measures to develop local productive capacities (Blomstrom and Kokko, 2003). Hence there is a need for a comprehensive approach to create a minimum level of industrial development, in order to gain the trust of both local and foreign investors, ensure spillover benefits from FDI and compensate for the Occupied Palestinian Territory's relatively limited domestic markets and natural resources.

B. Strategic orientation

Addressing the identified constraints on competitiveness and growth requires the aftercare strategy to adopt a three-track interactive approach, which targets priority and promising sectors with a view to:

(a) Generating additional capital investments from existing enterprises;

(b) Bringing local enterprises up to international standards in terms of product quality;

(c) Ensuring the widest possible spin-off benefits from FDI.

This approach can be implemented through a more robust and strategically targeted execution of the standard investment promotion agency (IPA) functions of investor aftercare services, policy advocacy and investor targeting.

As a standard IPA tool for investment promotion, aftercare focuses on addressing the needs of established TNCs and their affiliates in host countries. Young and Hood (1994) define aftercare as “all potential services offered at the company level by governments and their agencies, designed to facilitate both the successful start-up and the continuing development of a foreign affiliate in a host country or region with a view towards maximizing its contribution to local economic development”. Within this context, building on a survey of best practices across the globe, UNCTAD (2007b) divides aftercare services into three categories: (a) administrative, to enable and facilitate TNC operations in the host country by, for example, helping them obtain permits; (b) operational, to help TNCs achieve operational efficiency and effectiveness through, for example, export promotion schemes; and (c) strategic, to enable TNC progress along the corporate development path, by supporting their efforts to develop new capabilities for strategic expansion.

In a conflict/post-conflict situation such as the Palestinian case, aftercare should be deployed to embed TNCs in the host country’s economy and generate the widest possible benefits for national investors. In that sense, aftercare also promotes business/investment retention and expansion (BRE) as a way of generating direct additional employment and output as well as indirect benefits through multiplier effects and spin-off benefits, such as local purchases of supply and improved local skills. BRE aims at aligning the business environment around the strategic objective of addressing established enterprises’ development needs. As Clark (2002) explains, the focus of BRE is to “enhance the beneficial (or remediate the negative) impacts of the macro changes and the higher tier policies”.

Within this wider context, effective aftercare begins with a clear understanding of the problems facing investors during the start-up phase as well as in their daily operations and expansion activities. While some problems may be solved through the guidance and intervention of PIPA, many will require the assistance of other public institutions and decision makers.

At that point, policy advocacy and investor targeting become a natural outflow of aftercare. With an eye to development, this approach helps ensure the maximum utilization of local production capacities, enhance backward and forward linkages within the economy, facilitate the transfer of technology to priority sectors and ensure that economic and regulatory restructuring is conducive to investment.

C. Objectives and focus

Guided by the above-mentioned strategic orientations, the aftercare strategy is organized around the following objectives:

Objectives targeting the enterprise level

(a) Enhancing enterprises’ technological capabilities;

(b) Fostering enterprises’ backward and forward linkages;

(c) Diversifying enterprises’ export markets and supply sources;

(d) Familiarizing enterprises with the different aspects of firm-level competitiveness.

Objectives targeting the industry level

(a) Improving enterprises’ access to finance;

(b) Promoting laws and policies to promote investment retention/attraction and industrial development;

(c) Bringing focus to existing SME support initiatives and facilitating enterprises' access to them;

(d) Creating a coalition among clients to sustain long-term economic development efforts.

In tailoring the strategy, PIPA needs to be selective, focusing on specific priority sectors and localities within a precise time frame. This is so because the nature of the technological effort and the scope of learning vary by industry, thus requiring tailor-made packages that address the particularities and growth dynamics of each sector. Such a focus is also in tune with the results of the survey, which show that enterprises' performance and backward and forward linkages are very much a function of their location and type of activities. Moreover, focusing on specific priority groups of enterprises helps generate tangible impact, since it allows targeting efforts around a critical mass of interrelated enterprises. This prioritization would also facilitate the mobilization and efficient allocation of external assistance.

As previously shown, the PIPA client base comprises both labour and capital-intensive activities. Both types of activities should be included in the aftercare strategy, given their direct contribution to reducing unemployment and facilitating industrial restructuring. Capital-intensive sectors should be enabled to generate spillover benefits into the economy, while labour-intensive activities should be assisted to generate employment without sacrificing productivity. It is worth noting that the production of capital-intensive products does not necessarily require modern plants and mass production. Production of such goods by SMEs may be viable and profitable where economies of scale are less important. This is especially the case of relatively simple capital goods such as basic machine tools and agricultural equipment. The importance of SMEs in expanding these sectors is reinforced by the growing tendency of big firms towards fragmentation through outsourcing, strategic partnerships and other types of networking.

In selecting the targeted priority sectors, attention should be given to sectors that are capable of coping with the present conditions. If assisted, these can expand their investments, thereby constituting a tangible basis for future industrial restructuring under more stable conditions. In general, the targeted priority sectors should:

(a) Be capable of creating sustainable employment opportunities even after the end of the support programme;

(b) Have strong backward (especially natural resource) and forward linkages;

(c) Be strategically important for the economy and society at large;

(d) Favour capital investment that is relatively resistant to destruction and has a low replacement cost;

(e) Be capable of exporting or establishing strong local market presence, even under the present conditions.

On the basis of the above criteria, the first cluster of capital-intensive industries could include the more research-intensive industries to allow for the assimilation and diffusion of new technologies, in addition to those that entail huge capital investments. A number of industries could be considered under this cluster:

(a) Machinery and equipment, including transport and construction equipment;

(b) ICT activities, especially those more research-based and with linkages to the industrial sector;

(c) Tourism;

(d) Pharmaceuticals;

(e) Chemicals and their products;

(f) Rubber and plastic;

(g) Stone and marble cutting;

(h) Basic metals and their products.

The second cluster can focus on those labour-intensive industries that can achieve a simultaneous increase in employment and output to generate employment without sacrificing productivity. Targeted industries could include:

(a) Agricultural and crafts;

(b) Food and beverages;

(c) Textiles;

(d) Wood and its products, including furniture;

(e) Leather, including the manufacturing of bags and shoes.

The choice of sectors that will form the focus of each phase can be decided through focus groups that bring together main stakeholders from the different priority sectors. Moreover, to ensure efficiency, particularly during the early stage of strategy implementation, PIPA could consider targeting a certain number of activities from each component to pilot test the aftercare strategy.

D. Strategy components

UNCTAD experience in technical cooperation suggests that the success of any strategy requires integrating it into the implementing institution's core functions. Like any investment promotion agency, the work of PIPA revolves around policy advocacy, investor services, investment attraction and image building to promote the agency and the Occupied Palestinian Territory as an attractive investment destination. Thus individual strategy components should be used as strategic tools for expanding the scope of PIPA core functions. The advocacy function could be deployed to promote policy measures, laws and specialized services for retaining investment, and the aftercare services could be geared towards enhancing the enterprises' technological capabilities and backward and forward linkages. The investor attraction function could be used for supporting the strategy's objectives.

Above all, the strategy requires intensive cooperation with other market support institutions in view of the multifaceted nature of the problems facing PIPA clients. Thus, in addition to delivering specific components, PIPA is expected to leverage partnerships for establishing harmonized interventions, pooling resources and ensuring that the services and actions of one partner are not undermined by another. In this context, PIPA would strive to bring focus to existing enterprise support strategies and initiatives and integrate them into a one-stop shop information facility. To do this PIPA needs to work closely with relevant Palestinian Authority institutions, the Palestinian Private Sector Coordinating Council (PPSCC) and leading enterprise support institutions (annex III).

While the bulk of growth constraints and business development needs identified by PIPA clients can only be dealt with in the long run, they are amenable to immediate intervention. In this sense, PIPA can adopt an incremental approach, whereby each activity or service allows for accumulating tangible gains and achievements that can be capitalized on during the subsequent phases. This can be achieved by sequencing strategy components by priority within the context of a three-phased implementation plan, as shown below. Table 1 summarizes the proposed plan in the form of a matrix, which also identifies relevant public and private sector institutions that need to be involved in carrying out the strategy.

Investor aftercare services

In the short term, PIPA aftercare services should initiate the drive to help build investors' technological capabilities and linkages. This could involve building partnerships with specialized training and research and development institutions and disseminating information on opportunities and best practices. In the medium term, PIPA could combine targeted networking and clustering efforts to assist its clients, and the enterprise sector at large, in establishing inter-enterprise collaborative relationships and generating industry-wide gains. Such gains range from external economies that enterprises can accrue as a member of a group to joint action benefits that arise from deliberate cooperation among enterprises. Capitalizing on the networking and clustering efforts, PIPA could then focus on integrating its clients into regional and global value chains. The rationale for such an emphasis finds its base in the experiences of other developing countries, which show industrial clusters isolated from international value chains as following a low road growth path. As explained by Pyke (1992), the absence of adequate regional and global networks, and therefore limited access to modern technologies and export markets, leave enterprises with no choice but to seek competitiveness by cutting down on production costs. In contrast, clusters that are well integrated into these chains are more likely to follow the high road growth path, showing evolutionary growth based on the continuous upgrading of processes and products.

Information dissemination

PIPA is already providing investors with up-to-date information on the particular rules and regulations governing investment flows, business transactions and the economy's main performance indicators. This information is published on the institutional website, which also includes a database of registered clients. Capitalizing on its network of partners, PIPA could further develop this service category to ensure that clients are kept abreast of emerging developments and opportunities of direct bearing to their performance. This could be done by introducing the following products:

(a) Up-to-date information on training programmes by local and international specialist institutions;

(b) Lists of potential regional and international partners for joint ventures and strategic alliances with PIPA clients;

(c) A database on local, regional and international suppliers by sector;

(d) Results of research work by local, regional and international institutions of relevance to the clients;

(e) Up-to-date information on major international trade fairs organized by local and international institutions;

(f) Highlights on the positive elements of the Occupied Palestinian Territory's business environment and PIPA clients' successful experiences;

(g) Business development tools and best practices in strategic management and industrial organization;

(h) A risk self-assessment form for enterprises seeking external finance, so as to enable them to evaluate and improve their credit worthiness.

Building partnerships with specialized training and research and development institutions

Developing enterprises’ technological capabilities requires bringing them up to international quality standards, including quality assurance, environmental standards and labour norms, to name a few. PIPA could facilitate enterprises’ access to such standards by establishing partnerships with specialized regional and international training and research and development institutions. Such partnerships would enable PIPA to act as an interface between its members and these institutions.

Regardless of their form, the partnerships should seek to provide PIPA clients, and the enterprise sector at large, with tangible channels for developing enterprises’ technological capabilities. These could feature informal working relations or formal agreements in the form of, for example, memorandums of understanding (MOUs), to obtain benefits such as favourable terms for PIPA clients, fielding experts to the Occupied Palestinian Territory to assist enterprises develop their technological capabilities and promoting joint adaptive research between Palestinian universities and relevant regional and international institutions.

The first step for PIPA would be to identify relevant regional and international institutions. When approaching these institutions, PIPA needs to consider that the required upgrading of the enterprises’ capacities calls for fostering entrepreneurs’ skills in three specific areas:

(a) The first relates to investment decisions and involves developing entrepreneurs’ ability to identify and obtain the required technology, equipment and human resources. These determine the capital costs of the project, the appropriateness of the scale, product mix, technology and equipment, and the technology understanding gained by the operating firms;

(b) The second area concerns production processes and ranges from basic skills such as quality control, operation and maintenance to more advanced ones such as adaptation, improvement or equipment “stretching”, and further to the most demanding ones of research, design and innovation;

(c) The third area involves enterprises’ ability to transmit skills and technology to, and receive them from, component or raw material suppliers, subcontractors, service firms and technology institutions.

Promoting cooperation and networking among enterprises

Successful experiences show that enterprise development is only possible if the enterprises show a willingness to pool efforts and collaborate on a continuous basis. However, as Martinussen (1995) explains, enterprises are often hesitant to join efforts when the benefits will only be reaped in the future or they may simply be unaware of the potential benefits of joint action.

Enterprise networking provides a powerful tool for promoting inter-enterprise collaboration, allowing for a gradual consolidation of trust among enterprises and providing an efficient channel for knowledge transfer and collective learning. It involves targeted efforts to link interdependent enterprises with similar characteristics and growth dynamics together in a value adding production chain, with the ultimate objective of promoting growth inducing complementarities between their production processes.

PIPA could facilitate network formation by assuming the role of the “network broker”. The network broker is recognized as the driving force for network formation, serving as the facilitator for overcoming start-up problems and coordinating inter-firm relations, in addition to providing specialist support. As explained by Martinussen (1995) and Xinagang Xu and McNaughton (2003), network brokers usually assume the following tasks:

(a) Identifying potential networks: a network programme can be created in response to an initiative by a group of enterprises or proactively. In either case, the network broker has to undertake a diagnostic exercise to identify common problems and explore areas of mutual benefit to participating enterprises. The most common approach is to bring together a small group of 10 to 20 enterprises to identify opportunities and agree on common objectives or a network idea. Conversely, the network broker can propose network ideas, and then approach potential enterprises to bring them together to further develop the network idea;

(b) Overcoming the skepticism of participating enterprises: this might be achieved by providing immediate benefits to enterprises. This could mean, for example, pooling their resources to purchase raw materials in bulk, applying for a loan together, sharing equipment and eventually diversifying production and seeking new markets. The broker could act as a referee in disputes between enterprises and as an interface between enterprises and other public and private sector institutions;

(c) Creating commitment to the network among participating enterprises: this is perhaps the most difficult task. The most common strategy is to make exit more costly by ensuring a certain level of privileges to members.

The only subsidy to the network is the services of the network broker; these are initially free and over a period of time move to fee-based services. Moreover, and in order to ensure the network's sustainability, network brokers should be appointed for a limited period, after which participating enterprises must take over all the responsibility (Humphrey and Schmitz, 1996).

Given its limited experience in this area, PIPA could seek technical assistance from relevant organizations in designing its networking programme. PIPA can draw on the experience of Honduras, where the United Nations Industrial Development Organization (UNIDO) piloted the idea of network brokers with successful results.[7] Above all, PIPA should work closely with existing businesses associations and industry federations. PIPA has already established longstanding relations with some of these institutions and has invited them to join its board of directors.

Sectoral-geographical clustering

While networking facilitates inter-enterprise collaboration, enterprise clustering allows for generating industry-wide gains. Cluster development involves geographically or sectorally concentrated groups of interdependent enterprises and can take as its main focus the creation of industrial agglomerates from scratch or seek to enhance existing ones.

Markusen (1994) proposes a typology of industrial clusters based on the salient features of member enterprises and inter-firm cooperation. This typology involves four general types: (a) Marshallian clusters, comprising local SMEs and featuring substantial inter-firm trade and collaboration, as well as strong institutional support; (b) "hub and spoke" clusters, dominated by one or several large enterprises with numerous small suppliers servicing the large firms; (c) satellite platforms, dominated by externally-based TNCs and their affiliates with minimum inter-firm trade and networking; and (d) state-anchored, dominated by public entities, such as universities, government agencies and suppliers of services to public entities.

In the case of the Occupied Palestinian Territory, it would be more cost-effective to foster existing industrial clusters and focus on establishing the Marshallian type, at least during the early stages of the programme. This is particularly because of the prohibitive transaction costs that hamper the relocation of enterprises. Working closely with relevant public and private sector institutions, PIPA could spearhead the consolidation of such a cluster. The first step would be for PIPA to identify existing clusters and prioritize which ones to concentrate on initially. This could

[7] See UNIDO: http://www.unido.org/index.php?id=o4302.

be followed by an analysis of the cluster in terms of its areas of strength and weaknesses, the nature of its backward and forward linkages and skills shortages and the enterprise level. PIPA could then proceed with the establishment of a public–private sector focal team to develop a cluster vision and identify immediate and long-term needs. PIPA should also spearhead the establishment of institutional mechanisms, e.g. committees or an institution, to sustain the clustering process into the future.

Drawing on the work of Piore and Sabel (1984), UNCTAD (2004) emphasizes that clustering efforts in the Occupied Palestinian Territory need to focus on developing two sets of dynamics. The first relates to increasing inter-firm coordination through "flexible specialization", whereby the production process is decentralized through subcontracting arrangements to allow member enterprises to specialize in specific phases of the production chain. This will put enterprises in a better position to take advantage of different economies of scale at different stages of production, focus on product characteristics (instead of price) and achieve economies of scope through adaptive machinery and broader participation by multi-skilled employees so that the relationships between firms become organic and conducive to innovation.

The second set of dynamics relates to fostering inter-firm collaboration by facilitating enterprises' joint action. As explained by Schmitz (1997), the focus should be on generating "collective efficiency" as opposed to "static efficiency". The latter refers to passive externalities that accrue to firms by virtue of being part of a cluster, while the former materialize as a result of purposeful joint actions. Collective action can take the form of horizontal cooperation between companies operating at the same level of the production chain, or vertical cooperation between final producers and their input suppliers (backward cooperation). Vertical cooperation can also entail the exchange of market information between buyers and producers (forward cooperation).

Integrating existing investors into regional and global value chains

According to UNCTAD (2001), networking programmes need to proceed along two complementary paths: creating new linkages between local and foreign enterprises and deepening existing linkages with a view to developing domestic enterprises' productive capacity. The aim should be to facilitate upgrading the quality of local enterprises' products, with a view to increasing local outsourcing and the cluster's attractiveness to inward investment.

Viewed in this light, networking efforts should seek to help local enterprises form two-way strategic relationships that are focused on joint production and knowledge sharing. These partnerships could take the form of subcontracting arrangements or equity participation, based on a long-term vision rather than short-term considerations such as quick profit. UNCTAD (2003b) points out that for capital- and technology-intensive activities, the networking effort needs to create multiple linkages to TNCs, specialized research institutes and sources of supply. PIPA could assist its clients in structuring and negotiating joint ventures and technology transfer arrangements.

Best practices suggest that such programmes require focusing on existing clusters or networks with promising prospects, following a demand-driven approach that considers the needs of TNCs and seeks to assist local enterprises in meeting their requirements. The starting point would be to identify local networks or clusters and conduct a thorough assessment of the clusters' areas of strength and weaknesses. Once a network is formed, PIPA can then approach TNCs and link them with the local network of enterprises, thus shifting its role from a network broker to a network coordinator. This would involve combining matchmaking and local supplier upgrading activities to forge strategic partnerships between enterprises and TNCs.

Assuming such a role requires that PIPA identify possible forms of partnership and alliances for linking local enterprises with TNCs, in consultation with business associations and industry federations. Common measures for enabling technology mastery include internalized technology transfer (embodied in imported machines and equipment); licensing and arm's length purchase of know-how, patents, licenses and blueprints (i.e. royalty and license fees); and engaging foreign enterprises, particularly TNCs, in local capacity development through training and apprenticeship programmes. Such measures require arriving at a common understanding of the legal issues that arise from technology transfer. Here bilateral and regional agreements on common standards become necessary.

Table 1. Proposed action plan for PIPA aftercare

Aftercare activities	Short term	Medium term
Information dissemination	• Prepare new products for keeping investors abreast of emerging developments and opportunities of direct bearing to their performance • Pilot test the products • Launch the products	• Conduct a survey to solicit investors' feedback on the services and modify where needed
Partnerships with specialized training and research and development institutions	• Establish partnerships with relevant regional and international training and research and development institutions	• Act as an interface between its members and these institutions
Sectoral-geographic networking and clustering services		• Establish a compendium of investors' skill shortages by sector • Design an integrated networking and cluster development programme to promote direct cooperation and networking among investors and between PIPA clients and the Palestinian enterprise sector • Mobilize donor support for launching the programme • Assume the role of network coordinator
Integrating PIPA clients into regional and global value chains		• Develop a thorough understanding of relevant regional and global value chains and identify/target potential TNCs for the selected cluster, and their needs • Conduct a detailed survey of the various forms of possible partnership and alliances for connecting local enterprises with TNCs • Identify networks that bring together local enterprises willing to pool efforts and proceed within the context of the framework set to achieve the objective of the proposed network • Design linkage programmes and mobilize support for launching the programme

Policy advocacy

The policy advocacy function should be deployed to promote reform measures necessary for the successful implementation of the aftercare strategy and the development of the Palestinian economy's enterprise-level competitiveness at large. The analysis emphasizes a number of policy orientations and measures that need to form the focus of this function. These measures are outlined below and are sequenced to support the investor services function. PIPA could promote these measures through white papers, which adopt a problem-solving approach to investment retention and promotion. The papers should provide a clear articulation of the problem at hand

and identify strategic objectives and priorities with respect to investment and main policy options for meeting these objectives, along with possible programmes and forms of involvement (e.g. equity, non-equity, domestic and foreign investment options).

A comprehensive legal framework for governing investment

The consolidation and further development of the Palestinian legal framework should be accorded priority treatment by PIPA and form the focus of its advocacy function starting in the short term. Given the limited institutional capacity of the Palestinian Authority, a key requisite of successful legal reform is to set priorities and sequence new laws with simultaneous efforts to ensure effective enforcement. Below is a discussion of the general and specific issues that could be tackled by PIPA advocacy efforts in the area of legal reform. These issues relate to the 1998 Law on Investment Promotion and its proposed revision, which was recently prepared for consideration by the PLC. The proposed revision expands the membership of the PIPA Board of Directors to allow for greater involvement of line ministries and enhance public–private partnership (article 14) and broadens the agency's mandate with a special emphasis on aftercare services (article 15). It also provides additional investment incentives such as immediate citizenship to foreign nationals who undertake substantive investments in the Occupied Palestinian Territory (article 6).

General issues

(a) Streamlining and updating current legislation governing investment and unifying the legislations in both the West Bank and the Gaza Strip;

(b) Reviewing bankruptcy law and ensuring its enforceability;

(c) Differentiating between provisions that formulate the fundamental principles of the investment policy and the provisions that need to adjust to new circumstances. The former set of provisions should be incorporated in the investment law, while the latter could be the object of regulatory bodies;

(d) Including mandatory environmental review as part of the approval process for proposed investment projects and reflecting environment protection in the investment law.

Issues related to the existing investment law and its proposed revision

(a) A preamble to the investment law could be added to emphasize the main features and orientations of the reforms undertaken as well as the efforts made by the government to improve the general environment for investment;

(b) Definitions: the notion of investment should be extended and its constituent elements should be enumerated (article 1). The proposed revision constitutes a step in this direction, providing a clear definition of investment expansion and fixed assets. However, it needs to be substantiated with clear definitions of the remaining constituent elements of investment, including intangible property like patents and other intellectual property rights (IPRs) and portfolio investment. In addition, the definition of "national investor" should be made more explicit and precise;

(c) Entry and establishment requirements: the proposed revision does not articulate market entry and enterprise establishment requirements (article 3). The law should be substantiated with precise criteria;

(d) Exemptions and other incentives: the investment law should clearly define the exceptions to, and general criteria and procedures for, granting exemptions and other incentives to local and foreign investors. The proposed revision further elaborates the criteria for granting investment incentives. It increases the number of sectors that stand to benefit from exemptions and incentives (article 4); a step further would be to prioritize the sectors with strategic contribution to the development vision. It also provides a more accurate definition of the value of investments that stand to benefit from the law (article 23). Moreover, the proposed revision features special provisions for enterprises engaged in the ICT sector (article 23). However, the exceptions and procedures for granting exemptions and incentives need more substantiation, with detailed and clear-cut criteria (articles 24, 25 and 31). Moreover, given the extent of the ongoing economic crisis, it would be worth considering the inclusion of existing enterprises, particularly SMEs, among those eligible for investment incentives;

(e) Real estate transactions can be made easier and more flexible. The law should also deal with the issue of the mortgaging and pledging of related assets;

(f) Discrimination: the investment law includes several instances of discrimination, at different degrees and in different ways. These concern:

   (i) Situations resulting from the provisions of articles 3, 6, 10, 11 and 23 of the law, which need to be amended to ensure non-discrimination, transparency and non-arbitrary treatment. Notably, discretionary powers (articles 24 and 31) should be reduced;

   (ii) The incentives regime: the incentives system elaborated in article 23 is largely in favour of big enterprises at the expense of SMEs, which are too small to qualify for the stipulated benefits. There is also the need to reconsider the article's exclusive focus on foreign investors. Separate measures need to be put in place to grant locally-owned enterprises with special advantages. In this regard, the current tax regime, as well as the provisions of article 24, could be reviewed. Moreover, there is a need to expand investment incentives to include a wider range of fiscal, monetary and administrative measures. Such measures could include accelerated depreciations, loan guarantees and reinvestment allowances, which could be tied to the Palestinian Authority's development objectives and priorities;

   (iii) Selection criteria: PIPA lacks a detailed strategy and set of criteria for selecting strategic projects that can benefit from specific advantages;

(g) Export promotion: the investment law could be enriched with the inclusion of a regime for export-oriented investments and activities, particularly since the law already includes a provision on "exceptional exemptions to export projects". "Estates" could be accorded the status of export-oriented projects. However, discriminatory treatment against firms that are not located within a zone is not desirable. Therefore, a regime aimed at attracting export-oriented investments and covering the whole Occupied Palestinian Territory could be more advantageous. Under such a regime, any enterprise could take advantage of the law, irrespective of its location, provided that it complies with specified requirements;

(h) Investment protection: the provisions of articles 7 and 8 of the investment law could be more explicit regarding the conditions for lawful expropriation. Guarantees might be considered to cover the access of the investor to foreign currency in the situations described in articles 10 and 11. In addition, the law could mention the possible adherence of the Palestinian Authority to the provisions of multilateral and regional investment guarantee conventions. The work of PIPA in this regard could focus on (i) completing the provisions of the investment law regarding investment guarantees and protection along the lines described; (ii) reactivating cooperation with the Multilateral Investment Guarantee Agency (MIGA); (iii) creating a national investment guarantee institution; and (iv) setting up a national institution of deposit guarantee;

(i) The stability of the investment regime: the scope of article 33 of the investment law could be extended to apply to any change affecting investment conditions. The law might even go one step further in providing guarantees to investors so that if investment conditions are modified, the investor will be offered the possibility to benefit from the most advantageous regime and to exercise his own choice;

(j) The settlement of investment-related disputes (articles 39 and 40 of the investment law): it is advisable to include provisions on the settlement of disputes between private parties and to refer rules of arbitration as well as to those of the International Chamber of Commerce (ICC) and the International Centre for the Settlement of Investment Disputes (ICSID). It is also recommended to systematically introduce conciliation and mediation procedures as a compelling phase before starting arbitration procedures, thus utilizing the flexibility offered by alternative dispute resolution (ADR) instruments. Some specific issues relating to international disputes and their relationships with local arbitration legislation should also be taken into consideration. PIPA should present and support proposals along the suggested lines.

Issues related to distressed enterprises

(a) Concerning bankruptcy and other corporate issues, PIPA is well positioned to review specific financial insolvency situations, sponsoring private negotiations, notably by formulating flexible and not compulsory procedures such as intermediation, conciliation and mediation, and by establishing a list of experts;

(b) PIPA might consider promoting measures to ensure the survival of distressed enterprises and an effective functioning of the capital market. Notably, corporations and other types of business would be authorized to engage in security transactions and to issue certain types of securities, including secured and unsecured debt obligations;

(c) The above-mentioned measures should be accompanied by steps aimed at, for example, eliminating minimum capital requirements, reducing minimum par value, allowing the repurchase of the company's debt or equity instruments and improving the privileged status of holding and offshore companies. PIPA should be the promoter of the required transformations of the legal system;

(d) PIPA may also wish to consider presenting draft amendments to the current law to include contractual arrangements such as BOT (build-operate-transfer), leasing and farming out, as well as other contractual forms to facilitate private sector non-equity involvement, particularly in sectors where private participation is needed.

Issues related to intellectual property rights protection

Foreign investors are usually reluctant to make their technology and trademarks available to potential local partners or associates in the absence of adequate protection of intellectual property rights. There is a need to provide an incentive to undertake costly and risky investments in innovative activities. PIPA should therefore initiate a reform of the institutions and laws relating to property rights protection, their transmission, mortgage and non-judicial foreclosure on pledge assets. A first step in this direction could involve redefining the notion of investment in article 1 of the investment law in a way that would include IPRs.

In the meantime, deliberations for a separate law for the protection of IPRs should start to address the following issues: (a) recognizing and protecting trademarks; (b) providing the opportunity for third parties to oppose the registration of trademarks; (c) recognizing and protecting trade or industrial secrets, new technologies and moral rights as well as copyright of authors, artists and performers; (d) defining and identifying infringements; (e) establishing procedures for the confiscation and destruction of infringing goods; and (f) modernizing the trademark and patent registration system.

All of these proposals are important for ensuring the legal framework's conduciveness to retaining and attracting new investments. However, the sequencing of reform measures should be in line with Palestinian development needs and vision. It is worth mentioning that higher standards of IPR protection were implemented in the developed countries only when a threshold level of technological advancement was achieved. Therefore legal reforms related to IPR should involve an in-depth cost–benefit analysis and understanding their implications for development. This is particularly important since the Occupied Palestinian Territory is a net importer of knowledge-based products and may end up paying higher prices for these products before it is able to develop its own technological capacity. The Palestinian Authority should carefully study the consequences of adhering to international standards and agreements, particularly those embodied in the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). The Palestinian Authority should also consider adopting a sequenced approach to IPR protection since it is not a signatory to TRIPS and thus is not operating under a time-bound schedule of commitments.

Issues related to foreign exchange regulations

The investment law codifies some aspects of existing foreign exchange regulations in articles 10 and 11, which provide for the repatriation of foreign exchange related to foreign investment. In other countries, legal provisions go beyond a mere assurance that investors will be free to acquire foreign exchange. The investors are guaranteed that foreign exchange will be made available to them or that they will have priority access to it. It would therefore be advisable to introduce provisions in the investment law that would provide foreign enterprises with such guarantees. In this respect, PIPA could consider promoting the idea of establishing an offshore banking facilities system for investment. Benefits associated with such a system include reduced banking formalities, increased bank competition, transfer of banking know-how, rationalization of international transactions, development of the inter-bank market and, last but not least, the internationalization of the domestic banking system.

A more conducive tax system

Tax incentives could be improved even under the current adverse economic and political environment. In the short term, and as part and parcel of its efforts to contribute to legal reform, PIPA could initiate a comprehensive reform effort focusing on: (a) the carrying of losses forward; (b) the transfer of profits to legal reserves free of tax; (c) exemption of capitalized profits; (d) exemption of the dividends distributed by holding and offshore companies; (e) exemption of the interests paid on all current and saving accounts; and (f) exemption of the profits derived from the transfer of corporate shares.

Reinvestment of profits could also be encouraged by making them tax exempt even if the investment takes place in another domestic enterprise. Other measures include accelerated depreciation of physical assets, the carrying of losses and acceptance by the tax authorities of deductible expenses justified by the prevailing situation.

It would be worthwhile for PIPA to draw on the British and French experiences, which have succeeded in stimulating private equity. The two countries adopted similar tax incentives, involving: (a) “up front” tax relief at the time of investment; (b) an exemption from tax on dividends; and (c) an exemption from tax on capital gains. Private equity increased significantly in both countries in 2003 and 2004, where the growth of funds raised by companies in public markets had been relatively flat.

Measures conducive to skills development

Enhancing enterprises’ technological capabilities cannot be achieved unless local capabilities are in place to master and adapt the acquired technologies. After all, technological capability is embodied in people and not only in machines. The analysis points to the urgent need for marshalling labour policy around the strategic objective of consolidating and expanding existing technologies at the enterprise level. In this sense labour policy should be geared towards satisfying local skills requirements, involving measures to foster linkages with educational planning and creating a safety net for the labour force. In the long run, the Palestinian Authority needs to invest in establishing advanced training programmes and in creating local research and development capacities. Below is a list of suggested policy measures that PIPA could promote in the medium term of this strategy:

(a) Reorientation of training programmes by vocational centres around critical skill shortages identified by PIPA. Specific measures that could be proposed by PIPA include:

   (i) The establishment of advanced training courses to enable scientists and technicians to handle industrial engineering tasks and retraining courses to avoid dislocation effects as a result of technological upgrading. Such programmes can be established through cooperation agreements with specialized institutions and hosted by vocational training centres and/or universities;

   (ii) The introduction of incentive schemes (e.g. tax cuts) to assist enterprises in implementing their own training programmes. The Palestinian Authority could also consider launching an unemployment benefits package, including unemployment insurance, and subsidized loan programmes for the unemployed and venture businesses;

(b) A coaching or employment exchange programme to guide and counsel the different segments of the labour force, including the employed and self-employed as well as the unemployed;

(c) A specialized training centre in the Occupied Palestinian Territory. This includes mobilizing donor support and contributing to the design of tailor-made training courses to meet client skill shortages;

(d) Building research and development capacities to facilitate the assimilation, adaptation and improvement of imported technologies to suit local conditions. Developing this capacity requires going beyond increasing research and development expenditures to ensuring the active involvement of local institutions in research activities. Given the elevated costs and high degree of uncertainty associated with increasing research and development capacities, the Palestinian Authority may consider adopting a selective approach. In this sense, the Palestinian Authority could start by promoting research and development in areas that respond to the enterprise sector’s immediate needs, leaving investments in more advanced, innovative research and development to later stages as enterprises develop their productive capacities.

Increased financial intermediation

The surveyed enterprises’ growth dynamics identified in chapter II suggest that it would be wrong to conclude that more, and easier access to, external finance should wait until political uncertainty fades away. It would be equally wrong to conclude that facilitating access to finance alone will improve enterprise competitiveness. Rather, improving investors’ access to finance should be treated as one component of a comprehensive approach that tackles enterprises’ constraints on growth and enables them to use external finance in a strategic manner. Moreover, the problem of financial disintermediation should be also seen as a reflection of the limited investment opportunities under the ever-tightening Israeli movement restrictions and closure policy. With this in mind, PIPA could promote the following measures to facilitate enterprises’ access to finance during the second and third phases of the programme:

Expanding the range of eligible collateral

PIPA could promote the idea of using covenants as a substitute to collateral or as an additional security. Covenants normally cover such matters as working capital, debt–equity ratios and dividend payments. The most common covenants are a commitment by the enterprise to: (a) periodically report its financial status in detail; (b) ask the lender’s permission before making an investment that could endanger its solvency; and (c) pay higher interest and fees if its financial position goes beyond agreed upon limits.

Negative covenants can also be used for the same purpose. Typical examples of negative covenants are the ones used by the International Finance Corporation (IFC) to obligate borrowers not to incur further borrowing or increase their debt position without consultation with banks. PIPA, in coordination with the PMA, could examine the use of covenants and, possibly, improve their usability. An ad hoc committee would be set up in order to develop structured covenants that could be widely accepted by the lending financial institutions as a replacement for collateral or as an additional security.

Creating credit and insurance schemes

As previously mentioned, in light of commercial banks' conservative lending policies, MFIs and non-banking financial institutions (NBFIs) have come to play a critical role in meeting enterprises' financial needs. However, given their limited capacity and resources, these institutions cannot be considered as an alternative for the banking system. They should instead supplement the banking system in fulfilling its function as a provider of finance for PIPA clients and Palestinian enterprises at large.

This could be achieved by establishing special credit guarantee schemes that would allow MFIs and NBFIs to tap the banking system's deposit base to finance their credit lines, thereby acting as intermediaries between potential borrowers and the banks. These institutions would screen borrowers, monitor their performance and assume responsibility vis-à-vis the banks in case of default. It is important that guarantee schemes involve a process that includes local banks, business associations and chambers of commerce to provide applicants with assistance in the preparation and implementation of business plans. Such an approach allows for focusing on and favouring enterprises with reliable business plans. Moreover, to enable MFIs and NBFIs to assume such a role more effectively, they should be adequately staffed to process and handle loan requests without delay and take immediate remedial actions when certain default levels are reached. Capacity-building measures should focus on: (a) the design of interest rates and fees scales that are sufficient to cover the programme's operational costs as well as its imputed costs of funds; (b) rapid access to follow-up loans/credit to allow entrepreneurs to build their businesses and encourage repayment; (c) strong delinquency management; (d) achieving high volumes and significant outreach by designing appropriate loan and savings products; (e) better coordination and cooperation between microfinance institutions, such as the exchange of information on "bad borrowers", the setting of minimum industry performance standards and over time, the establishment of a credit rating agency.

Yet another mechanism for facilitating enterprises' access to external finance would be the establishment of loan insurance schemes. Such schemes safeguard the borrower's loan against default risks by imposing an insurance premium that is shared between the borrowing enterprise and the government. PIPA could also promote the establishment of a separate credit guarantee scheme to finance SMEs' trade activities, as well as a loan insurance scheme.

Table 2. Proposed action plan for PIPA policy advocacy

Policies advocated	Short term	Medium term
A comprehensive legal framework for governing investment	• Conduct a review of the Palestinian investment law	• Lobby for enacting the proposed revised investment law
A conducive tax system	• Based on the results of the investment policy review, present proposals for improving the existing tax system	• Lobby for the introduction of the improved tax system
Skills development	• Initiate contacts with specialized regional and international training and research and development institutions to solicit their advice in the area of skills development and explore the possibilities of establishing strategic partnerships	• Propose laws to protect IPRs in line with the Palestinian development vision, with a special focus on the priority sectors that require support and protection • Propose appropriate strategies to enhance the technological capabilities of priority sectors • Propose training programmes to address the identified critical skills shortages (table 1) • Propose retraining courses to avoid dislocation effects associated with technological upgrading • Propose an employment exchange programme • Lobby and mobilize support for: - launching specialized training courses to address identified skills shortages; - launching specialized retraining courses to avoid dislocation effects as a result of technological upgrading; - launching the employment exchange programme; - establishing a specialized training centre in the Occupied Palestinian Territory
Increased financial intermediation	• Set up a committee to prepare and review proposals on financial intermediation	• Present proposals for expanding the range of collateral eligible to offset credit risks • Working closely with MFIs and NBFIs, assist in designing special credit guarantee scheme(s) and loan insurance scheme(s) • Present a proposal for the establishment of a foreign trade insurance and reinsurance company for the Palestinian Authority's consideration

Investor targeting

PIPA could consider orienting the investment attraction function from a focus on increasing the sheer quantity of inward FDI flows towards servicing priority sectors by mobilizing FDI from particular source countries and TNCs. In this regard, PIPA could lead the coordination with governmental institutions and private sector organizations to establish investment attraction campaigns for the targeted sectors. The campaign should identify potential investors in the Occupied Palestinian Territory, either local, Arab or international, with an emphasis on Palestinians living abroad. It should also be implemented parallel to and fully integrated with the activities proposed above. In a sense, PIPA could use the proposed activities as a vehicle to deliver the message of its investment attraction campaign. For example, the network proposed for integrating Palestinian enterprises into regional and global value chains could be used to promote investment in Palestine.

Table 3. Proposed action plan for PIPA investor targeting

Investor targeting	Short term	Medium term
Investor targeting	• Lead the coordination with governmental institutions and relevant private sector organizations to identify target sectors for investment attraction campaigns	• Design, launch and modify sector-focused investment attraction campaigns

E. Capacity needs of PIPA

Established in January 2000, PIPA has yet to build its institutional capacity and consolidate its organizational structure. PIPA is currently organized into six functional departments: One-Stop Shop, Incentives, Promotion, Aftercare, Research and Development, and Foreign Investment. These departments are serviced by the Administrative and Finance Department, Public Relations, International Relations Department and a Legal Unit. All these report to the Director General who in turn reports to the Board of Directors, which brings together 15 members, of which five are from the private sector and the rest represent Palestinian Authority institutions. The Board of Directors is chaired by the Minister of National Economy, with a representative of the Ministry of Finance serving as Deputy Chairman.

The agency is slated for organizational restructuring in the near future to streamline activities and improve overall efficiency and effectiveness. This makes it difficult to arrive at a clear conceptualization of how best the individual programme components could be integrated into the main departments. Regardless of the new shape of its organizational structure, PIPA is awkwardly placed to consolidate and operate the proposed aftercare strategy. Specifically, PIPA lacks:

(a) Experienced industry-specific staff;

(b) Experienced staff in the area of surveying and database management;

(c) Experience in the best practices of aftercare;

(d) Experience in the area of cluster and network brokerage;

(e) Internal sources of funds: PIPA remains heavily reliant on the Palestinian Authority for covering its wage bill and the costs associated with service delivery;

(f) Established contacts with TNCs and their affiliates in regional and global markets;

(g) Country- and sector-specific information in target countries.

Most of the above-mentioned capacity shortfalls are attributed to the adverse economic and political environment, which also limits the Palestinian Authority’s ability to support PIPA. As a public institution, PIPA has been effectively impaired by the Palestinian Authority’s financial crisis. The agency has witnessed the dwindling of its human resources, having lost key staff to the private sector, including those who received formal training under different donor-funded projects. As a result, PIPA has been forced to scale down its activities to registering new investments, in addition to supporting the Palestinian Authority’s renewed investment promotion efforts.

Such an adverse situation renders donor support critical for kick-starting the aftercare strategy. And even if PIPA was endowed with resources and government support, it would be difficult, if not impossible, for it to implement the programme on its own. It would be equally difficult to launch all the proposed activities in a single undertaking. As such, PIPA should cooperate with other institutions and consider dividing the strategy into short- and medium-term phases, with each focusing on a limited number of activities, as detailed in tables 1–3 above. Specific areas of focus for capacity-building efforts are detailed in the table below (table 4), which sequences activities across the short and medium terms. These activities should be preceded by a comprehensive programme for consolidating the organizational structure of PIPA. Such a programme should also equip PIPA with the required information management systems to streamline its procedures, as well as in-house expertise skills in the area of strategic management.

Table 4. Proposed action plan for PIPA capacity-building

Capacity-building activity	Modality	Possible international partners	Output
Short term			
Developing the PIPA information management system	• Advisory services for developing the PIPA information management system, including updating existing programme software and/or installing new software • Training PIPA staff on the use of the updated information management system	• Local/international ICT companies	• A modern information system tailored to the internal organizational and managerial needs of PIPA and conducive to enhancing the agency's visibility • In-house expertise for maintaining and updating the system
Developing the surveying capacity of PIPA	• Advisory services for designing and installing a user-friendly database of PIPA clients • Training PIPA staff on the use of the database • Training PIPA staff in the area of survey design and management	• International survey companies	• A user-friendly database of PIPA clients installed at PIPA headquarters • In-house expertise for maintaining and updating the database • In-house expertise in conducting survey-based needs assessments
Assisting PIPA in establishing strategic partnerships	• Advisory services to assist PIPA in identifying potential regional and international IPAs and research centres • Technical and legal advisory services to identify appropriate forms and terms of partnership arrangements between PIPA and relevant regional and international institutions	• UNCTAD • World Association of Investment Promotion Agencies (WAIPA) • World Bank	• A list of potential partners • Partnership mechanisms (e.g. MOUs) for future use by PIPA

Capacity-building activity	**Modality**	**Possible international partners**	**Output**
Assisting PIPA in further developing the Palestinian investment law	• Advisory services to assist PIPA in conducting an investment policy review	• UNCTAD	• A revised investment policy for the Palestinian Authority's consideration
Familiarizing PIPA staff with development-driven economic policies	• Participation in training workshops by regional and international research and development institutions on development-driven economic policies under globalization, particularly the inter-linkages between trade and investment as well as between tax policy, labour policy, IPRs and enterprise development.	• UNCTAD • WAIPA • World Bank • World Trade Organization • World Intellectual Property Organization • Specialized research institutions	• PIPA staff familiar with development-driven economic policies
Assisting PIPA in fostering its visibility, particularly its lead role in the area of investment retention	• Advisory services to assist PIPA in designing promotional strategies for each programme component	• UNCTAD • Location consultancy firms	• Promotional materials for immediate use by PIPA
Medium term			
Assisting PIPA in designing an integrated networking and cluster development programme	• Advisory services to assist PIPA in designing and conducting a survey-based assessment of its clients' skill shortages • Advisory services to design and pilot test the integrated networking and cluster development programme • Training services to familiarize PIPA staff with international best practices and successful experiences in the area of networking and clustering	• UNCTAD • UNIDO • WAIPA	• A needs assessment questionnaire for PIPA to use in future needs assessments • A compendium of PIPA clients' skill shortages by sector • An integrated networking and cluster development programme for consideration by PIPA • In-house expertise in the area of networking and cluster management
Familiarizing PIPA with best practices for covenants enforcement	• Training services to familiarize PIPA with the use and enforcement of covenants	• World Bank	• PIPA staff familiar with the use and enforcement of covenants, particularly as a means for expanding the range of eligible collateral

Capacity-building activity	Modality	Possible international partners	Output
Assist PIPA in designing sector-focused investment attraction campaigns	• Advisory services to assist PIPA in designing sector-specific investment attraction campaigns	• UNCTAD • UNIDO • Private sector	• Sector-specific investment attraction campaigns
Assist PIPA in designing a linkages programme	• Advisory services to allow PIPA to develop a thorough understanding of relevant regional and global value chains and identify/target potential TNCs for the selected cluster, and their needs • Advisory services to assist PIPA in conducting a detailed survey of the various forms of possible partnership and alliances for connecting local enterprises with TNCs • Advisory services to assist PIPA in identifying and establishing networks that bring together local enterprises willing to pool efforts and proceed within the context of the framework set to achieve the objective of the proposed network	• UNIDO • UNCTAD • International Trade Centre • GTZ • Japan External Trade Organization (JETRO) • United States Agency for International Trade Development	• PIPA familiar with regional and global value chains and having a list of potential TNCs for the linkages programme • A detailed survey of the various forms of possible partnership and alliances for connecting local enterprises with TNCs • Draft proposals for establishing networks that bring together local enterprises willing to pool efforts and proceed within the context of the framework set to achieve the objective of the proposed network
Familiarizing PIPA with best practices in credit and insurance schemes	• Training services to familiarize PIPA on credit and insurance schemes	• World Bank	• PIPA staff familiar with best practices in credit and insurance schemes

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Annex I. Profile of PIPA clients

A. Introduction

The client base of PIPA consists of (mostly local) enterprises that were founded following the establishment of the Palestinian Authority in 1994. Around 73 per cent of the enterprises were established during the period 1994–2000 and another 14 per cent were established during the period 2000–2004. The remaining 13 per cent were established before 1994.

Investors exhibit a low level of diversification, with 40 per cent of the surveyed enterprises engaged in manufacturing activities and 30 per cent in mining and quarrying. Moreover, a breakdown of the manufacturing enterprises by activity shows a heavy concentration in the production of food and beverages. This skewed sectoral distribution mirrors that of the enterprise sector, reflecting the modest success of PIPA in attracting investments in new areas.[8] It is also worth mentioning that most of the newly established enterprises over the period 2000–2004 follow the economy's overall structural transformation towards low skill, low productivity activities.

PIPA clients also share features common to the Palestinian SME sector (UNCTAD, 2004). They are dominated by small enterprises and stand as an important source of employment generation, with a workforce consisting mainly of paid employees. The majority of the surveyed enterprises are managed by middle- and old-aged entrepreneurs with prior business experience in areas related to their present activities. Agricultural and industrial enterprises are owned by entrepreneurs with vocational training only, while enterprises involved in the health and education sectors are owned by holders of university degrees. University degree holders also own most of the information and communication technology enterprises, as well as tourism enterprises and those involved in the provision of business services.

The survey results also reveal that, as is the case of Palestinian SMEs, PIPA clients have weak backward and forward linkages with other sectors. This is manifested in their limited access to commercial loans and raw materials and the fact that they sell directly to customers. Moreover, only 17 per cent of the respondents reported involvement in subcontracting arrangements, with the majority subcontracted to Israeli enterprises where the benefits of such arrangements are questionable. PIPA clients also show a heavy focus on local markets, and export-oriented enterprises are heavily dependent on Israel as the main outlet for their products. The surveyed investors also exhibit a narrow export mix (mainly wearing and apparel, paper and related products, rubber and plastic, stone and marble, in addition to tourism services).

As for the features that differentiate PIPA clients from the SME sector, these mainly relate to the nature of their production processes and management structures. Whereas the majority of Palestinian SMEs are involved in labour-intensive activities, most PIPA clients reported specialization in capital-intensive activities and involvement in the production of final goods. Furthermore, in contrast to the sole proprietorship and informal management structures of the SMEs, PIPA clients are registered as limited liability companies and exhibit formal management structures. The enterprises dedicate a significant number of staff members to managerial, accounting and marketing activities.

As explained below, these general features mask discrepancies among PIPA clients that need to be taken into account to ensure proper policy responsiveness. Most notable in this respect are the discrepancies between local and foreign investors as well as those related to location.

[8] Recent official Palestinian statistics on the Palestinian enterprise sector can be found in PCBS (2006a, 2006b).

B. Sectoral distribution and size[9]

PIPA clients are concentrated in the industrial sector, with 40 per cent of the surveyed enterprises engaged in manufacturing activities and 30 per cent in mining and quarrying. Tourism enterprises represent the third largest segment, accounting for 11 per cent of the enterprises, followed by ICT and business support enterprises, with a combined share of 10 per cent. Agriculture and craft enterprises and those involved in health and education constitute the smallest segments, with each representing 5 per cent of the surveyed enterprises.

A breakdown of the manufacturing enterprises by activity shows that the majority are involved in the production of food and beverages. These enterprises constitute the largest segment, accounting for 35 per cent of the manufacturing clients of PIPA. Enterprises producing rubber and plastic constitute the second largest segment, with a 19 per cent share, followed by manufacturers of metal products, which represent 16 per cent of the surveyed enterprises. The remaining enterprises are involved in manufacturing wearing and apparel products, paper and its products, and medical products, accounting for 10 per cent, 6 per cent and 4 per cent of the surveyed enterprises, respectively.

PIPA clients are also dominated by small enterprises, which account for 54 per cent of the surveyed enterprises. Medium enterprises account for 33 per cent, while large ones account for 14 per cent. Moreover, and as shown in table AI.1, small enterprises are concentrated in the agricultural and craft subsectors (77 per cent) and in the tourism sector (75 per cent). Medium sized-enterprises are mainly engaged in the provision of education and health services (57 per cent), while large establishments show the strongest presence in the manufacturing subsector (21 per cent) and in the ICT and business services subsector (20 per cent).

This general trend masks discrepancies between local and foreign enterprises. As shown in table AI.2, most foreign enterprises are involved in the provision of ICT and business services. Foreign enterprises also feature a stronger presence of large firms, which constitute 24 per cent of the surveyed enterprises, while the share of medium enterprises is 16 per cent. In contrast, 13 per cent of local enterprises are large, and 35 per cent are medium.

C. Location

PIPA clients are concentrated in the Occupied Palestinian Territory's main industrial cities. Local enterprises are mainly located in Hebron (20 per cent of local enterprises), Gaza city (19 per cent), Ramallah (13 per cent) and Nablus (11 per cent). In contrast, foreign enterprises are concentrated in Ramallah (32 per cent), Gaza city (32 per cent) and Hebron (21 per cent).

The enterprises' choice of location seems to be closely associated with the nature of their activities. Mining and quarrying as well as manufacturing enterprises are concentrated in industrial areas. Enterprises involved in ICT and business support services and those operating in the education and health sectors are concentrated in residential areas, while agricultural and crafts industries are based in agricultural areas.

Moreover, as shown in table AI.3, the majority of local enterprises are situated in industrial areas (47 per cent of local enterprises), followed by those located in residential areas (26 per cent). Local enterprises operating from residential areas are mainly concentrated in non-industrial cities, namely Qualqilya (100 per cent of the surveyed local enterprises), Khan Younis (64 per cent), Jericho (60 per cent) and Gaza (38 per cent). In contrast, the majority of foreign

[9] In line with the Palestinian Central Bureau of Statistics (PCBS, 1998) classification, the survey categorizes enterprises according the size of their workforce. Enterprises employing 5–19 persons are regarded as small, while those employing 20–50 persons are considered medium-sized. Those employing more than 50 persons are classified as large enterprises (PCBS, 2003).

enterprises are located in residential areas (50 per cent of foreign enterprises), with those located in industrial areas constituting the second largest segment (36 per cent).

As will be shown later, the enterprises' location decision is also a reflection of their limited focus on satisfying domestic demand and the nature of their backward and forward linkages.

D. Legal status and date of establishment

Around 92 per cent of the surveyed local and foreign enterprises are registered as limited liability companies. The remaining local enterprises are sole proprietorships (4 per cent) and partnerships (4 per cent), while the remaining foreign enterprises are subsidiaries of large firms. In addition, one foreign enterprise is a member of a group of firms and another is a joint venture (alliance with a firm abroad).

Around 73 per cent of the enterprises were established during the period 1994–2000, and only 13 per cent were founded before the establishment of the Palestinian Authority in 1994. The remaining 14 per cent were established during the period 2000–2004. Foreign investors show a similar trend, with 71 per cent of the respondents (or 20 foreign enterprises) reporting commencement of operations during the period 1994–2000 and 21 per cent (six enterprises) during the period 2000–2004.

Table AI.4 shows that agriculture and craft industries registered the highest "birth" rates during the period 2000–2004, with 29 per cent of the total enterprises established during this period operating in the two sectors. The tourism sector ranks second, with 23 per cent of the sector's enterprises created during the said period, followed by mining and quarrying with an 18 per cent share of enterprises, the ICT and business services with a 16 per cent share and the manufacturing sector with an 11 per cent share. Moreover, 76 per cent of the enterprises established during 2000–2004 are located in the West Bank areas, continuing a trend from the 1994–2000 period. However, table AI.5 reveals that the West Bank's historic industrial districts of Tulkarem, Nablus and Qualqilya did not see new entrants. In Gaza, most of the new entrants are located in Deir-Balah and Rafah.

E. Production processes

Around 73 per cent of the respondents described their enterprises' production processes as capital-intensive.[10] This is particularly the case for medical products manufacturing enterprises (100 per cent of the surveyed enterprises), rubber and plastic manufacturing (90 per cent), paper and its products manufacturing (86 per cent), and mining and quarrying enterprises (83 per cent). Table AI.6 reveals regional variations in the relative importance of the labour factor, with enterprises operating in Khan Younis, Rafah and Deir-Balah showing a significant reliance on labour-intensive activities. Moreover, the majority of foreign enterprises are involved in capital-intensive activities, representing 90 per cent of total foreign enterprises. In contrast, 86 per cent of local enterprises were found to be in such activities.

The majority of the surveyed enterprises produce final goods (table AI.7), especially those involved in mining and quarrying and manufacturing (table AI.8). Table AI.9 shows that enterprises producing final goods are concentrated in Qualqilya, Hebron, Tulkarem, North Gaza and Rafah. Enterprises based in Tulkarem, Hebron, Nablus and Rafah also stand out as significantly engaged in the production of semi-final goods. The results of the survey also reveal a limited participation of the service enterprises in the provision of auxiliary services (i.e. the

[10] While the probability of error in this case is below 1 per cent, the results should be treated with caution given the absence of data on the relative importance of the labour factor in the enterprises' production processes.

support of industrial production). Only 15 per cent of the enterprises engaged in ICT and business services reported involvement in supporting industrial production.

F. Target markets

The majority of PIPA clients focus on meeting local demand. The West Bank accounts for 56 per cent of West Bank-based enterprises’ sales, while the Gaza Strip accounts for 76 per cent of Gaza-based enterprises’ sales. While Gaza is not a main market for West Bank enterprises (representing 6 per cent of their total sales), the West Bank ranks as the second main market for Gaza-based enterprises (though accounting for only 13 per cent of these enterprises’ sales).

Enterprises engaged in export activities constitute a minority and are mainly concentrated in the West Bank areas. These account for 38 per cent of West Bank-based enterprises and less than 1 per cent of Gaza enterprises. Moreover, Israel accounts for the lion’s share of West Bank-based enterprises’ total exports (18 per cent), as opposed to a 3 per cent share for Gaza-based enterprises. Export-oriented enterprises also exhibit a narrow export mix. They are concentrated in a limited number of sectors, including wearing and apparel enterprises (70 per cent of the enterprises in this sector are export-oriented); tourism (50 per cent); paper and related products (43 per cent); rubber and plastic (43 per cent); and mining and quarrying activities (37 per cent).

An examination of West Bank-based enterprises’ regional partners shows Arab countries at the bottom of the list. Arab countries were referred to as part of “other” export markets and account for 11 per cent of the enterprises’ total sales. Countries singled out as main markets include Europe, though it accounts for a meagre share of 5 per cent of the enterprises’ sales, followed by Jordan with a 2 per cent share and the United States with a 2 per cent share. Moreover, as shown in table AI.10, exports to Europe and the United States are mainly driven by Bethlehem-based enterprises.

The results also reveal that Europe represents the first main market for enterprises involved in tourism activities, followed by the United States and Israel (table AI.11). The United States is the second main export market for mining and quarrying industries and for manufacturing industries, preceded by Israel, albeit with a big gap between the two markets.

G. Entrepreneurial profile

Around 37 per cent of the surveyed enterprises are owned by middle-aged investors belonging to the age group 36–45 years old, and another 38 per cent by old-aged investors between 46–55 years old. Young investors (25–35 years old) own 8 per cent of the enterprises, with the elderly (above 55 years old) owning or managing the rest. Foreign investors show a slightly different age distribution, with 54 per cent of the enterprises belonging to the old-aged group. Middle-aged investors constitute 25 per cent of the respondents, and elderly and young investors account for 14 per cent and 2 per cent of the respondents, respectively.

Around 79 per cent of the owners have prior business experience in areas related to their present activities, including 81 per cent of local investors and 70 per cent of foreign investors. The owners also have formal training, with 48 per cent educated up to the university level and another 37 per cent reporting successful completion of formal vocational training programmes. Those with university degrees are mainly involved in the health and education sectors, constituting 93 per cent of the respondents involved in the two sectors. Holders of university degrees also show a strong presence in the ICT and business services (82 per cent) and the tourism sector (63 per cent). Owners with vocational training are concentrated in agricultural and craft industries as well as mining and quarrying (50 per cent), in addition to the manufacturing sector (43 per cent).

H. Labour force characteristics and management structures

The enterprises' workforce is dominated by paid employees. The average number of family members per enterprise ranges between two (in small and medium-sized enterprises) and five members (in large enterprises). Moreover, and irrespective of their size, the surveyed enterprises exhibit formal managerial structures, with a significant number of employees dedicated to managerial, accounting and marketing activities (table AI.12).

I. Backward and forward linkages

Sources of finance

Personal savings stand out as the main source of finance for the majority of local investors for covering start-up activities, operational costs and expansion plans (AI.13). Bank loans rank second and are mainly used for financing start-up costs of large enterprises.[11] In terms of activities, tourism enterprises seem to have the largest access, with 45 per cent of the respondents benefiting from such loans. The stock market does not figure on the respondents' list as a source of finance. Only 2 per cent of local enterprises are registered with the Palestinian Security Exchange (PSE).

Other sources of finance include family and friends, money lenders, leasing and retained profits (AI.13). Money lenders and leasing are particularly common among Gaza-based enterprises for financing working capital.

Such weak backward linkages with the formal financial sector are only to be expected since the ongoing economic crisis has increased credit and investment risks. Foreign investors reported that they do not rely on any of the identified sources. They did not identify their sources of finance, however, reflecting their hesitancy to disclose such information to the public.

Sources of equipment and raw materials

Around 50 per cent of the surveyed local and foreign enterprises reported the Occupied Palestinian Territory as a main source of raw materials and another 50 per cent identified Israel. Europe was singled out by 31 per cent of the respondents, while the Arab countries were at the end of the respondents' list (identified by 11 per cent of the respondents), along with Asia (11 per cent) and the Americas (10 per cent). Foreign enterprises depart from this general trend. As shown in table AI.14, they are less dependent on Israel and show greater diversification towards Arab countries.

Table AI.15 shows agricultural, crafts and manufacturing enterprises as particularly dependant on Israel for raw materials, as well as those involved in the provision of business support and ICT services. In contrast, mining and quarrying enterprises exhibit greater reliance on local markets. Moreover, and with the exception of tourism enterprises, a significant percentage of the enterprises have established relations with European suppliers. This is especially the case of the manufacturing enterprises, with 51 per cent of this sector's respondents identifying Europe as a main source of supplies. As for the relation between enterprises' sources of raw materials and location, table AI.16 shows that most of the Gaza-based enterprises purchase their raw materials from Israel. Enterprises operating in Bethlehem, Qualqilya and Hebron purchase most of their supplies locally.

[11] The results of the survey show that only 20 per cent of the small enterprises benefited from bank loans for start-up activities at the eve of the crisis, as opposed to 25 per cent and 34 per cent of medium and large enterprises benefiting from these loans, respectively. While the probability of error for this question is more than 5 per cent, the result can be considered as indicative when cross-referenced with the results of a previous UNCTAD survey of Palestinian SMEs (UNCTAD, 2004). The results of this survey show that only 18 per cent of small enterprises benefit from bank loans.

Table AI.17 shows that around 73 per cent of local and foreign enterprises purchase their machinery and equipment from Europe. Another 21 per cent identified Israel as their main source of supply, while the Occupied Palestinian Territory was identified by 17 per cent of the respondents. The Arab countries were at the end of the enterprises' list of suppliers (2 per cent), preceded by the Americas (8 per cent) and Asia (10 per cent). A breakdown of the respondents' sources of machinery and equipment by the enterprises' location (table AI.18) and economic activity (table AI.19) reveals the same ranking.

Linkages to markets

Around 62 per cent of the enterprises involved in export activities sell directly to consumers. The rest operate through market intermediaries, with 15 per cent selling through local agents, 6 per cent through Israeli agents and 5 per cent through foreign agents. There are also those who channel their sales through foreign partners, representing 11 per cent of the export-oriented enterprises.[12]

As for enterprises targeting local markets, table AI.20 shows that they are exclusively owned by local investors and exhibit a tendency to sell directly to customers. Enterprises involved in manufacturing and the production of agricultural and crafts products form an exception, with the majority selling mainly through wholesalers (table AI.21).

Involvement in e-commerce

PIPA clients are not involved in e-commerce and only 30 per cent of the respondents reported having institutional websites that are mainly used for promotional purposes. Around 76 per cent of the enterprises with institutional websites are large, and the majority are involved in tourism and the provision of ICT and business services. Moreover, enterprises with institutional websites are concentrated in Bethlehem, Jericho and Ramallah.

Subcontracting arrangements

Only 46 local enterprises, or 17 per cent of the surveyed enterprises, reported involvement in subcontracting arrangements. The majority are located in Tulkarem, Nablus and Hebron, 30 of which are contracted by Israeli enterprises and the rest by Palestinian enterprises.

Surveyed investors contracted by Israeli enterprises are involved in mining and quarrying, manufacturing and tourism, while those contracted by Palestinian establishments are involved in the provision of ICT and business services. The tasks assigned to the contracted enterprises involve activities such as sales, support services and manufacturing. Offered benefits include access to international markets and raw materials, in addition to product development and franchising.

J. Perceived competitiveness

The results of the survey reveal that the enterprises' competitiveness was slated for improvement at the eve of the second intifada, with 81 per cent of the respondents reporting concrete plans to expand their activities. These enterprises are mainly located in residential (39 per cent of enterprises with expansion plans) and industrial areas (34 per cent). It is also worth mentioning that most of these enterprises were established over the period 1994–2000 (77 per cent) and are dependent on Israel for obtaining raw materials as well as machinery and equipment (70 per cent).

The enterprises' expansion plans involved introducing new product lines (85 per cent of the respondents), increasing the size of the workforce (69 per cent), entering new markets (48 per

[12] These results should be interpreted with caution, since only 140 enterprises responded to this question.

cent) and establishing subsidiaries in the Occupied Palestinian Territory (23 per cent). Moreover, around 12 per cent of the respondents indicated that they were planning to establish a presence abroad, particularly in Jordan and Dubai. Table AI.22 shows that these plans were to be financed not only by personal savings, but also by bank loans and retained profits, indicating a certain degree of financial leverage.

The tightening of the Israeli measures and closure policy since October 2000 has forced the enterprises to postpone their expansion plans or cancel them altogether. Enterprises are also becoming increasingly inward-looking, with 58 per cent of respondents stating that they are "not interested" in export activities. Another 22 per cent indicated that they are contemplating relocating their businesses, including 27 per cent of small enterprises, 10 per cent of medium enterprises and 32 per cent of large enterprises. Local sites offering better facilities were cited by 42 per cent of the respondents as a possible relocation destination, though the respondents did not identify specific facilities. Another 33 per cent identified industrial areas, while 17 per cent indicated that they will be moving abroad (without specifying destinations). The rest said that they are actively seeking to move away from areas subjected to recurrent closure.

As shown in chapter II, the respondents reported a range of strategic business development needs, including product quality and skills improvement. Yet the majority considers their enterprises' competitiveness in local and regional markets as within average in relation to relative price levels, export capacity, level of technology and ability to adapt existing products. Table AI.23 shows that the majority consider their enterprises as within the average in local markets in terms of prices, market adaptation of existing products and export capacity. Moreover, they consider themselves as above the national average in terms of product quality and the level of technology. In contrast, the majority of the enterprises perceive their competitive position as within average in regional markets as measured by the five mentioned indicators. Such a ranking suggests low overall competitiveness standards on the part of existing investors. In other words, it seems that the investors are mainly focused on adapting to survive as opposed to strategic long-term business development and expansion.

Tables

Table AI.1. Breakdown of PIPA clients by economic activity and enterprise size

as a percentage of total respondents

Economic activity	Small	Medium	Large
Mining and quarrying	53%	36%	11%
Manufacturing	45%	34%	21%
ICT and business services	56%	24%	20%
Agriculture and craft industries	77%	15%	8%
Tourism	75%	25%	0%
Education and health	43%	57%	0%

Table AI.2. Breakdown of local and foreign enterprises by economic activity

as a percentage of total respondents

Economic activity	Local	Foreign
Mining and quarrying	94%	6%
Manufacturing	91%	9%
ICT and business services	59%	41%
Agricultural and crafts	100%	0%
Tourism	97%	3%
Education and health	93%	7%

Table AI.3. Breakdown of local and foreign enterprises by location

as a percentage of total respondents

Location	Local	Foreign	Average
Industrial	47%	36%	45%
Commercial	10%	11%	10%
Residential	26%	50%	28%
Agricultural	12%	4%	12%
Tourism	6%	0%	5%

Table AI.4. Enterprises’ date of establishment by economic activity

as a percentage of total respondents in each region

Economic activity	Date of establishment		
	Before 1994	1994–2000	2000–2004
Mining and quarrying	9%	73%	18%
Manufacturing	22%	66%	11%
ICT and business services	8%	76%	16%
Agricultural and crafts	0%	71%	29%
Tourism	0%	77%	23%
Education and health	0%	100%	0%

Table AI.5. Enterprises' date of establishment by region

as a percentage of total respondents in each region

Region	Date of establishment		
	Before 1994	1994–2000	2000–2004
Jenin	19%	62%	19%
Tulkarem	11%	89%	0%
Nablus	29%	71%	0%
Qualqilya	0%	100%	0%
Ramallah	14%	57%	29%
Jericho	0%	100%	0%
Bethlehem	0%	87%	13%
Hebron	11%	60%	28%
North Gaza	22%	67%	11%
Gaza	8%	86%	6%
Deir-Balah	11%	56%	33%
Khan Younis	9%	91%	0%
Rafah	0%	80%	20%

Table AI.6. Relative importance of labour in production by region

as a percentage of total respondents

Region	Capital-intensive	Labour-intensive
Jenin	79%	21%
Tulkarem	89%	11%
Nablus	79%	21%
Qualqilya	100%	0%
Ramallah	86%	14%
Jericho	100%	0%
Bethlehem	87%	13%
Hebron	96%	4%
North Gaza	100%	0%
Gaza	88%	12%
Deir-Balah	63%	38%
Khan Younis	56%	44%
Rafah	60%	40%
Average	87%	13%

Table AI.7. Enterprises' production processes by production activity

as a percentage of total respondents

Production activity	Local enterprises	Foreign enterprises
Final goods	74%	46%
Semi-final	14%	29%
Assembly	3%	0%
Packaging	2%	0%

Table AI.8. Enterprises producing final and semi-final goods by sector

as a percentage of total respondents

Economic activity	Final goods	Semi-final goods
Mining and quarrying	96%	20%
Manufacturing	92%	22%
ICT and business services	11%	4%
Agricultural and crafts	71%	7%
Tourism	7%	0%
Education and health	7%	0%
Average	71%	42%

Table AI.9. Enterprises producing final and semi-final goods by region

as a percentage of total respondents

Region	Producing final Goods	Producing semi-final goods
Jenin	70%	20%
Tulkarem	90%	30%
Nablus	62%	24%
Qualqilya	100%	0%
Ramallah	53%	11%
Jericho	60%	0%
Bethlehem	48%	17%
Hebron	96%	30%
North Gaza	94%	6%
Gaza	52%	6%
Deir-Balah	78%	0%
Khan Younis	82%	0%
Rafah	100%	42%
Average	71%	15%

Table AI.10. Enterprises' main export markets by region

as a percentage of total sales

Region	Israel	Europe	United States
Jenin	5%	0%	0%
Tulkarem	10%	0%	0%
Nablus	7%	0%	0%
Qualqilya	11%	0%	0%
Ramallah	11%	4%	2%
Jericho	6%	18%	2%
Bethlehem	32%	24%	10%
Hebron	32%	2%	1%
North Gaza	1%	0%	0%
Gaza	4%	0%	0%
Deir-Balah	1%	0%	0%
Khan Younis	2%	0%	0%
Rafah	0%	0%	0%

Table AI.11. Enterprises' main export markets by economic activity

as a percentage of total sales

Economic activity	Main export markets		
	United States	Europe	Israel
Mining and quarrying	41%	8%	51%
Manufacturing	14%	2%	38%
ICT and business services	3%	9%	3%
Agricultural and crafts	0%	0%	2%
Tourism	42%	81%	5%
Education and health	0%	0%	1%

Table AI.12. Enterprises' employment structure by size – 2004

average number of employees per firm

Size	Specialization				
	Production	Management	Accounting	Advertising	Other
Small	5	2	1	1	1
Medium	20	4	1	1	1
Large	75	20	4	12	36

Table AI.13. Local enterprises' sources of finance by usage

as a percentage of total respondents

Usage	Sources of finance					
	Personal savings	Bank loans	Family/ friends	Leasing	Money lenders	Retained profits
Starting capital	88%	22%	13%	12%	12%	3%
Working capital	57%	11%	7%	10%	8%	5%
Expansion	25%	8%	3%	4%	4%	4%

Table AI.14. Enterprises' main sources of raw materials

as a percentage of total respondents

Source	Local	Foreign
Occupied Palestinian Territory	50%	50%
Israel	51%	36%
Europe	33%	14%
Asia	11%	7%
Americas	10%	14%
Arab countries	10%	18%

Table AI.15. Enterprises' main sources of raw materials by economic activity

as a percentage of total respondents

Economic activity	Sources of raw materials		
	Occupied Palestinian Territory	Israel	Europe
Mining and quarrying	78%	47%	11%
Manufacturing	26%	62%	51%
ICT and business services	33%	37%	30%
Agricultural and crafts	57%	86%	57%
Tourism	79%	17%	0%
Education and health	50%	29%	38%

Table AI.16. Enterprises' main sources of raw materials by region

as a percentage of total respondents

Region	Israel	Occupied Palestinian Territory	Europe
Jenin	65%	40%	30%
Tulkarem	100%	90%	40%
Nablus	38%	41%	45%
Qualqilya	75%	100%	25%
Ramallah	42%	39%	37%
Jericho	60%	60%	20%
Bethlehem	4%	78%	13%
Hebron	26%	63%	30%
North Gaza	83%	28%	39%
Gaza	66%	43%	30%
Deir-Balah	78%	44%	22%
Khan Younis	55%	36%	27%
Rafah	100%	20%	20%
Average	**50%**	**50%**	**31%**

Table AI.17. Enterprises' main sources of machinery and equipment

as a percentage of total respondents

Source	Local	Foreign	Grand average
Occupied Palestinian Territory	18%	14%	17%
Israel	21%	21%	21%
Europe	76%	43%	73%
Asia	8%	0%	10%
Americas	8%	3%	8%
Arab countries	2%	7%	2%

Table AI.18. Enterprises' main sources of machinery and equipment by region

as a percentage of total respondents

Region	Occupied Palestinian Territory	Europe	Israel
Jenin	25%	80%	25%
Tulkarem	10%	90%	30%
Nablus	17%	69%	14%
Qualqilya	50%	100%	25%
Ramallah	14%	53%	19%
Jericho	0%	8%	0%
Bethlehem	44%	87%	30%
Hebron	20%	87%	11%
North Gaza	6%	94%	17%
Gaza	13%	56%	26%
Deir-Balah	0%	78%	22%
Khan Younis	9%	27%	30%
Rafah	0%	80%	40%
Average	**17%**	**73%**	**21%**

Table AI.19. Enterprises' main sources of machinery and equipment by sector

as a percentage of total respondents

Economic activity	Occupied Palestinian Territory	Europe	Israel
Mining and quarrying	15%	91%	17%
Manufacturing	10%	76%	23%
ICT and business services	15%	26%	19%
Agricultural and crafts	0%	93%	7%
Tourism	55%	59%	38%
Education and health	36%	43%	7%

Table AI.20. Local enterprises' distribution channels in local markets

as a percentage of total respondents

Local distribution channels	Percentage
Directly to customers	45%
Wholesalers	13%
Retailers	27%
All intermediaries	20%

Table AI.21. Local enterprises' distribution channels in local markets by activity

as a percentage of total respondents

Economic activity	Directly to customers	Whole-salers	Retailers	All intermediaries
Mining and quarrying	67%	4%	5%	20%
Manufacturing	20%	46%	19%	27%
ICT and business services	48%	0%	0%	7%
Agricultural and craft industries	36%	79%	29%	14%
Tourism	38%	3%	3%	3%
Education and health	57%	7%	7%	0%
Average	**45%**	**27%**	**13%**	**21%**

Table AI.22. Enterprises' sources of finance for expansion at the eve of the crisis

as a percentage of total respondents

Sources of finance	Percentage
Personal savings	47%
Bank loans	37%
Retained profits	25%
New partners/joint ventures	8%
Money lenders	7%
Mother company (for foreign investors)	5%
Family and friends	4%
Leasing	1%

Table AI.23. Local enterprises' perceived local and regional competitiveness

as a percentage of total respondents

Factors	Local markets			Regional markets		
	Below average	Average	Above average	Below average	Average	Above average
Price	20%	74%	6%	27%	53%	20%
Quality	0%	42%	58%	3%	61%	36%
Technology	0%	45%	55%	7%	67%	26%
Adapting to consumers' needs	0%	64%	36%	7%	70%	23%
Ability to export	19%	43%	38%	23%	53%	25%

Annex II. PIPA clients' needs – survey results

Table AII.1. Foreign investors' perceptions of the business environment

as a percentage of foreign investors

Factors	Ranking		
	Helpful	Neither help nor problem	Problem
Availability of overland transport services at reasonable prices	35%	32%	32%
Availability of maritime transport services at reasonable prices	12%	73%	16%
Customs and overland transport procedures	18%	64%	18%
Quotas and non-tariff barriers in target markets	14%	76%	10%
Availability of telecommunication services at reasonable prices	52%	37%	11%
Availability of information on international markets and export opportunities	39%	61%	0%
Availability of skilled staff locally at reasonable costs	74%	7%	19%
Development policies and business support programmes at the national level	70%	11%	19%
Development policies and business support programmes at the regional level	62%	27%	12%
Obtaining licenses to establish a business	82%	4%	14%
Renewal of licenses to maintain operations	86%	4%	11%
Renting and purchasing premises	64%	21%	14%
Access to raw materials	24%	27%	50%
Cost of raw materials	12%	15%	73%
Dispute settlement mechanisms	29%	32%	39%
Finding suitable distributors	34%	48%	19%
Finding business partners	36%	50%	15%
Availability of external finance at reasonable terms	35%	43%	22%

Table AII.2. Local investors' perceptions of the business environment

as a percentage of local investors

Factors	Ranking		
	Helpful	Neither help nor problem	Problem
Availability of overland transport services at reasonable prices	55%	7%	38%
Availability of maritime transport services at reasonable prices	42%	41%	18%
Customs and overland transport procedures	28%	42%	30%
Quotas and non-tariff barriers in target markets	31%	59%	10%
Availability of telecommunication services at reasonable prices	55%	32%	12%
Availability of information on international markets and export opportunities	42%	47%	10%
Availability of skilled staff locally at reasonable costs	81%	6%	13%
Development policies and business support programmes at the national level	80%	8%	13%
Development policies and business support programmes at the regional level	71%	20%	10%
Obtaining licenses to establish a business	69%	11%	21%
Renewal of licenses to maintain operations	76%	13%	12%
Renting and purchasing premises	62%	22%	16%
Access to raw materials	29%	14%	57%
Cost of raw materials	21%	8%	72%
Dispute settlement mechanisms	31%	40%	29%
Finding suitable distributors	54%	30%	15%
Finding business partners	42%	41%	17%
Availability of external finance at reasonable terms	66%	12%	22%

Table AII.3. PIPA clients' membership in SME support institutions

as a percentage of total respondents

Support institutions	Local enterprises	Foreign enterprises*
Chambers of commerce and industry	70%	44%
Palestine Federation of Industries	53%	57%
Businessmen Association	22%	17%
PalTrade	28%	13%
Hotels and restaurants associations	10%	9%
PITA	2%	13%
Doctors' associations	1%	4%

*Response rate is 82 per cent.

Table AII.4. Type of assistance received from SME support institutions

as a percentage of total respondents

Types of assistance	Local enterprises	Foreign enterprises
Financial support	19%	7%
Market information services	42%	21%
Advice on product development	28%	14%
Support services to participate in international trade fairs	35%	18%
Marketing	18%	11%
Training	25%	14%

Table AII.5. Foreign enterprises' requirements for strategic business development

as a percentage of foreign enterprises

Requirements	Ranking		
	Very important	Important	Not important
Receiving FDI	58%	19%	23%
Increased use of local suppliers	42%	46%	12%
Increased use of regional suppliers	27%	39%	35%
Training of local staff	62%	23%	15%
Adapting products to target markets	56%	24%	20%
Improving product quality	56%	32%	12%
Good relations with government	60%	28%	12%
External finance	65%	19%	15%

Table AII.6. Local enterprises' requirements for strategic business development

as a percentage of local enterprises

Requirements	Ranking		
	Very important	Important	Not important
Linkages with TNCs	51%	30%	15%
Receiving FDI	54%	30%	16%
Increased use of local suppliers	52%	35%	13%
Increased use of regional suppliers	48%	34%	17%
Training of local staff	73%	25%	3%
Adapting products to target markets	67%	31%	2%
Improving product quality	79%	19%	3%
Good relations with government	54%	43%	14%
External finance	62%	24%	13%

Table AII.7. Local enterprises' ranking linkages with TNCs as critical to strategic business development by economic activity

Economic activity	Percentage of respondents*
Mining and quarrying	64%
Manufacturing	49%
ICT and business services	62%
Agricultural and crafts	36%
Tourism	73%
Education and health	42%
Grand average	**56%**

* Includes respondents reporting linkages with TNCs as "very important"

Table AII.8. Factors driving local investors' emphasis on linkages with TNCs

as a percentage of local respondents

Factors	Ranking		
	Very important	Important	Not important
Lack of growth opportunities in local markets	28%	53%	19%
Access to finance	63%	23%	14%
Access to technology	71%	26%	2%
Risk diversification	17%	74%	10%
Access to skilled labour	54%	34%	12%
Exposure to best practices in strategic management	63%	33%	4%
Information about business opportunities abroad	56%	31%	14%

Table AII.9. Factors driving local investors' emphasis on TNC linkages by activity

as percentage of total respondents ranking the factors as very important

Factors	Economic activity					
	Mining and quarrying	Manufac-turing	ICT and business services	Agri-culture and crafts	Tourism	Education and health
Lack of growth opportunities in local markets	12%	30%	22%	17%	53%	100%
Access to finance	81%	48%	44%	80%	85%	67%
Access to technology	87%	67%	67%	50%	69%	50%
Risk diversification	14%	17%	30%	25%	7%	50%
Access to skilled labour	67%	41%	56%	60%	80%	33%
Exposure to best practices in strategic management	81%	49%	44%	67%	77%	67%
Information about business opportunities abroad	83%	42%	33%	60%	58%	50%

Annex III. Enterprise support system in the Occupied Palestinian Territory, 2008

Agency	Core services
Palestinian Authority institutions	
Palestinian Industrial Estates and Free Zones Authority (PIEFZA)	Design, develop and supervise the Palestinian Industrial Estates and Free Zones programme
Palestinian Standards Institute	Standards, quality assurance and technical services for enterprises
Market support institutions	
Chambers of commerce, industry and agriculture	Certificates of origin, dissemination of trade information, training services in the area of business management, organization of trade fairs abroad and local exhibitions, organization of thematic and sectoral workshops, in addition to facilitating the exchange of trade delegations
Federation of Palestinian Chambers of Commerce, Industry and Agriculture	Technical assistance for chambers of commerce, networking the chambers with their international counterparts within the context of the Euro-Med project, point of reference for donor-funded projects extended to the chambers of commerce, networking diaspora Palestinians with local enterprises, vocational training and policy advocacy
Palestinian Federation of Industries and Business Associations	Policy advocacy, inter-firm linkages
Palestinian Shippers' Council	Represents and protects the interests of Palestinian importers and exporters that are end-users of maritime shipping, air freight and land transport
Palestine Trade Center (PalTrade)	Trade promotion and market development, trade facilitation and economic policy development, and capacity-building and market information services
Palestinian Information Technology Association (PITA)	Exhibitions, business development and training services and policy advocacy
Consulting firms	Tailor-made advisory services in the area of business management
JETRO	Trade promotion services
Palestinian Banking Cooperation (PBC)	Corporate finance (syndicated loans and profit-sharing loans), trade finance, advisory services in the area of financial management and training services in the area of entrepreneurship (EMPRETEC Palestine project).
Commercial banks	Credit facilities for SMEs.
World Bank/MIGA	Guarantee fund for private investment
USAID	Promotes business and agricultural development, including increased Palestinian exports, through technical assistance and loan programmes.
GTZ	Targeted capacity building activities to strengthen the Occupied Palestinian Territory's SME support system.