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PRIVATE INVESTMENT IN THE PALESTINIAN TERRITORY: RECENT TRENDS AND IMMEDIATE PROSPECTS

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PRIVATE INVESTMENT

IN THE PALESTINIAN TERRITORY:

RECENT TRENDS AND IMMEDIATE PROSPECTS*

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* This study is prepared by the UNCTAD secretariat, drawing mainly on a field report by UNCTAD consultant Dr. Hisham Awartani (An-Najah National University, Nablus) and Dr. Nasr Abdel Karim (An-Najah National University, Nablus, the West Bank). The substantive orientation and design of the study have been conceived within the frame of the intersectoral research project of the UNCTAD secretariat on "Prospects for sustained development of the Palestinian economy in the West Bank and Gaza Strip". The opinions expressed in this study are those of the authors and do not necessarily reflect those of the Secretariat of the United Nations. The designations employed and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delimitation of its frontiers or boundaries.

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Introduction

As part of the work programme of the UNCTAD secretariat, pursuant to resolution 239 (XXIII) of the Trade and Development Board and resolution 44/174 of the General Assembly, the UNCTAD secretariat initiated, in 1990/91, an intersectoral research project on prospects for sustained development of the economy of the West Bank and Gaza Strip. Part One of the project deals with a comprehensive assessment of the economic and social situation in the West Bank and Gaza Strip, the main impediments to sustained growth and development, pressing needs and corresponding measures for immediate action to promote recovery. Part Two of the project constitutes an in-depth analysis of prospects under different scenarios for the future development of the Palestinian economy. Part Three of the project is intended to provide a strategy framework and policy guidelines for the revival and sustained future development of the Palestinian economy in the West Bank and Gaza Strip.

For the implementation of the project, a total of 25 in-depth studies were initiated at the field level, covering economic and social sectors and issues. Concurrently, and in order to facilitate the technical aspects of work on Parts Two and Three, the UNCTAD secretariat also prepared an in-depth study of a quantitative framework examining future options and prospects under several scenarios. The summary findings of Part One of the field studies, in particular an identification of pressing needs and corresponding feasible measures for immediate action, were presented to an expert group meeting (held in May 1992) for further consideration. The report of that meeting is separately published (UNCTAD/DSD/SEU/2), in addition to the study of the quantitative framework for analysing future prospects (UNCTAD/ECDC/SEU/6).

In order to provide more detailed substantive background to the findings and recommendations of the expert group meeting, and to enable donors to further develop their programmes of assistance to the Palestinian people, the first parts of a selected number of the field studies, commissioned within the scope of this project, have been published in a special study series on Palestinian economic and social development. The findings of the second and third parts of the field studies are being consolidated by the UNCTAD secretariat and will appear in a comprehensive intersectoral study on policies and strategies for sustained development of the Palestinian economy.

In the context of this project, and in order to examine relevant developments under the new policy environment created by the Israel-Palestine accords of 1993-1995, the secretariat has investigated in greater depth recent trends and immediate prospects for private investment in the Palestinian territory. This has been mainly aimed at supplementing and updating information and research findings already available on the subject, while also providing further substantive background for the relevant sections of the secretariat’s Programme of Technical Cooperation Activities in Support of Palestinian Trade, Finance and Related Services. Accordingly, this study aims at meeting these objectives.

Since 1967, economic transformation in the West Bank and Gaza Strip has been shaped under an environment, depicting mainly the situation engendered by military occupation. This encompassed all facets of life in the territory, including those related to patterns of economic growth. Because of their political implications, the dynamics of economic change during that period gained considerable interest, both locally and at an international level. The situation is abundantly documented in a range of studies and publications, including those prepared by the UNCTAD secretariat, other United Nations bodies, Palestinian, Israeli and international researchers and, most recently, by the World Bank.

International interest in the economic development of the Palestinian territory and in the region in general, has undergone a major qualitative and quantitative shift ever since the launching of the Middle East peace process at the Madrid Conference of 1991. This interest has found concrete forms of expression since the signing of the Israel-Palestine Declaration of Principles in September 1993. The signatories to that historic document have expressed deep conviction in translating the dividends of peace into tangible improvements in the quality of life of all peoples in the region, especially those most directly affected by the prolonged confrontation between Israel and its Arab neighbours. The international community has pledged significant moral and material support in this regard, beginning with the October 1993 Conference to Support Middle East Peace which brought together donors and representatives of the concerned parties for the first time. For obvious reasons, the Palestinian people are especially concerned with the outcome of this process, in both its political and economic aspects.

The emerging international strategy to promote development in the region, as it relates to the Palestinian people, is that a massive effort should be targeted at rehabilitating physical infrastructure and social overhead capital in the Palestinian territory, which were neglected for more than 25 years. Such an effort is deemed imperative in order to improve the level of some vital services needed by ordinary citizens and help lay down the foundation for a vibrant and competitive private sector involved in the reconstruction and development process.

Parallel to this public investment programme, the rejuvenation and restructuring of the Palestinian economy, and in particular its productive sectors, is conceived as the domain of the private sector, both in terms of capitalization and management. This has been a fundamental benchmark for the economic policy of the Palestinian leadership, as originally expressed in the Palestinian Development Programme of 1993. The Programme assumes a dominant role for the private sector in spearheading development efforts. This is envisaged to be possible only in the context of a significant and sustained flow of investment into the local economy, from both domestic and external sources. But given the legacy of a complex and out-dated regulatory regime, weak institutional framework and continued security considerations and related imperatives, this process will not make much progress barring a major shift in the investment climate. This would require a thorough evaluation of the investment climate as it has evolved during the past two decades, and the identification of those measures and policies which are deemed appropriate to help attract private investment into the Palestinian economy. This is the principal focus of this study.

Chapter I reviews major recent developments affecting private investment, including the regulatory framework and policy environment, trade and financial regimes and recent performance. Chapter II examines the major supportive capacities for private investment, namely, institutional development, technical capabilities, financial facilities, transport and related services and others. Chapter III analyses available data on the scale, scope, composition and impact of private investment in the Palestinian economy, especially since 1993. Chapter IV investigates prospects and policy options relevant to private investment in the short and medium-terms, especially economic policy, institutional capacities, market orientation and trade relations, sectoral output orientation, as well as financial, technical, human resource and legal prerequisites for the effective allocation of private investment in future Palestinian development efforts.

Chapter I

POLICY AND RELATED DEVELOPMENTS AFFECTING PRIVATE INVESTMENT IN THE PALESTINIAN TERRITORY

The scale and orientation of private investment in the Palestinian territory have been subject to a range of factors which continue to exert their influence, in varying degrees, on immediate and potential investment activities. Since occupation in 1967 and until the early 1990s, the West Bank and Gaza Strip were subject to a policy setting which was not conducive to a healthy investment climate. 1/ In the absence of an active role by government in providing the regulatory framework for the encouragement of private investment in the Palestinian territory, the impact of local private institutions in this regard has been very limited. The security situation also provided major disincentives to investment. Security-related measures entailed significant constraints on economic development. Geopolitical uncertainty overshadowed the investment climate and all aspects of economic and social life in the occupied territory. Meanwhile, the legal system relative to private investment in the West Bank and Gaza Strip did not provide an atmosphere of predictability, security and incentives conducive to investment flows. The confusion created by the ambiguous relationship between a heterogeneous mix of British Mandate, Jordanian, Egyptian and Israeli laws, amended or superseded by military orders and Civil Administration directives deterred investors, especially those living abroad.

The legacy of the pre-1993 financial and trade regimes continues to influence developments in the new circumstances, and indeed constitutes a major object of economic reform efforts in the Palestinian territory. As for financial resource needs, by the end of 1993, all of the branches of the two Arab banks operating in the territory provided credit of only $37 million, equivalent to less than 1.5 per cent of GDP, a low ratio compared to regional and international standards. 2/ Viewed in the context of their broader impact on the Palestinian economy, it is considered that fiscal and monetary policies in the occupied territory served to constrain economic activities. In particular, those policies discouraged investment activities, especially for those investors based outside the territory. 3/ Accordingly, investment in social overhead capital (especially residential property) was favoured over investment in productive sectors whose prospects for growth were viewed as uncertain under the circumstances. Meanwhile, trade relations between the West Bank and Gaza Strip and with external markets were characterized by distortions which entailed far-reaching consequences on production patterns and investment motives. External trade was affected by exogenous factors on which Palestinian producers had little or no influence. This applied not only to trade with Israel, but also with Jordan and other Arab countries. 4/

From a turbulent and restrictive policy environment, recent developments have revealed prospects for a move to an open and vibrant climate favouring investment, growth and development. This chapter examines the main aspects of the regulatory, legal and institutional framework affecting private investment in the Palestinian territory. While the new situation promises to address the inadequacies that characterized the situation up to 1993, the complex process of reform can only proceed gradually, in accordance with progress on the political and security levels. Nevertheless, a range of policy, legal and institutional reforms are required to create the optimal conditions for vigorous and effective flows of private investment for the development of the economy of the Palestinian territory.

A. Policy, institutional and general legal framework

The launching of the Middle East peace process at the Madrid Conference of October 1991 created the momentum for changing the policy environment affecting economic activities in the Palestinian territory and in the region as a whole. Prospects for regional economic cooperation were further reinforced following the signing of the Declaration of Principles between Israel and Palestine in September 1993, and the subsequent international interest and support for the process. Underlying this was a belief that if peace was to have the chance to succeed and receive the sustained public support it needed, then the dividends to this process should be tangibly felt by ordinary people on all sides of the Middle East conflict. This was most pertinent to the situation of the Palestinian people, whose cause was recognized to be at the core of the prolonged state of hostilities in the region. As the peace process has gained momentum, it has increasingly involved other countries in the region, as well as the international community as a whole.

International interest in the economic implications of the peace process has entailed significant developments in the policy environment bearing on the private sector and socio-economic development. These changes were initiated as of 1991, after Israeli authorities reviewed their policies and measures affecting economic activities in the Palestinian territory. 5/

The shift in Israeli policies encompassed a wide range of policies and measures, including the following changes which positively influenced the economic situation: 6/

- Licensing procedures of new firms were expedited, and foreign trade clearance regulations were tangibly relaxed;

- Regulations to encourage foreign investment, including fiscal incentives and less strict foreign exchange controls, were introduced;

- Restrictions on the transfer of funds to the territory were relaxed;

- Taxation policies were emptied of their punitive component. The situation in this regard improved further following the transfer of matters on taxation to the Palestinian Authority (Palestinian Authority) in the summer of 1994;

- Curfews, road blocks and other obstructions to normal transportation were sharply curtailed; the release of Palestinian prisoners and other goodwill measures in the context of the Israel-Palestine accords also added to the growing confidence in the local investment climate.

The spirit of reconciliation embodied in the Declaration of Principles was later translated into formal detailed agreements between Israel and Palestine, signed in Cairo in May 1994, followed by the extension of the scope of the self-government arrangements in Washington in September 1995. The Cairo Agreement dealt with most major issues of contention between the two sides. Economic aspects were addressed in a special protocol, negotiated in Paris between Palestinian and Israeli teams. The agreement provides a number of achievements for the Palestinians, notwithstanding a significant continued involvement of Israeli authorities in the process of domestic legal reform and their influence in determining the orientation of most aspects of joint economic relations. This Israeli role is embodied in provisions in the text of the agreement, as well as through the establishment of a Joint Economic Committee (JEC), which is bestowed with ultimate authority on issues brought to it by either side.

Although it falls short of providing Palestinians with full authority over domestic natural resources and over economic management for the time being, the Paris Economic Protocol envisages fundamental changes bearing on such major issues as trade, taxes, finance, labour and overall management of the local economy. Once applied to the whole territory under the jurisdiction of Palestinian Authority (as the September 1995 agreement is unfolded for implementation), the Protocol promises the Palestinian people the greatest measure of autonomous economic decision-making ever known. This in itself constitutes a major and irreversible transformation of the policy environment affecting Palestinian economic prospects.

The improved policy environment affecting economic activity was also apparent in other respects, among which the following were notable:

- An international conference of donor countries was convened in Washington on 1 October 1993, at which participants pledged some $2.4 billion for the reconstruction of the occupied Palestinian territory over the period 1994-1998. This aid package was intended to provide immediate improvement in the living conditions of local residents, and at the same time rehabilitate the debilitated physical infrastructure needed for sustained economic development;

- In light of strong international interest in the economic implications of peace in the region, and at the request of the parties concerned, both the World Bank and the International Monetary Fund became actively involved in the economy of the occupied territory, something which they could not do until then. The role of those two institutions since has been central in the management of aid programmes and has gained prominence in various spheres of economic policy and development planning in the territory. In addition to the direct impact of their activities, the involvement of the World Bank and the IMF has provided strong encouragement to private investors; and,

- The new circumstances have also created a much more favourable environment for the operation of NGOs which were faced with various restrictions on their activities until 1993, thus allowing them to concentrate energies on their primary functions and services.

While restrictions affecting the movement of persons to Jordan and Egypt have been eased especially since 1994, travel within the West Bank and between the West Bank and Gaza Strip, as well as transport of goods between the West Bank and Gaza Strip, have become extremely complicated. The Israeli-Palestinian agreement in principle to establish a safe-passage corridor between the two regions remains to be implemented. The economic situation in the West Bank and Gaza Strip continue to be disturbed by frequent prolonged closures of the territory by the Israeli authorities in 1994, 1995 and 1996 for security considerations in the wake of violent incidents. The closures, coupled with the gradual reduction in the number of Palestinians permitted to work in Israel and the growing difficulties affecting the movement of exports and imports from/to the territory, have contributed to growing unemployment since 1993 and have squeezed incomes, savings and investment. These measures and the security considerations that have prompted them, have acted to dampen business confidence and to perpetuate doubts about the immediate prospects of cooperation between Israel and the emerging Palestinian economy.

The gradual improvement in the overall policy framework bearing on private investment and economic development in general, has generated profound interest in the international business and NGO communities (see Chapters II and III). Among the most visible manifestations of that was the sudden influx to the territory since 1994 of businessmen, including many diaspora Palestinians, with the intention of exploring business and investment potentials and opportunities. High expectations for the future have also spurred many transnational corporations to identify investment and business opportunities in the emerging Palestinian market. Until the end of 1995, the involvement of the private sector remained largely an exploratory and preparatory process and had yet to take decisive and final forms.

There are various factors attributed to explain the reticence of many investors to commit resources to specific projects until mid-1995. 7/ The following factors are considered to have played an important role at one point or another since 1993:

- The stuttered pace of the peace process has been discouraging, and left investors uncertain about the interim and final outcome of the current peace negotiations;

- The slow delivery record of donors until mid-1995 engendered doubts about international perceptions of the region’s future. Unintentionally, the sluggish performance of the donor effort in this period sent the wrong message to the private sector, and dampened much of its early enthusiasm. Furthermore, the constrained flow of aid depressed actual economic growth below initial expectations and impeded efforts to improve the debilitated infrastructure; and,

- The uncertain pace of reform of the legal system, especially in relation to the business sector, contributed to doubts and speculation. Investors have thus concluded either that the Palestinian Authority was denied independent legislative authority until election of a representative council, as per the Cairo Agreement, or that it had yet to develop the institutional and other prerequisites for discharging its legal obligations. Neither explanation offered much encouragement to investors.

An additional source of concern to institutional and individual investors in the post-1993 period was the slow pace and uncertain direction of development of Palestinian governmental institutions at the outset of the interim period of self-government. Certainly, the task of building such institutions from scratch was daunting and was perhaps underestimated by those concerned within both the Palestinian Authority and the private sector. While all involved manifested eagerness to develop an active working relationship, mismatched expectations and the different pace and modes at which the government and private sector operated were factors contributing to investors’ caution.

A number of specific problems encountered in Palestinian institutional development with a bearing on the prospects for investment and economic growth have been noted during the past two years: 8/

- The tendency to vest day-to-day authority over the management of aid and investment flows solely at the level of the political echelon, sometimes at the expense of the role of technocrats in specialized departments. This was seen to have undermined the effectiveness of the legal and administrative systems catering for the needs of the business sector;

- The slow assumption of the intended role of aid coordination and management entrusted initially to the Palestinian Council for Development and Reconstruction (PECDAR). More recently, PECDAR has received stronger support from the executive branch of the Palestinian Authority, though its temporary and transitional status has also been acknowledged by all concerned;

- The role of PECDAR was impeded by a degree of overlapping with various ministries, since a clear division of responsibilities was not easy to define at the early stage. Viewed against a background of institutional rivalry, this further complicated project planning and implementation through 1995;

- The staffing policies of the Palestinian Authority have manifested strong sensitivity to political affiliation, especially with regard to senior posts, many of which were filled by former political and military activists;

- During the first year after the inception of the Palestinian Authority, donors voiced concern with regard to the transparency and accountability of aid management policies. Although differences in views and pending problems were largely resolved by mid-1995, this further disturbed the investment climate; and,

- Licensing and administrative procedures relating to the business sector and external trade remained vague and non-institutionalized. The fact that Palestinian government institutions, even those belonging to the same ministry, are located between Gaza, Jericho, Ramallah and Nablus, was an additional element causing confusion within the business community.

Learning from its own experience and encouraged by the donor community, the Palestinian Authority has taken significant corrective measures in 1995 aimed at rectifying the above-mentioned deficiencies. Expectedly, this has resulted in a marked improvement in the management of the Palestinian economy and instilled greater confidence in the future of the economy. But the successes achieved are still limited and more will be needed to create a vigorous influx of foreign investment. These issues are addressed in greater detail in Chapter IV.

Meanwhile, in some respects it is considered that legal uncertainties became greater between 1993 and 1995, since there were different legal systems observed in different areas of the territory, according to the ruling authority until the end of 1995: Gaza Strip and Jericho (under the Palestinian Authority), east Jerusalem (Israeli law) and the remaining parts of the West Bank (Israeli Civil Administration). The existence of several legal systems covering the same economic entity, which were not harmonized or modernized, posed important problems in the commercial field, especially in such areas as company formation, registration, and licensing procedures. The situation was further complicated in late 1994 following the transfer of several civilian spheres of authority in the West Bank to the jurisdiction of the Palestinian Authority in the context of "early empowerment" arrangements, including direct taxes and tourism. But as the court system and security in the West Bank were not transferred to Palestinian authority at that stage, the executive capacity of the Palestinian tax authorities outside the Gaza-Jericho area was undermined. Only with the full implementation (by early 1996) of the September 1995 agreement on extension of the Palestinian Authority’s jurisdiction into the rest of the populated areas of the West Bank, will the legal asymmetry experienced until 1995 between different regions of the territory begin to be rectified.

In one important area of relevance to business activity and investment prospects, intellectual property laws prevailing in the Palestinian territory have their roots mainly in the pre-1967 legal systems, and as such are of a relatively rudimentary and out-dated nature. 9/ Until 1993, the legal system did not provide effective protection of patent rights and trade marks. In the West Bank, the Jordanian Trademark Law No. 33 of 1952 and the Patent and Design Law No. 22 of 1953 continue to be in force until today. In the Gaza Strip, trademarks and patents are still covered by the British Mandate laws on these issues of 1938 and 1924, respectively. This has resulted in a marked degree of chaos in the labelling of manufactured products, many of which were inferior imitations of international brands. The same applied to academic textbooks used in local universities which were reprinted without permission from original owners of copyrights. Despite efforts by the Israeli authorities, especially in recent years, to control quality, health and safety standards of Palestinian goods marketed in Israel, this did not result in an overall improvement in the application of product standards in the territory, barring a few exceptions.

The Palestinian Authority has been charged in the Declaration of Principles and subsequent agreements with the authority to reform and manage the legal system, in coordination with Israel through the Civil Affairs Coordination and Cooperation Committee. So far, no new laws have been enacted formally nor have old laws (and military orders) been officially revoked or amended. Yet, the Palestinian Authority has exercised considerable legal flexibility within its territory, by selective recourse to laws and regulations left over by previous authorities. This has been supplemented, in some cases, with publication of new draft laws enacted by the Palestinian Authority and intended for adoption by the Palestinian Council once it is officially convened following the 1996 elections. Clearing the way for the formulation of new laws and regulations is a fundamental prerequisite to vigorous growth in the Palestinian private sector and in improving the investment climate.

Because of inadequacies in the legal system and in its implementation, Palestinian entrepreneurs have developed informal adaptive mechanisms that enable them to continue doing business in an environment of political and administrative instability. Indeed, one increasingly common way of expediting business interests, in the absence of clearly developed rules and institutions, is through the intervention of Palestinian officials. Such informal mechanisms of resolving problems and doing business, while perhaps necessary until now, will place strong limits on the effectiveness of anticipated legal reforms and the quality of the investment climate. To the extent that legal reforms can comprehensively and flexibly address the interests of the business community, other concerned parties and the population at large, formal structures and procedures will be able to replace informal modes of operation currently favoured.

B. Investment encouragement laws and regulations

Laws governing investment in the West Bank consisted until recently of the 1967 Jordanian Encouragement of Capital Investment Law, and Military Orders 1342 and 1055 of 1991. The incentives provided in these regulations include a three-year tax exemption for approved investments, broad commitments to non-discriminatory treatment, and unhindered repatriation of profits for foreign investments. As the operation of the 1967 Law could not be guaranteed under conditions of occupation, it was only after 1991 when the two Israeli Military Orders were promulgated that some investors actually attempted to benefit from the new conditions offered. By 1993, a number of new, mainly small-scale, industrial and other business ventures had been licensed by the authorities, but few could benefit from the incentives offered. The political developments since 1993 created the impetus for a complete revision and reform of this area of legislation, a process which has yet to be completed.

After many months of complex political and legal discussions, the

Palestinian Authority enacted, in April 1995, the Investment Encouragement Law, which provides for a range of tax concessions and relaxed regulations with regard to the transfer of accrued profits. The law calls for the establishment of a joint interdisciplinary investment commission for administering its provisions, the Palestinian Higher Agency for the Encouragement of Investment, which is to be entrusted with overall coordination of investment activities. The Agency is responsible to the Chairman of the Palestinian Authority and it comprises 15 members representing the public and private sectors, chaired by the Minister of Economy. The Agency therefore follows the model of an autonomous public-private sector organization, with the balance of control held by the public sector.

The Law covers projects in all sectors, applicable to investors of all nationalities. It introduces guarantees against nationalization, expropriation and requisition. Tax incentives include exemption from import duties and corporate income tax abatement, in conjunction with special tax incentives for the use of Palestinian labour. The Law provides equal incentives for local, Arab and other investments. In particular, tax holidays for a period ranging from three to six years are given to approved investment projects depending on their capital size, the period over which investments are actually deployed and employment capacity. The repatriation of the foreign exchange equivalent of profits and the original capital of non-Palestinians are equally guaranteed, subject to payment of dues (unspecified) prescribed by Palestinian law. It also offers rights of permanent residency to Palestinian investors from abroad. Special exemptions may be granted to projects with a minimum export and local material content.

The objective of these incentives appears to be the promotion of savings and attraction of local and foreign investment where propensities are high at the private sector level, even though it may be at the expense of some loss in government revenues. While the potential net effect of these incentives is difficult to determine now, it is widely believed that at a later stage the beneficiaries of the incentives may serve as new "tax handles", leading to the creation of a broader tax base, and hence, increased public revenues.

Despite its vital positive implications, the Law is considered to require further elaboration in a number of aspects. 10/ The most prominent of these are as follows:

- The legal, institutional and operational aspects of investment promotion need to be adequately ascertained. It is important to distinguish between what needs to be covered under the basic law itself and what can be included under its institutional and operational aspects as guidelines for its implementation. The law combines institutional, technical/legal and operational aspects of investment promotion. While there may be no objection to such an approach, it is advantageous to clearly separate issues that are of institutional and operational nature. As the subject of promoting private investment is for the first time being introduced in the Palestinian territory, it would be helpful if the law and its related operational procedures provide clear and adequate guidelines for potential investors, both in the territory and abroad.

- Certain basic terminologies/words used in the law and other Acts issued by the Palestinian Authority need to be consistent and reflect a uniform understanding for all concerned. For example, the use and implication of terms such as Council of the Authority, Head of the Authority, Prime Minister and others, need to be consistent so as to avoid giving different impressions in different Acts and/or decrees as well as in related rules and regulations. In a related vein, the Part on definitions needs to be expanded. This is particularly necessary as legislation on business activities and other related issues is lacking at present in the territory. Even some of the terminologies used in the draft need to be defined, to avoid confusion and ambiguous interpretation or application of the law.

- Under Part II, dealing with the Palestinian Higher Agency for the Promotion of Investment, the powers and authority of the Governing Body of the Agency and that of the Agency itself need to be clearly separated. As it is, the Governing Body and the Agency are covered under different Articles. It may be advisable to devote a set of successive Articles to the Governing Body and another set to the Agency. It is important not to diffuse the powers and responsibilities of the two bodies throughout the Act.

- As for the Part of the law dealing with exemptions, it is difficult to see how the law in its present form will succeed in encouraging much investment. Investment encouragement laws in various countries devote special attention to incentives, particularly under conditions of keen global competition to attract investments in desired areas. Apart from exemption from "income tax" and "dues" covered under four categories of investments (i.e. declining amounts of capital and number of workers) no other incentives are envisaged in the law. There is a myriad of incentives that can be considered depending on the objectives and the presence of a number of factors influencing the decision of private local and foreign investors. Investment incentives do not stop with income tax holidays but include a range of other fiscal, monetary and administrative measures, such as grants, subsidies, low interest loans, loan guarantees, accelerated depreciations, reinvestment allowances, use of land, and a number of other concessions. These can be tied to Palestinian development objectives and priorities and the nature of the enterprise, including exploitation and use of domestic raw materials as against imports, promotion of exports, protection of the environment and many other considerations that are embodied in the Palestinian Development Programme (PDP). Moreover, instead of providing blanket incentives covering all types of enterprises in all sectors, specific areas could be designated to benefit from incentives. This could be tied to priorities of the economy such as the establishment and development of export processing/industrial zones. Similarly, it is advisable not to tie incentives to paid-up capital. The aim of incentives should be to maximize total investment in an enterprise and not to be tied to its paid-up capital only.

- It also has been noted by local experts and entrepreneurs that most of the existing firms in the Palestinian territory may not benefit from the tax holidays specified in the Law, since they are mostly too small to qualify for the stipulated benefits. Furthermore, many locally-owned firms believe they are entitled to special measures to guarantee effective non-discrimination as compared to foreign corporate investors, which have numerous distinctive advantages in terms of management, capital and international standing.

- Measures related to tax subsidization policy need to be reconsidered in connection with this Law. The Palestinian Authority has yet to elaborate a clear strategy and objective set of operational criteria for selecting projects that should benefit from such measures. Needless to say, such measures are to be carefully considered in light of the costs involved and their general impact on the economy, notably with regard to the distortion created in the allocation of the factors of production and the consequent impact on comparative or completive advantages. It is not clear that corporate tax subsidization can, in the long run, result in a stable economic structure.

- It is not clear as to what the criteria are for approving investment applications and the establishment of enterprises. It is also not clear whether enterprises entitled to the incentives are only shareholding companies such as corporations and joint stock companies or cover also partnerships with limited liability, and proprietorships. While the juridical personality of enterprises are defined under commercial law, for purpose of incentives it is useful to specify this. For example, the different forms of enterprises corporation versus proprietorship are subject to different rates of income taxes. As the aim is to mobilize investments, the law could fruitfully concentrate on encouraging joint ventures at this juncture until the corporate form of enterprise gains wider acceptance and the financial market also develops to facilitate financial intermediation.

- There is also a need for the jurisdiction of an international arbitration body, particularly in disputes involving the Palestinian Authority. Furthermore, an isolated measure like the Law is less effective in providing incentives for investment as compared to a stable and transparent system of commercial laws and enforcement mechanisms, and therefore could prove ineffective if unaccompanied by such basic reform.

C. The new framework affecting the financial and trade sectors

The Declaration of Principles and subsequent economic agreements have provided an opportunity to rebuild the inadequate and ineffective Palestinian financial system. Israeli-Palestinian accords on banking, followed by corresponding Jordanian-Palestinian accords and the agreement reached between the Bank of Israel and the Central Bank of Jordan in December 1993, have contributed to the liberalization of entry for new banks and expansion of existing ones (see Chapter II).

The Paris Economic Protocol has allowed for the establishment of the Palestinian Monetary Authority (PMA), which is bestowed with most of the functions typical of a central bank. It will act as the Palestinian Authority’s official and financial adviser, and as its sole financial agent, both locally and internationally. It will hold all the Palestinian Authority’s foreign currency reserves, authorize and regulate foreign exchange dealers, register and regulate banks, and act as lender of last resort. The PMA will license local and foreign banks which are now operating in the Gaza Strip and West Bank, as and when the respective parts of the territory come under the jurisdiction of the Palestinian Authority. The Basle rules will apply to foreign banks controlled by the PMA and to relations between foreign and local banks. The Paris Protocol, on the other hand, has left the question of issuing a Palestinian currency for later agreement. This may raise some doubt on the ability of the PMA to serve as lender of last resort, since it will be denied the ability of creating high-powered money.

The actual establishment of the PMA, however, became effective only a year after the conclusion of the Paris Accords, which created a serious vacuum in the regulatory framework governing the Palestinian banking system during that period. Following the commencement of operations by the PMA in mid-1995, more confidence was instilled in the Palestinian financial system. Yet it should be noted that until the end of 1995 the PMA had not assumed its authority in regard to the regulation and supervision of the banking sector in the West Bank and Gaza. Except for the licensing of new bank branches in the Gaza Strip and Jericho area, the PMA as yet has had little influence until 1996 over bank operations. The PMA had no authority over the areas which were not under the jurisdiction of the Palestinian Authority (i.e. in the West Bank where most bank branches are located). Moreover, the PMA is still not fully operational in terms of personnel, regulatory framework, and logistical support.

Meanwhile, the Palestinian Authority took some steps towards reforming the financial system, beginning with conclusion of a Memorandum of Understanding with Jordan on joint money and banking issues. The agreement reached between the two parties on the main features of a permanent banking framework, and signed in early 1995, should have removed a factor that unnecessarily increases the risk of operating in the West Bank and Gaza Strip. This factor stems from the termination provision in the Memorandum, which states that the framework established will expire not later than the end of the interim period, or whenever banking and monetary responsibilities and authority in the West Bank and Gaza Strip are transferred to Palestinian authority. This clause leaves the institutional setting under which Jordanian and other banks will operate uncertain for at least the next few years.

The new arrangements cover the operation of banks of any nationality, with provisions regarding the establishment of local banks, including subsidiaries of foreign banks. This is essential because Jordanian banks in particular needed to know what their environment would be relative to that of other banks, especially those established locally. The current agreement is fully consistent with the Basle Concordat, and furnishes clearer rules for the banks now starting their operations in the West Bank and Gaza Strip. This should encourage banks to think strategically when they consider investing in the West Bank and Gaza Strip economy, and in training local staff and promoting long-term relations with their customers. These actions would reduce both the long run costs and the risks of operations, hence resulting in higher ratios of credit to deposits. Most recently, the PMA announced that it had drawn up the necessary legislation for assuming its responsibilities in the rest of the territory following Israeli redeployment and the extension of Palestinian jurisdiction as of early 1996. 11/ This will cover all bank branches (Palestinian, Jordanian, Israeli and others), though coordination on banking and monetary issues is still envisaged between Israel, Jordan and the Palestinian Authority, on the basis of the Basle Concordat.

Many of those active in the local business and academic communities consider that banks in the Palestinian territory continued into 1995 to pursue conservative policies. These have been to a great extent justified by the prevailing political, legal and economic uncertainties in the territory. No less important, Jordanian banks have been constrained by the terms by which they have been permitted to reopen and operate, as stipulated in the bilateral agreement between the Central Bank of Jordan and the Bank of Israel. The most important of these still in effect at the end of 1995 were as follows: 12/

- Bank branches are not allowed to deal in foreign currencies nor to open letters of credit for local businessmen, except through Israeli banks. They also cannot make transfers in foreign currencies, except through their headquarters, outside the territory;

- The assets of the branches of banks should not exceed 35 per cent of their total assets;

- There is a ceiling imposed on deposits in Jordanian dinars, to be determined by Israeli authorities;

- Banks are required to maintain a surplus on their liabilities equivalent to $1 million, or 8 per cent of their total assets, whichever is greater; and,

- Banks should maintain a high liquidity ratio as well as a high reserve for Israeli shekel deposits (i.e. about 38 per cent).

The above-mentioned regulations entail continued constraints on the growth of the Palestinian banking system. Obviously, they are intended to maintain effective control by the different authorities concerned over the monetary and banking policies in the West Bank and Gaza Strip. By controlling the ceiling of JD deposits, the use of this currency may be more effectively manipulated, though this constrains the ability of Jordanian banks to expand their operations in view of domestic market needs. Furthermore, the continued circulation of Israeli currency in the Palestinian territory provides seigniorage revenue to the Israeli monetary authorities and contributes to monetary stability in Israel. 13/ Nevertheless, while alternative currency arrangements may be envisaged (provision for negotiations on this issue are made in the Paris Protocol), the post-1993 interim agreements provide the only workable basis for development of the monetary sector in the immediate future.

There is no stock exchange market in the West Bank and Gaza Strip, nor any of the financial intermediaries, laws or regulatory institutions that one would expect in a growing modern economy. By the end of 1994, there were about 47 publicly held corporations in the West Bank and 6 in the Gaza Strip. 14/ The issuance and transfer of shares is still covered by the Jordan Companies Law of 1964, for companies registered in the West Bank, and by the Palestine Companies Law of 1929 for companies registered in the Gaza Strip. Neither law is applied to the trading of securities. Shares are traded informally or through the offices of respective companies. Since there is no formal market, there are no statistics on the number or value of shares traded, but there is a general agreement among experts that the volume of this trade is very small. There are no provisions for custodial services, and the limited financial information published appears only when firms publish their final accounts in the annual meeting of shareholders.

Recent political developments have prompted some investors to examine the idea of establishing a stock exchange market (SEM). They are encouraged by the over-subscription, sometimes by more than 100 per cent, of newly registered firms. This is indicative of both high liquidity and the scarcity of dinar-denominated investments. Efforts are currently under way by the Palestinian Authority and a recently established Palestinian transnational corporation to pursue licensing requirements and procedures for establishing a stock market, expected to commence operations in Ramallah by the beginning of 1996. 15/

Establishing a stock market is certainly a high priority for building an efficient financial system. But there are certain measures that must be taken before opening this market for public trading. These measures are usually designed to make the market operate as efficiently and effectively as possible, and to earn the confidence of potential investors. These include an adequate legal and regulatory framework (a new companies law covering both the West Bank and Gaza Strip and a securities market law), an efficient exit mechanism where investors can quickly and easily buy and sell, upgrading of accounting and auditing standards, as well as regulating brokerage firms and stock dealers. Until those measures are taken, the Palestinian investment bank which is currently proposed for establishment, could include as one of its business activities, the management of a limited formal stock market through a window in the bank or through an independently capitalized subsidiary. At the outset, the bank could follow Jordanian laws and practice, or international guidelines for stock market operations, with regard to the issuance of stock, trade and settlement and custody.

The Palestinian Authority has acquired substantial powers in the areas of fiscal policies. It is able to exercise full discretion on direct tax policies, budget, banking operations and insurance activities. The fairly wide leeway generated by these fiscal adjustments should provide investors with additional confidence in the local economic system, assuming of course that written injunctions are rapidly translated into tangible measures, procedures and dealings.

As for tax reforms affecting investment activity (other than the measures discussed previously), the Palestinian Authority has amended the rates and exemptions for personal income taxes. Despite some reductions, the current rates are still believed to be high. The administration of the tax system is undergoing a complete overhaul in close cooperation with the IMF. This includes the establishment of transparent rules for assessments and advance payments of income taxes, the creation of a credible and efficient institutional mechanism for settlement of tax disputes and the application of commonly acceptable collection and enforcement methods. An ad hoc committee was recently established by the Ministry of Finance to set up a framework for a proposed tax advisory panel. As for Value Added Tax, the Palestinian Authority is allowed, by the terms of the Paris Protocol, to move within a limited range of plus or minus 2 per cent from rates prevailing in Israel (currently at 17 per cent).

One of the most visible features of the new tax administration relate to changes in its manpower. The number of staff in the tax department has risen sharply following its transfer to the Palestinian Ministry of Finance, from 28 in late 1994 to 420 by September 1995. 16/ Furthermore, numerous pre-service and in-service courses have been organized for recruited staff, which have greatly helped raise their aptitude and improve their performance. It is interesting to note that much of the training has been coordinated with relevant institutions in Israel.

Palestinian foreign trade relations have undergone fundamental changes following the signing of the Paris Economic Protocol. Provisions relevant to trade have the following major implications for the investment climate:

- Israel and the Palestinian territory would establish a customs union which would allow for free trade between the Palestinian economy and Israel. This includes agricultural produce, with the temporary exception of five commodities, which are also to be freed in 1998. Given the pronounced differences in the cost structure between the two sides, it is expected that the opening of Israeli markets will result in a marked increase in the volume of agricultural exports to those markets. Accordingly, a vigorous and well-targeted investment programme to encourage agricultural reform and restructuring appears imperative;

- The commitment of both sides to free trade at the regional and international levels is an important criteria for a thriving private sector. At least in theory, the opening of the relatively huge Israeli market to Palestinian agricultural and manufactured products should be perceived as a significant opportunity to investors in the

Palestinian economy. Even if Israel opens up its trade with other countries, the Palestinians will continue to enjoy an important proximity advantage, in addition to thorough knowledge and familiarity with the Israeli economy and business community; and,

- Granting Palestinian Authority the right to establish its own import policies with other countries, especially Jordan and Egypt, provides an important impetus to Palestinian-Arab trade-related investments. Accordingly, the Palestinian Authority is permitted to import from those countries a wide range of products at tariff rates which they may set independently from Israel, but in quantities which meet only part of local market needs. Liberating the Palestinian economy from the trade constraints it has suffered for 27 years with Arab markets, no longer closed for boycott considerations, is an important boost for local productive sectors, especially agriculture and industry.

More than one year after the signing of the Paris Protocol, the implementation record of this agreement has reportedly fell short of Palestinian expectations. 17/ The flow of agricultural produce into Israel was proceeding at low levels, considerably below the pre-agreement period. This is partly owing to market conditions in Israel and stiff phyto-sanitary and health conditions applied to imports to Israel from the territory. Trade between the West Bank and Gaza Strip has also been severely curtailed due to regulatory restrictions related to the frequent closure of the territory. Furthermore, the Palestinian Authority only recently began to exercise its options of importing relatively cheaper production inputs and strategic goods from Jordan and Egypt (especially cement, fertilizers and fuel). Yet the territory has been increasingly faced with the unregulated import of manufactured consumer goods coming from neighbouring Arab countries, especially Egypt and Jordan, through Israeli or informal channels. This latter form of trade has reportedly caused serious damage to some local manufacturing branches, which are considerably less competitive under the present setting than many imported consumer goods from abroad.

Chapter II

SUPPORTIVE CAPACITIES FOR PRIVATE INVESTMENT

A. Enterprise development

1. Companies and related establishments

The high expectations generated after 1993 with regard to the economic future of the region were clearly reflected in the sharp rise in the number of registered companies, mostly involving partners from outside the Palestinian territory. According to data made available by the Companies Registrar, 700 new companies were registered in the West Bank in 1994, which amounts to nearly one fourth of all registered companies as until the end of that year (see table 1). The registration of new companies during the first five months of 1995 seems to have maintained its high pace since 1993. Almost as many companies were registered in the 1993-1995 period as were registered during the entire pre-1993 period. Furthermore, it is noted that many of the newly registered companies are types which were previously uncommon in the Palestinian territory. In the Gaza Strip, the increase in registration of different types of companies has also been significant, with the number of companies almost doubling between June 1994 and December 1995, as shown in table 2.

Despite the rapid proliferation in the number of newly registered enterprises, until 1995, the economic impact of this increase remains to be seen. The tentative nature of the recent growth in company registration was most evident in the low volume of investments which have been actually mobilized since the inception of the peace process in 1991 (see Chapter III). It has been frequently noted that potential investors have visited the country in large numbers since 1993, but the majority have so far refrained from initiating actual business operations. While a number of investors are not yet convinced that the climate is ready for concrete commitments, many others are hopeful for the future and have initiated the needed organizational structure to commence actual operations when the time is appropriate for more active involvement. Among other things, this has involved renting office premises and hiring a minimum core staff. Some have gone further and purchased land and registered subsidiary firms with local partners.

The investment climate and scope of economic activity in the Palestinian territory is heavily influenced by the proficiency of the support system which serves and articulates the private sector. The role of the support system has assumed increasing significance in the light of the pronounced thrust towards the liberalization of trade and ensuing exposure of local firms to regional and international competition. This is particularly true in the Palestinian territory where it has been apparent for some time now that the inadequate performance of private sector support institutions has not enabled them to promote sustained growth in the Palestinian economic base.

There are only partial and aggregate data available on the quantitative and qualitative aspects of the support system relevant to investment. Some aggregate indicators on the total number and types of institutions engaged in services bearing on economic activity are provided by the establishment census conducted recently by the Palestinian Central Bureau of Statistics. Table 3 shows that a total of 53,820 establishments in the Palestinian territory were in operation in 1994 employing a total labour force of 147,218 persons. Of these, around 500 are service-related establishments, excluding the major categories of distributive and personal services which also have a bearing on the institutional infrastructure affecting investment. Comparisons with previous years are not possible because the publications of the Israel Central Bureau of Statistics do not contain data corresponding to those of PCBS.

The following sections examine the existing institutional framework for business-support in the Palestinian territory as it had evolved by 1995.

2. Chambers of commerce

Chambers of commerce were established in the West Bank and Gaza Strip well before the onset of Israeli occupation. However, since 1967, they did not play a significant role. As their business-oriented functions weakened after 1967, chambers of commerce started performing administrative functions as against services considered to be of greater relevance to the promotion and regulation of commercial activities in the territory. Since the late 1980s, chambers of commerce attempted to acquire greater responsibilities in the area of export certification and representation of the interests of the business community, but the impact of such efforts remained largely marginal.

Issuing certificates of origin was perceived during the occupation period as one of the most important functions of Palestinian chambers of commerce. This role was particularly significant in the absence of relevant Palestinian governmental institutions. Consequently, some major foreign trading partners, such as Jordan and the European Union, agreed to recognizing certificates of origin issued by local chambers of commerce. Such certificates were issued after filling appropriate forms and against a modest fee, after which the consignment was inspected by an authorized representative from the local chamber of commerce.

The potential role of chambers of commerce has grown in the past few years, initially as a consequence of electing members of their Boards as of 1992, for the first time in many years. This process revived interest in those institutions and brought to the fore a new generation of young, highly motivated and politicized business leaders, nearly all enjoying the endorsement of the Palestine leadership. Furthermore, the new set of chambers of commerce recently began to benefit from technical and logistical support of a variety of international organizations and NGOs, a process that has intensified following the inception of the peace process and the return of the Palestinian leadership to the territory. It is important to note, in this connection, that the Israeli Civil Administration has not obstructed the reactivation of the role of chambers of commerce; indeed it was the loosening of Israeli restrictions since 1991 that permitted the reactivation of this long-neglected institutional component of the Palestinian business community.

Chambers of commerce are becoming actively engaged in a variety of functions which are aimed at serving the local business community. They are recognized by most foreign donors, trade delegations, financial institutions and incoming business firms and investors as the main focal point in the Palestinian territory. It is generally believed that the new political and economic setting permits chambers of commerce to play a considerably more active role. For instance, they can become an important intermediary between their members and relevant Palestinian Authority institutions, such as tax and licensing authorities. This could be of vital significance, given the still embryonic nature of many of those institutions. Furthermore, chambers of commerce can play an active role in facilitating international trade, especially that restrictions on such trade have been significantly reduced following the conclusion of the Paris Economic Protocol. In order that they can perform those functions, chambers of commerce are in need of more technical, legal and financial support.

3. Legal and notarial services

Company registration, legal and notarial services are performed by district offices located in the major town of the respective district. These offices were staffed by local Palestinian legal officers, accountable until 1995 to the Israeli officer-in-charge of justice. Notarial offices performed a wide range of legal functions, usually without recourse to Israeli officials. Following the emergence of the Palestinian Authority in the Gaza Strip and in Jericho, relations between notarial and company registration offices in both regions were severed with the Civil Administration and affiliated instead to the Palestinian Ministry of Justice. As the Palestinian Authority extends its jurisdiction over the remainder of the Palestinian territory, upon the implementation of 1995 Israel-Palestine accords, the new configuration will reduce administrative and legal confusion facing many firms in the private sector. During the 1993-1995 period, for example, some newly-established companies found themselves obliged to register with the Civil Administration, as well as with the Palestinian Authority in Jericho and in the Gaza Strip, in order to ensure that their activities were legal in all areas of the Palestinian territory. Needless to say, businesses also intending to operate in east Jerusalem must adhere to a separate process of registration with the relevant Israeli authorities and the municipality of Jerusalem.

B. Technical capabilities

1. Market information

The Palestinian private sector has operated for many years without access to modern market information facilities. This was primarily due to strong dependence of the Palestinian trading community on Israeli commercial agents, hence leaving Palestinians with minimal, if any, contacts with foreign markets. Moreover, informal marketing and trade information systems emerged over the years, adapted to the patterns of domestic production and manufacturing operations and to dependence on trade routes through Israel. Few major problems in obtaining adequate information were experienced until recently (as a result of increased border closures which impaired access by Palestinians to sources of market information in Israel).

The market information gap has been reinforced by the absence of foreign market information offices, as usually exist in embassies and consulates. There are six European consulates in east Jerusalem, in addition to one representing the United States. But most of these diplomatic missions were inadequately equipped to perform ordinary commercial functions such as those provided by commercial attachés of such missions. The majority of diplomatic missions in Tel Aviv, on the other hand, have refrained from extending the activities of their commercial offices to the occupied territory, which was outside their scope of jurisdiction. In addition to the above-mentioned factors, the poor level of market information was compounded by the deteriorating command of the English language among the local business community, which for more than 25 years found its interests served better by mastering the Hebrew language. The scope of communication in English has been so limited that it became an obstacle to taking advantage of important market information made available through a variety of channels and media.

Deficiencies in market information are not only confined to external markets, as they are often observed in local markets as well. This is particularly significant in regard to wholesale markets of farm produce, where it is reported that marked differences are sometimes detected. Such deficiencies are attributed to unsatisfactory channels of communication between local markets. Despite deficiencies in the system of market information, this was less of a drawback for Palestinian traders dealing with their two major trading partners, Israel and Jordan. The physical proximity and the openness of borders with both countries helped to create an informal, but fairly expedient, flow of market information between Palestinian businessmen and their Israeli and Jordanian counterparts, based mainly on direct personal contacts. Obviously, such links have deteriorated since 1993 as a result of security measures and border closures, highlighting the limits of informal market information networks and the need for modern institutionalized services in this respect.

2. Advertising and promotion

The means and mechanisms for advertising and promotion in the Palestinian territory have evolved in ways which conform with overriding economic and political constraints affecting the private sector. In the absence of local television and radio stations until 1994, the main promotion forum used by the business community has been local newspapers, in particular the daily Al-Quds, which has become the principal promotional forum in the territory.

Advertising in Jordanian and Israeli audiovisual media has been inaccessible for different reasons. Jordanian authorities until 1995 denied Palestinian firms access to the promotional services of Jordan television and radio stations, presumably on account of compliance with Arab boycott regulations. On the other hand, Palestinian firms refrained from approaching Israeli media for this purpose, both for political reasons and because the mainly Hebrew-language Israeli media is not consulted by the vast majority of Palestinian consumers.

The availability of advertising services and media has widened considerably over the past two years. Jordanian authorities have changed their policy regarding access to local media by businesses from the territory. Furthermore, a number of local commercial television and radio stations have begun to operate in the West Bank and Gaza Strip, all of which have an interest in establishing strong links with the business community. The establishment of the "Voice of Palestine", the Palestinian radio station in July 1994, has also opened a new venue for Palestinian enterprises, especially as it quickly became the most popular public media in the territory. Advertising opportunities in local papers have also widened considerably following the emergence of many new papers and periodicals in the past year. While advertising and promotional services in the territory are at an early stage of development, Palestinians' exposure to, and experience in, regional and international media provides a sound basis for rapid improvement of such services.

3. Management and manpower training

The Palestinian private sector in the West Bank and Gaza Strip has always been handicapped by the inadequate managerial and technical capabilities prevailing in local business enterprises. This has been the outcome of several transformations bearing on the educational system. For many years, the Palestinian higher educational system has been characterized by strong orientation towards external labour market needs, especially in the Arab States of the Gulf. By contrast, local universities and community colleges have displayed inadequate sensitivity to the needs of the local labour market, both in terms of quality of education and scale of demand for different skills.

The household nature of business enterprises also provides further disincentives to the induction of professional management cadres in Palestinian firms. By virtue of the small size and low level of capitalization of enterprises, senior management is usually assumed by principal owners or immediate kin. This pattern of management culture does not allow for the proper selection of individuals based on merit and not on ownership considerations, although it was on the whole compatible with the needs of the dominant forms of small, family-based business enterprises prevalent in the territory.

Although the majority of managers seem to be deficient in skills required in international trade, they have nevertheless developed remarkable "survivalist" skills in operating under adverse circumstances. Furthermore, Palestinian business enterprises have acquired profound experience in the Israeli economy and business sector, which may turn out to be an important asset in the context of broader regional economic cooperation.

The management and manpower training needs of the private sector have broadened during the past two years owing to growing international interest in the economic development of the region, which was triggered by the first tangible results of the peace process. Many banks, transnational corporations and development agencies have commenced assigning staff at their newly established offices in the territory. Although the pay scale is set at higher rates than previously prevailed in the private and public sectors, it has become increasingly evident that the local market is deficient in high calibre managerial expertise. The dynamic recruitment policies of incoming enterprises have caused some disruption in local pay scales, as domestic businesses are faced with stiff competition as regards the wages they can offer for similar skills.

The deficiencies in modern management skills have spurred an influx of training facilities sponsored by local and expatriate NGOs. Such activities gained strong support from a wide range of donor institutions. The list of organizing venues includes local NGOs (such as National Foundation for Industrial Development and MA’AN Development Centre), official Palestinian institutions (e.g. the Palestinian Organization for Vocational Training), and university-based programmes (e.g. Continued Education Programmes at the University of An-Najah, Bir Zeit and Hebron). Profit-oriented management training firms are still rare, such as the Palestinian/Arab company TEAM International, which has a well-established record in its previous work for Palestine and in the region.

The proliferation in management training institutions and programmes raises many basic questions which shed doubt on the long-term impact of these activities on the Palestinian private sector. The following issues are of special concern:

- The vast majority of training offered is of short duration, rarely extending beyond 30 hours of actual instruction and practical training. And, as the majority of trainees are reportedly of unsatisfactory academic aptitude to begin with, the brief training they receive is not likely to produce considerable changes in their effective managerial capacities;

- So far, the interest of local universities in management training has been mainly confined to brief courses which fall outside the domain of academic teaching. The training process could have had greater impact had such activities been integrated within the regular course of study;

- The multiplicity of management training institutions and the lack of effective forms of coordination between most of them is conducive to excessive waste and adverse consequences on the quality of training.

4. Computer services

In recent years, there has been a pronounced growth in the computer industry and related skills in the territory. Many new firms were established during the past 10 years, engaging in both soft and hardware facets of this industry. The level of sophistication of existing firms is commensurate with current needs as they evolved during the pre-1993 period.

Following the achievements of the peace process, and in anticipation of a sizeable jump in development needs, several new computer firms have been established of a more international calibre. By 1995, there were some 26 such enterprises in the territory (see table 3). These firms are specialized mainly in networking and communication. The range of services provided by the emerging computer facilities is noticeably wider and more sophisticated than was available until recently. A recent addition to such services is the relative ease and low cost of connection to electronic mail and, to a lesser degree, the Internet. This is emerging as a vital technological innovation which, as elsewhere, has significant bearing on the business community as well as on many other educational and social institutions in the territory.

5. Research and development

The status of private sector-related research and development (R & D) services stagnated during the pre-1993 period. This applies in particular to agriculture, where research stations were closed since the early years of occupation. Although some R & D needs in agriculture have been accessed from Israeli sources, this form of technology transfer has not reflected the full range of research needs in the agricultural sector, especially in relation to rainfed production patterns. In other sectors, including industry, R & D has remained an in-house preoccupation, if at all, and is usually conducted on an ad hoc, informal and product-by-product basis. Technological transfer has been mainly from/via Israeli enterprises, generally geared to ensuring satisfactory operation of subcontracting arrangements with Palestinian producers.

Palestinian universities have failed to play an active role in regard to R & D needs of the private sector. Local universities are burdened by enormous teaching obligations, which leaves them little scope for extracurricular activities. And the majority of research currently conducted by university faculties is focused on academic issues, so that it may be credited towards faculty promotion purposes. However, the wide range of research and technical capabilities among the Palestinian academic community constitutes an immediate source of potential R & D activities for the private sector, assuming appropriate arrangements can be established between the business community and the institutions and researchers concerned.

6. Business advisory services

As with other supportive services mentioned earlier, the growth trend of the Palestinian private sector has been skewed towards small and household-type businesses, where advisory services are not deemed essential for the welfare of the majority of those businesses. And in any case, there have been no professional firms engaged in this kind of activity. The only need which was commonly felt for many years is that of evaluating the economic feasibility of new projects, and formulating professional project proposals. Even this service was demanded mainly when applying for loans from sources of concessionary credit, involving Arab, international and local NGO credit or aid institutions. The calibre of such studies reportedly is often of a low professional standard.

The need for business advisory services has become far more imperative during the past two years, following the extensive improved prospects facing the private sector. Advisory assistance is needed for a variety of basic decisions and issues, such as the following:

- Identifying satisfactory investment opportunities in various economic sectors. This involves conducting pre-feasibility and full-fledged feasibility studies which are of a high professional calibre;

- Exploring the local and export market potential for various products;

- Identifying the right local firms which could be interested in joint ventures with incoming investors. Negotiating such ventures may require a complex package of legal and business services;

- Preparing professional profiles on firms and/or specific projects, in preparation for negotiating joint ventures or applying for loans; and,

- Conducting progress appraisal or terminal studies on specific projects.

The Palestinian territory has recently witnessed a profound increase in the number of enterprises which advertise business advisory services. But the reported experience of senior business leaders, especially those based outside, is that the professional capacities of such enterprises are still weak, at least when viewed by international standards. This may explain why some banks and leading investment enterprises have opted to set up their own business advisory services, which will also meet the needs of other clients in the business community.

C. Financial facilities and related services

1. Banking facilities

Post-1993 expansion of banking services in the West Bank and Gaza Strip has introduced more competition in the local financial market and broadened the access of Palestinians to traditional banking services. Of special interest is the extent to which this expansion has introduced better quality and a broader range of banking services. An examination of the current status of the financial sector in the West Bank and Gaza Strip suggests that the principal impediments to the development of this sector still exist. Banks are small, restricted, and confronted with an uncertain economic climate. They still suffer from inadequate expertise of local staff in most required skills.

As a result of the recent developments in the banking sector, as outlined in Chapter I, the Bank of Palestine has since 1993 opened several branches in the Gaza Strip and expanded its operation to the West Bank (Jericho, Ramallah, and Nablus). The Cairo-Amman Bank has also established branches in many cities of the West Bank, including Jericho and in the Gaza Strip. In addition, 3 other pre-1967 banks were reopened and 4 new banks were established by early 1995 (see table 4), bringing to 10 the number of banks active in the territory. Since the data in table 4 was published, a further 10 branches had been established by these banks, bringing the total branches in Gaza Strip to 17 and in the West Bank to 34, by late 1995. 18/

Late in 1995, two new Palestinian banks funded by Palestinian, Jordanian and other Arab investors were licensed by the PMA, with authorized capital of $10 million and $20 million, respectively. 19/ Meanwhile, by the terms of the Israeli-Jordanian agreement on banking, the Israeli authorities issued licences to two more Jordanian banks to open branches in the territory. 20/ Together with these most recent developments, a total of 14 banks with 55 branches were established in the West Bank and Gaza Strip by the end of 1995.

The growing number of banks and branches in the West Bank and Gaza Strip has introduced competition and has led to a marked improvement in the quality and range of financial services. It has also improved the access of a larger spectrum of the population to banking services, which in turn leads to more effective financial intermediation. However, the real impact of liberalization of entry and expansion of banks on the Palestinian economy is not yet certain.

Banking services are still in need of major upgrading, despite the fact that most of them are subsidiaries of well-established foreign banks. Delays still occur, whether in cashing cheques or transferring money, both inward and outward. Automated teller machines are yet to be provided and services of a non-traditional nature, such as personal investment management, business consultancy for clients, credit card provision and stock underwriting are still limited. Moreover, while the volume of deposits is still rising and the number of banks is increasing, the volume of loans remains low and the cost of credit is relatively high. This suggests that the current institutional framework for intermediation has yet to demonstrate adequate technical efficiency.

Recent statistics on banking activities reveal increasing involvement of banks in the development process, at least at the basic levels of financial intermediation, namely attracting deposits and extending credit facilities. Total deposits in the Palestinian banking system grew from $589 million in December 1994 to $828 million in March 1995, i.e. by 41 per cent. 21/ By the end of 1995, total deposits had reached $1 billion. 22/ This compares with deposits of under $150 million in the few branches of the two banks operating prior to 1993. 23/ This increase has been precipitated by three main factors: increased foreign aid flows; transfers of private deposits from external banks; and, a trend towards depositing private cash holdings, traditionally kept liquid, in local banks which are increasingly perceived as safe and necessary instruments. The share of current account deposits from total deposits (in mid-1995) was nearly 60 per cent, which is high, under any circumstances. The shares in Jordan and Israel are 19 per cent and 5 per cent, respectively.

One of the notable features of the credit policies of local banks is the relatively small size of their loan portfolio, which limits their role in the local economy. Prior to 1993, the two banks operating in the territory had insignificant loan portfolios amounting to under $20 million. However, the situation was effectively transformed afterwards, in line with the activation of the financial system. Total volume of loans in December 1994 amounted to $163 million, equal to 24 per cent of total assets and 28 per cent of customers' deposits. By the end of March 1995 total loans rose to $288 million, i.e. 30 per cent of total assets and 35 per cent of total deposits. However, a major portion of the incremental loans between December 1994 and March 1995 was extended to governmental institutions in the Gaza Strip and Jericho. Credit extended by local banks did not grow subsequently in 1995, despite increased deposits of almost $200 million between April and November 1995. 24/ This brought the ratio of loans/deposits to under 30 per cent by the end of the year, still an inordinately low ratio by any standard. The ratios of private sector loans to total customers' deposits in Jordan and Israel are significantly higher than in the territory: in 1994 the ratio was 80 per cent and 86 per cent, respectively.

The continued limited role of bank lending in the local economy becomes more apparent due to the fact that most of the credit provided to the public (86 per cent) is in the form of overdraft facilities. Term loans and bills discounted, on the other hand, accounted respectively for 6 per cent and 1 per cent of total loans. The effectiveness of bank loans is further undermined by the fact that the average size of loans is small, owing to the limited options for providing collateral and continuing high perceptions of risk by bankers.

As noted in Chapter I, informal banking sector mechanisms consist primarily of non-commercial credit institutions (i.e. credit NGOs) and money-changers. Much of the activities undertaken by both sets of facilities are attributed to the prolonged absence of a modern banking system in the territory. While these facilities have managed to perform a variety of important functions, it is abundantly clear that they have been unable to fill the gap ensuing from the absence of a formal banking system.

Most NGO credit institutions commenced their operations since 1987 and have since increased in number and scope of activity. By now, there are three major local credit NGOs, which had accumulated by mid-1995 an aggregate credit portfolio of nearly $23 million (see table 5). In the meantime, these institutions have succeeded in developing their management capacity and improving their efficiency, drawing mainly on the financial and technical assistance received over the years from the European Community. Despite a total volume of loans which is as large as that provided by any of the local banks, the role of these institutions has been too small and fragmented to make a significant impact on the economy of the territory. The recent consolidation of the three institutions into one new credit agency promises to enhance the impact of this special and valuable component of the Palestinian financial sector.

2. Accounting and auditing

Development of accounting and auditing services over the years of occupation tended to reflect the chaotic but sustained growth in the business sector. Furthermore, the technical status of this profession has been adversely influenced by the regulatory system emanating from occupation. The level of this profession has deteriorated to the point where, in the West Bank (including east Jerusalem), only 6 out of a total of 58 practising chartered accountants have received formal certifications either from Israel or abroad. 25/ The rest are allowed to practise on the basis of a minimum requirement of one year training, certified by the Israeli authorities. There were very few opportunities for unlicensed accountants to practise in the West Bank during the occupation period, except for some bookkeeping on behalf of licensed accountants. This explains why the number of unlicensed accountants has remained so low.

The situation of the accounting and auditing professions in the Gaza Strip is even worse. There are about 2,500 accountants in Gaza, all of whom practise on the basis of membership in the Arab Society of Accountants and Auditors. Membership requirements include merely a university degree in accounting plus a short training course in taxation. The relatively loose licensing requirements of the accounting and auditing professions in the Gaza Strip explain the huge discrepancy between the number of practising accountants there as compared to the West Bank.

It is important to note that private accounting offices in the West Bank and Gaza Strip have over the years accumulated rich experience in settlement of tax cases with the Civil Administration. Their professional standing in other areas is modest. Accounting and auditing standards need to be modernized so that they provide relevant and accurate information to both management and investors. A complete revamp of the accounting and auditing standards, rules, and practices is needed if the private sector is to grow beyond small, workshop-type operations. A formal financial system and good tax administration requires acceptable financial reporting certified by qualified auditors. A system of training, certifying and regulating accountants and auditors need to be put in place.

Recent political and economic developments in the West Bank and Gaza Strip have prompted international accounting firms to enter the local market, and attracted more effort by Palestinian Authority officials, academics and practitioners to regulate and modernize the accounting profession. For instance, Ernst & Young and Arthur Anderson have appointed representatives in Ramallah, and Coopers & Lybrand (International) has appointed an east Jerusalem-based firm as an associate. The Palestinian Ministry of Finance has lately formed a committee in an attempt to regulate and standardize accounting practices by both the public as well as the private sector entities. Reportedly, a draft law on the accounting profession is now being formulated by relevant institutions of the Palestinian Authority.

3. Insurance

Until 1993, only one Palestinian insurance company, the Arab Insurance Establishment (AIE), operated in the West Bank and Gaza Strip. All other insurance companies were agents for Israeli firms. Automobile insurance comprised more than 80 per cent of the total volume of insurance in the West Bank and Gaza Strip. In most countries, insurance premiums are an important source of investment in the local economy. By contrast, none of the premiums collected by Israeli insurance firms operating in the West Bank and Gaza Strip (currently estimated at more than $27 million) or AIE deposits in Israeli banks was invested in the West Bank and Gaza Strip. The AIE, on the other hand, has invested a small part of its cash holdings in local projects, either by contributing to local shareholding firms or by providing short-term loans for construction and commercial ventures and to policyholders (9 per cent of the company's $1.25 million of assets in 1984 were in loans and discounted bills).

The insurance business, however, started to pick up in the post-1993 era. Companies undertaking reconstruction projects are expected to contribute around 15 per cent annual increase in the insurance market, as long as foreign aid for public sector projects continues to flow. Two insurance companies were established in 1993 and two more in 1994. Thus, by the end of 1994 there were five local insurance companies operating in a market with a business potential estimated at $40 million. Several Jordanian and Egyptian insurance companies also have received provisional permits to operate in the territory, though the conditions attached are not clear. 26/ Expectedly, Palestinian enterprises have started to switch from Israeli to Palestinian and Arab insurance firms, and other, less traditional, insurance services are beginning to be introduced. While vehicle accident insurance is estimated to constitute some 85 per cent of insurance activity in the territory, the share of other forms of commercial and personal insurance is expected to increase in the coming period. 27/

The absence of a clear and flexible legislative and regulatory framework governing insurance activity in the territory is a source of growing concern among domestic insurance brokers. 28/ The legal and institutional vacuum affecting insurance services, while perhaps related to the transitional nature of current arrangements and the slow pace of legal and institutional development of the Palestinian Authority, calls for urgent consideration and reform. In particular, some recently registered companies have not fulfilled the requirement to deposit with the Palestinian authorities 10 per cent of their subscribed capital (which itself should be equivalent to at least $5 million), nor have these companies' financial standing and reinsurance arrangements been adequately controlled prior to receiving operating permits. In addition, Arab insurance companies have been permitted to export their services to the Palestinian market without fulfilling deposit requirements applicable to foreign insurance companies. In some cases, companies have only paid as little as $20,000 to begin operating in the territory. Combined with these foreign companies' greater financial weight and wider experience, such factors have placed domestic insurance companies at a disadvantage in the present circumstances.

4. Foreign exchange regime

Since 1967, the Israeli shekel and the Jordanian dinar have been considered legal tender in the West Bank, whereas only the shekel has been the recognized currency in the Gaza Strip. However, neither of these currencies performs all the usual functions of money. Within the West Bank and Gaza Strip economy, the shekel is mainly used as a means of payment or as a medium of exchange. It is only partially used as a unit of account and is not favoured as a store of value. Moreover, until the closure of Israeli banks in 1988, the shekel was the only currency fully accepted in banking transactions. Yet, Palestinians did not make much use of Israeli bank services. In contrast, the dinar is not only used as a means of payment and a medium of exchange, but also as a store of value and a unit of account. That is because, especially until the summer of 1988, the JD was a relatively stable currency and has now resumed that status. But the JD never performed completely the role of a legal tender, even after the reopening of Arab banks, because of the restrictions imposed on those banks' operations.

Foreign currencies, and in particular the United States dollar, circulate freely in the West Bank and Gaza Strip. Arab currencies are brought in or transferred by Palestinian migrant workers. United States dollars, and to a lesser extent the pound sterling, come into circulation through a variety of means, mainly foreign NGOs and tourists. Until the spring of 1988, the bulk of foreign currencies was handled by money-changers who used to convert their JD surpluses into dollars in the Amman money market. A great portion of the West Bank foreign currency holdings was bought by Israeli brokers. This process was necessitated by the fact that the West Bank and Gaza economy suffered a chronic deficit in its commodity trade with Israel, which is not adequately covered by labour remittances.

Israeli authorities tolerated the hard currency inflow to the territory, partly because it was considered to have a positive impact on the Israeli economy. Yet in February 1988 stiff restrictions were imposed on the money flow from abroad (by Military Order No. 1221). Money-changers, as with other travellers, were prohibited from bringing more than the equivalent of $600 per person across the border. This limit was also applicable to money transfers in JD or in foreign currencies. Such restrictions were intended to control the inflow of funds during the intifada. These restrictions were lifted in 1992.

Currency exchange constitutes the major function for money-changers, constituting around 75 per cent of their total business. 29/ The exchange of shekels and dinars is constantly requested for the daily needs of the local population. Money-changers have always managed to go around foreign exchange regulations imposed by the Israeli or Jordanian authorities, creating an institutionalized black market that serves both Israeli and Palestinian clients. The illicit exchange of foreign currencies has generally been tolerated by the authorities. All exchange transactions are tax free, in contrast to foreign currency purchases at Israeli or Arab banks, and they are conducted without record keeping or documentation. This explains in part why foreign currency transactions by the local population with Israeli banks or Arab banks have been of little significance, at least until 1995.

Money-changers determine their exchange rates according to local market patterns of demand and supply as well as current and expected trends in the world foreign exchange markets. 30/ Since money-changers do not possess sophisticated technological links to international market information services, they obtain their rates mainly from the world radio and television broadcasting networks. The exchange rate of the dinar versus the shekel is calculated as a cross-rate of their respective rates versus the dollar. Leading money-changers tend to adjust their exchange rates in proportion to expected changes on the world market during the subsequent two to three days, since that is usually the time it takes them to transfer surpluses to international financial centres. Other smaller money-changers follow their lead.

The monetary dualism characterizing the Palestinian financial sector has provided some advantages, but has also burdened the local economy with some disadvantages. The services rendered by money-changers have facilitated the bypassing of Israeli foreign currency controls. Furthermore, residents of the territory could hold accounts with commercial banks in Amman. The trade surplus with Jordan and transfer payments from abroad have provided the Palestinian economy in recent years with relatively stable currencies like the Jordanian dinar and the United States dollar. On the other hand, the impact of inflation in Israel on the economic situation in the territory has been multifaceted. Inflationary pressures arose from the close economic links of the territory with Israel. The main consequences of that pressure have been: increasing prices of imported goods from Israel, which amounted to almost 90 per cent of total imports; diminishing real wages paid to workers employed in Israel; and declining value of the financial assets of Palestinians held in Israeli currency. The soaring inflation rates, especially in the mid-1980s, resulted in a decline in the disposable income of most income groups. Since then, this problem has been less evident. In contrast, the sharp decline in the value of the JD in 1988 caused a considerable decline in the wealth and living standards of most income groups, particularly those whose wages are in JD.

To summarize, the monetary system in the Palestinian territory has been characterized by a marked degree of adaptability. It has developed through a process of trial and error under adverse circumstances in order to serve the local economy, using each legal tender according to its designation, with the JD playing the dominant role. This monetary dualism will be maintained during the interim period specified in the Israel-Palestine accords (i.e., 1994-1998). As noted, the Paris Protocol called for the establishment of a Palestinian Monetary Authority, entrusted with many of the functions of a central bank. It holds foreign currency reserves of the Palestinian Authority, and authorizes and regulates the operations of money-changers and banks. At the same time, the Protocol leaves the possible creation of a Palestinian currency for the final phase of the peace process, and keeps the Israeli shekel as a legal tender in the territory during the interim period. The JD will also be a legal tender in the territory during this period, as per agreements between the Palestinian and Jordanian authorities.

D. Transport facilities

The transport sector has witnessed significant expansion since 1967 as regards shared taxis and trucking services for small freight (under 10 tons). The number of taxis has risen sharply, and the quality of service has improved significantly. The same has occurred with regard to medium-sized vehicles with a freight capacity of up to 12 tons. Notwithstanding improvements in these two transport branches, the situation has deteriorated in several other ways. Buses are losing importance as means of public transportation, and nearly all bus companies face critical financial situation. A sizeable number of vehicles used in public transportation consists of old and worn out private cars which are used illegally for carrying passengers. Lorries used in hauling farm products are mostly old models, and none are equipped with refrigeration or cooling facilities. This has undermined the quality of produce transported locally, and impaired competitiveness in export markets.

The situation in the transport industry has further deteriorated as a consequence of poor conditions of local roads (unlike those accessing Israeli settlements), and the scarce parking facilities within all major cities. These problems have helped create acute traffic and parking crises within all towns, and have resulted in a sharp rise in accidents and traffic hazards. Transport and traffic problems on roads in the West Bank and Gaza Strip have been severely aggravated as a consequence of the steady rise in the number of vehicles, which increased by 20 times in the West Bank and 8 times in the Gaza Strip during the period 1970-1993 (see table 6). Though the largest increases were noted in private vehicles, trucks and commercial vehicles also registered strong growth.

Transport-related problems are to a large part caused by the indifferent regulatory environment, such as those relating to licensing fees and, more importantly, the quality of roads. Poor technical competence surrounding the servicing of cars and inadequate insurance policies have added to the problem. Severe regulatory constraints on the widening and maintenance of roads, and small amounts of funds allocated for this purpose have worsened the situation. Moreover, local transport firms have been severely constrained by deep-rooted problems relating to limited financial resources and the lack of skilled management manpower. These and other problems accumulating over the years have undermined the potential of public transportation enterprises in competing with those in neighbouring countries, which have witnessed sharp growth and modernization during the past decades.

Transport facilities relating to external trade have for many years been closely controlled, owing to security considerations. Commercial traffic with Jordan has been restricted to Damya bridge in the middle of Jordan Valley. Lorries moving across this bridge were subject to an elaborate set of regulations and fees that caused a sharp rise in costs and a considerable increase in risk margins. Although using Israeli border terminals for exports and imports, this was subject to cumbersome regulations which delayed clearance operations and added considerably to their cost. While new arrangements following Palestinian accords with Israel and Jordan promise more expeditious and less costly transport for trade, these have yet to take effect.

The transport system has undergone fundamental transformations since 1994, as a consequence of the periodic closures of the borders with Israel. This entailed minimizing the number of Palestinian vehicles permitted entry into Israel, ultimately leading to resort to back-to-back freight handling at border points for all merchandise exports to Israel, with Palestinian trucks discharging their loads directly into Israeli trucks. Inevitably, this has resulted in a decline in the volume of export trade into Israeli markets. Such acute disruptions in transportation have also caused a substantial contraction of trade between the West Bank and Gaza Strip. Similarly, exports to Europe have had to wait at border points for such long periods with adverse effects on their value and future prospects.

Meanwhile, imports from Egypt and Jordan were as of mid-1995 subjected to similar back-to-back transport arrangements at border points between the Gaza Strip and Egypt and between the West Bank and Jordan. Import trade across the bridges between the West Bank and Jordan continues to be confronted with numerous problems which have impeded progress towards free trade between the two trading partners. Imported shipments are still subject to elaborate security checks, which act as significant deterrents to trade. Furthermore, it was recently discovered that the load capacity of the bridges was too low to permit the entry of long lorries with a capacity of over 20 tons. This has tangibly reduced the potentials for import to the territory of several competitive strategic commodities from Jordan, such as cement and fertilizer, since transport costs cannot benefit from potential economies of scale.

Chapter III

SALIENT FEATURES OF PRIVATE INVESTMENT IN THE PALESTINIAN ECONOMY

Following the review of developments in the policy environment and institutional setting affecting private investment in the Palestinian territory, this chapter examines the major aggregate patterns of investment in general and private investment in particular. While pre-1990 data on the scale, structure and trends of investment in the territory are relatively abundant, since then a number of factors have severely limited the availability and scope of data on investment and most national accounts indicators. Estimates have been made of such indicators by various sources, especially since 1993, but there remains a sharp contrast between the comprehensive and detailed data on the pre-1990 period and the more sporadic and aggregate estimates on development indicators since. This chapter commences with an analysis of the role, composition and dynamics of investment in the Palestinian economy in the pre-1993 period, with a focus on those features of a more long-term and structural nature. Indeed, even after 1993, investment behaviour remains subject to many of the same structural weaknesses which have prevailed for years. The chapter follows with an examination of post-1993 developments, drawing on available data for major indicators and relevant information on recent investment initiatives by the emerging private sector.

A. Role of investment in the Palestinian economy until 1993

1. Sources of investment

Investment flows in the Palestinian territory are derived from three main sources, namely, public sector institutions, the business sector and households. The first source was of minimal significance during the occupation period. While the Israeli authorities maintained current public expenditures at minimum levels necessary to operate basic government services, little investment was made in "social overhead capital" (including education, health and other areas in which the Government was active). Over time, this undermined the level and quality of those essential social services and eventually debilitated the infrastructures which are deemed vital for the efficient functioning of a modern economy.

On the other hand, notwithstanding the insecure and hostile investment climate, the household sector has played a central role as a source of private investment. This has been possible despite the absence of a functioning system of financial intermediation in the territory which would mobilize savings and direct them towards appropriate investment opportunities. Yet, it is noted that total private investments were much lower than total savings (see below). In addition to the absence of a financial intermediation system, this phenomenon may be attributed to high political and economic risk perceptions. Furthermore, the household sector is characterized by strong kinship ties. Even the largest industrial enterprises are dominated by family ownership. The kinship factor frustrated the establishment of full-fledged corporations or modern capital markets, hence discouraging the channelling of household savings into corporate investments. This feature of investment in the Palestinian territory impeded the growth and modernization of business enterprises, especially in the industrial sector.

It should further be noted that foreign direct investment was non-existent until 1992, owing to restrictions on the entry of foreign funds, the lack of an appropriate regulatory framework and the overall political uncertainty and insecurity which prevailed since 1967. The only form of "foreign" investment experienced in this period was the repatriation of Palestinian emigrants' remittances which played an important role in investment in residential construction in the territory. However, neither Palestinian, Arab nor foreign investors found any attractive opportunities for profitable investment in the territory during the occupation period, a perception which has only recently begun to change.

2. Savings and investments

At the root of the marginal role of investment in the Palestinian economy has been the poor performance of private (household and corporate) savings. With private consumption exceeding GDP for most of the period since 1967, the ratio of domestic savings to GDP (calculated as the difference between GDP and total consumption as a ratio of GDP) has always been negative. 31/ After peaking in 1987, this ratio was estimated in 1990 at -41 per cent in Gaza Strip and -7 per cent in the West Bank, indicating domestic dis-savings of around $200 million in that year. On the other hand, the ratio of national savings (calculated as the difference between GNP and total consumption over GNP), which draw upon factor income from abroad, showed a positive performance. By 1990, national savings equalled some 21 per cent of the West Bank's GNP, and 14 per cent of GNP in the Gaza Strip.

The difference between domestic and national savings underlines the importance of external sources of income in supporting the Palestinian economy with the resources necessary for its growth. One indicator of the crucial role of external financial resources in generating savings is found in the data for private savings, calculated as the difference between gross disposable private income from all sources (including private transfers from abroad) and final private consumption expenditure. 32/ While the real value of private savings increased steadily until 1987, their significance in terms of overall income displayed a declining trend as of the mid-1980s. Whereas in 1980, private savings equalled 20 per cent of the gross disposable private income in the West Bank and 29 per cent in Gaza Strip, by 1987 these were down to 16 per cent and 20 per cent, respectively.

These trends point to the inability of the Palestinian economy to mobilize savings from the resources available to it, both when domestic and national savings are considered. Savings increasingly were squeezed by private expenditure, which was inflated by conspicuous consumption in the 1980s, as indicated, for example, by data on increase in ownership of durable goods (e.g., washing machines, televisions, refrigerators, appliances and private vehicles). 33/ These levels of expenditure would have been unsustainable were it not for the flow of externally-generated income. The lack of adequate institutional arrangements for mobilizing financial resources in the territory may have facilitated the ready diversion of (potential domestic and actual external) savings from investment to consumption purposes. In the 1988-1992 period, the reduction in private consumption levels caused by the intifada, the Gulf crisis and subsequent developments, helped to narrow the gap between domestic and national savings, especially in the West Bank.

Despite the shortfall in domestic savings and the inadequacies of financial intermediation in the territory, positive national savings (dependent on external sources of income) have generated significant investment flows, largely outside an institutional framework. Aggregate investment (or gross fixed capital formation - GDCF) was equivalent to around a third of domestic output since 1980 (see table 7). In 1987, GDCF totalled $590 million: $420 million and $170 million in the West Bank and Gaza Strip, respectively. According to rough estimates by the Israel CBS, during the 1988-1992 period, total investment averaged $535 million per annum, still below pre-1988 levels. 34/ By 1993, investment was estimated between $600 and $640 million, equivalent to between 23 per cent and 31 per cent of GDP, depending on different estimates of domestic product for that year. 35/ Thus by 1993, aggregate investment flows had recovered to their 1987 levels, as the economy gradually resumed the positive growth trends of the pre-1988 period which had been interrupted by the turbulence experienced during 1988-1992, and as the impact of improvements in the policy climate began to be felt (see also section B below).

By 1987, domestic dis-savings were -14 per cent of GDP in the West Bank and -49 per cent in Gaza Strip. At the investment levels of 1987 (equivalent to 30 and 35 per cent of GDP, respectively), the gap between savings drawn from domestic resources and actual investments equalled 44 per cent and 84 per cent of the GDP of the West Bank and Gaza Strip, respectively. This implies a shortfall of domestic resources for investment equivalent to around $1 billion for the territory as a whole, or 53 per cent of Palestinian GDP. When foreign flows are incorporated into the picture, the gap takes less dramatic proportions. Thus in 1987, the investment/GNP ratios for the West Bank and Gaza Strip were 24 per cent and 21 per cent, respectively, while national savings/GNP ratios equalled 11 per cent and 13 per cent in each case. This implies a resource gap of 13 per cent and 8 per cent of their respective GNP, which total around $300 million for the territory as a whole. This savings/investment gap is effectively bridged by external resources, through the current account deficit.

3. Composition of investment

As with savings, the bulk of investment flows is accounted for by the Palestinian private sector, which in the 1980s undertook between 82 per cent to 88 per cent of total investment expenditure in the territory. Private investment has steadily increased in importance in the Palestinian economy for many years, while the share of government investment out of total domestic capital formation and domestic output has been shrinking. Gains in the absolute levels of government investment were reversed after 1988, especially in the West Bank, whereby government investment declined to late-1970s levels.

In 1987, the last year for which comprehensive official data are available, private investment totalled some $350 million and $140 million in the West Bank and Gaza Strip, respectively (see table 8). In subsequent years, estimates of private investment indicate a decline, or at least stagnation, in private investment standing between $400 and $500 million annually, corresponding to the disruptions and heightened insecurity of the period until 1992. 36/ Only then did private investment begin to recover, as a consequence of the improved policy and security environment (see Chapter I).

As for the composition of private investment, two types of flows predominate, namely social overhead investment (termed in official statistics as "building and construction works") and productive investment ("machinery and equipment"). Since 1967, the former has constituted the largest part of private investment. In the 1980-1987 period, 88 per cent and 82 per cent, respectively, of fixed capital formation in Gaza Strip and the West Bank was in building and construction works. Construction activities accounted for an annual average of $305 million of investments during the period 1975-1991. 37/ The remaining share of private sector investment, covering machinery, transport and other types of equipment, averaged around $75 million in current prices during the period 1975-1991. Consequently, in the early 1970s the share of productive investment out of private investment was around one third in the territory; it has declined to near one fifth since the early 1980s.

The differential rates of growth in the two types of private investment reveal the different priorities accorded to each, whereby the former grew by some 15 per cent per annum between 1972 and 1987, as compared to 9 per cent growth for the latter. A disproportionate share of economic resources are used for housing in the Palestinian territory. Though the housing output per thousand population is similar to those in comparable economies, the ratio of investment in private building and construction in the Palestinian territory is about three times higher, i.e. 20.3 per cent vs. 7.4 per cent of GDP. 38/

While the aggregated nature of data on the sectoral distribution of private investment flows blurs the pattern of investment absorption in the economy, it is none the less clear that investments in directly productive activities and hence in the expansion of domestic productive base have been disfavoured. Investment behaviour in the territory was clearly more responsive to Palestinian housing needs than to the requirements of the ailing productive base. Structural constraints resulting from generally high risks, limited opportunities, policy restrictions and the absence of an adequate financial system and other services have undoubtedly contributed to this behaviour. The unusually high share of housing in the national economy is precipitated by a number of important factors, notably the following:

- A high priority is attached in Palestinian society to the ownership of the family house, as opposed to home rental;

- An acute and worsening housing crisis, reflected most clearly in soaring rents and construction costs;

- Houses are widely perceived as tangible forms of property, which is hoped to help hedge against confiscation hazards;

- Increased savings accruing to rising income and wage earnings, up until 1986; and

- Absence of alternative venues for investment, as those usually available in more developed economies and financial markets.

4. Investment and domestic output

Private investment grew at its highest rates in the 1970s, with the trend slowing as of the early 1980s. The post-1987 declines in investment entailed further weakening in the growth rate of private investment, leading to negative growth in some years. However, the magnitude of the decline after 1987 seems smaller and less serious both when compared to changes in earlier years and to the fall in the levels of other economic variables, especially consumption.

The relation between investment and domestic output seems more problematic, given the divergence between their annual growth rates, particularly after 1975. Thus, in the West Bank, when private investment grew annually at more than 18 per cent in 1976-1980, GDP grew at 5 per cent. In the period 1981-1987, investment grew at a rate that maintained the share of investment out of GDP, which was rising at around 8 per cent per annum. Similarly, in Gaza Strip, private investment grew faster than GDP in the late 1970s, and virtually maintained at the same rate in 1981-1987. The share of investment in GDP remained steady. Structural and cyclical factors affecting GDP, as well as external financial stimuli to private investment in residential construction, account for the divergences between growth of GDP and of investment.

Accordingly, the divergence in the behaviour of GDP and investment makes it difficult to determine with certainty the precise levels of the incremental capital output ratio (ICOR) prevailing in the economy. The level of investment varies greatly from year to year and between the West Bank and Gaza Strip, and even takes negative values depending on the period under consideration. However, if "abnormal" values (i.e. negative or excessively high values) are excluded from the calculations, available data suggest an ICOR of 3 to 4 in the West Bank during the 1980s, compared with lower rates in the early 1970s. 39/ Data for Gaza Strip do not allow for any meaningful or conclusive computation of the ICOR, though it appears to be generally higher than in the West Bank.

B. Investment in the Palestinian economy since 1993

1. Trends in aggregate investment

Private investment flows were slated to experience substantial growth following the Israel-Palestine accords of 1993 and subsequent detailed implementation agreements. The international assistance programme, and the ensuing boost it gave to Palestinian public investment projects for the rehabilitation and development of physical and institutional infrastructures, have created an important enabling environment and impetus to private investors. Motivated by strong profit anticipations, and encouraged by major political developments, hundreds of expatriate individual and corporate investors, both Palestinian and foreign, have been allured into visiting the Palestinian territory since 1993 in search of investment opportunities. The influx of visiting investors cuts across a wide range of nationalities, but many were diaspora Palestinians, eager to examine the opportunities for re-establishing themselves and their business in the West Bank and Gaza Strip.

There are no comprehensive, official data available on the tangible outcome of the private investment euphoria in the 1993-1995 period. It is perhaps unlikely that accurate statistics will be generated on these developments, for a number of reasons. Israeli statistical coverage of the Palestinian territory effectively halted in 1993, following several years of difficulties in data collection and the increasing resort to estimation techniques in statistical series published after 1988. 40/ Until the end of 1995, the Palestinian Central Bureau of Statistics had not yet been able to establish its economic statistical activities in a systematic manner capable of generating reliable data on such indicators. 41/ Furthermore, the undocumented nature of investment operations since 1993, and the general reluctance of most investors to fully commit resources until well into 1995, render it difficult to differentiate between actual investment initiated in the 1993-1995 period, on the one hand, and investment intentions and projects announced, but not initiated, on the other. In addition, the absence of an authorized Palestinian supervisory or regulatory agency to deal with local and incoming investors has rendered data collection and analysis fragmented and thus incomplete.

Despite the hectic investment activity since 1993, reported on a regular basis in local and international media and noted on the ground throughout the territory, there is a broad consensus among experts and officials interviewed that the volume of foreign private investment actually deployed in the Palestinian territory between 1993-1995 is not substantial. While traditional forms of domestic investment, especially housing and real estate development, have recovered and even accelerated since 1993, the investment climate had not, by mid-1995, become adequately clear or secure to permit commencement of full-fledged operations by new investors in non-housing sectors. While generally optimistic about the medium and long terms, investors continued into 1995 to perceive risks inherent to the political/security and regulatory framework, which demanded careful planning and gradual execution of investment ventures. 42/ Nevertheless, the continuing improvement in the policy and security situation since late 1995 promises to encourage a growing involvement of individual and corporate investors in a range of traditional and new branches of the Palestinian economy, in primary, transformative and tertiary sectors.

Official data on investment flows in the 1993-1995 period have not been published, though some estimates are available from international sources, using different assumptions and estimation techniques. According to one source, GDCF accounted for 23 per cent and 21 per cent of GDP in 1993 and 1994, respectively, equivalent to just above $600 million in each year. 43/ Such estimates of investment rates are well below the averages of over 30 per cent witnessed since

1980, and as such imply a major shift in the composition of aggregate demand. Nevertheless, owing to higher levels of GDP in the first half of the 1990s, these estimates translate into aggregate investment levels which barely exceed those prevailing before 1988. While the pre-1988 investment rates may be considered abnormally high, and the 1988-1991 period certainly entailed declines in investment flows which were not immediately recouped, there is neither an a priori reason, nor empirical evidence, to expect that the rate of investment should have fallen by some 8 per cent of GDP between 1987 and 1993. Furthermore, while government investment and productive private investment may have witnessed decline or stagnation until 1993, the favoured and predominant form of private investment, namely in residential housing, was one of the most secure components of aggregate demand for most of the period, and remained so in periods of calm and turbulence. Thus, even assuming minor declines in investment rates by 1993, it appears that GDP may have been lower than reported by these sources, and that aggregate investment was greater than the estimated $600 million, i.e. that investment rates were above the 21-23 per cent range indicated above.

An alternative set of estimates for these indicators in the post-1992 period may be derived assuming no major transformation in the major macroeconomic relationships and balances featured in the Palestinian economy, though against a background of increasing policy liberalization and recovery of domestic economic activity in line with pre-1988 trends and levels. 44/ While this approach expects that policy and institutional reforms will encourage structural transformation and new trends as of 1996, for the 1993-1995 period at least, the Palestinian economy continued to exhibit the same structural weaknesses and inefficiencies that characterized its recent performance.

According to calculations made on this basis, GDP is estimated to have grown in 1993 and 1994 to $2,020 million and $2,500, respectively, while the higher rate of investment (than indicated above) of 31 per cent generated around $640 million and $770 million of aggregate investment in the respective years. Public investment is estimated to account for at least 11 per cent of the total, though actual performance indicates a higher share, at least in 1994. By the same token, GDP is estimated to have attained some $2,900 million in 1995, with investment at over $900 million, implying a slight fall in the investment rate to 30 per cent. By this year, with the public investment programme beginning to take shape, private investment was still predominant, though still in the range of $600-$700 million, most of which was concentrated in construction.

2. New conduits for Palestinian private investment

Convinced that the future holds promise, most visiting investors have proceeded to establish the organizational and logistical infrastructure they will need once the time is appropriate for effecting tangible investments. This includes such measures as registration with local authorities (to date this has entailed in most cases dual registration, i.e. with the Palestinian and with the Israeli authorities), renting premises and hiring a core staff. Expectedly, this preparatory activity by newcomers has triggered a sharp rise in the price and rental value of office and residential buildings in several major urban centres and in the price of real estate in general. These developments have entailed some unfavourable consequences for the domestic private sector, as they encouraged speculative activities and aggravated the severity of the housing crisis, especially for low- and middle-income households.

The influx of business encouraged by positive developments in the peace process covers a wide range of enterprises, such as banks, insurance, construction contractors and general trading companies. An early and prominent example was a leading investment firm established in October 1993 under the name of Palestine Development and Investment Limited (PADICO). 45/ Owners consist of a conglomerate of individual and corporate diaspora Palestinian investors, mainly based in Jordan and led by the Arab Bank Ltd. The initial share capital of PADICO is $200 million, to be expanded at a later date to $1 billion. PADICO envisages managing a total project portfolio of $1.4 billion by the end of the decade. 46/

In order to attain maximum efficiency in its operations, PADICO established three autonomous enterprises catering for construction (based in Gaza), tourism (based in Jerusalem) and industrial projects (based in Nablus). The share capital of these enterprises is $25 million, $15 million and $20 million, respectively. Each of them is managed by its own board of directors and its own shareholders, with PADICO as the major partner represented on respective boards in proportion to its subscribed capital. All three firms and the holding company have managed to establish efficient working relations with the Palestinian Authority. PADICO has already set up offices and commenced activities in the territory through its affiliated firms. Many projects are planned in residential construction, industry and tourism, though only a few had commenced implementation by the end of 1995. The PADICO real estate subsidiary (Palestine Real Estate Investment Company) was to commence work in early 1996 on two large-scale housing projects in the Gaza Strip. 47/ Using land provided by the Palestinian Authority and finance from local banks and PADICO, as well as advance payments by prospective buyers, one of the projects (costing $300 million) will provide 2,400 medium-high income housing units, while the second (costing $100 million) will build 1,800 low-income housing units.

In late 1995, PADICO was also negotiating contracts with the Palestinian Authority in fields as diverse as electricity generation, telecommunications and the construction and management of export-processing zones. It had also been commissioned by the Palestinian Authority to plan and manage the first security exchange market (SEM) for the Palestinian territory. The market will be based in Nablus, linked at the outset of operations to the Amman Stock Exchange, and was expected to commence operations in early 1996 with 40 local companies listed at the outset, and up to 60 expected to qualify for listing by the end of 1996. 48/ Such a development will certainly add a needed institutional and regulatory framework for the emerging private sector in the territory as capital needs will rapidly grow as the development effort proceeds.

The PADICO corporate model has been duplicated by a number of holding companies which have been established during the past two years outside the territory. Such investment firms are owned and financed largely by expatriate Palestinian investors, with tangible input and involvement of the domestic business community. Like PADICO, these firms look forward to playing an important role in industry, construction, tourism and utilities, but they have not yet commenced actual business operations. One such corporation, also with an initial share capital reported at $200 million, originated from a group of Palestinian investors based in Saudi Arabia. Another large holding company was established by Palestinian and Arab investors based in Qatar, with similarly diverse interests.

The latter company, Salam International Investment Company (SIIC), constitutes a special example of corporate structure, as it includes about 300 founding private and official shareholders. 49/ The Palestinian Authority will hold a quarter of the intended $40 million of share capital to be raised by the end of 1995, while Qatar, the United Arab Emirates and a multitude of private investors subscribed to the rest of the share capital. The company intends to further expand its capital base in 1996 and subsequently, through share offerings to Arab, international and domestic investors. SIIC announced plans in late 1995 to participate in financing three major ventures: a $62 million project to construct a 275-room hotel on the Gaza beachfront financed in consortium by SIIC, two international companies and the Palestinian Authority offering the land, with international loan guarantees covering the other half of the needed investment funds; provision of start-up capital for the Palestinian Investment Bank, in cooperation with bilateral donors; and the establishment of a $40 million land and satellite communications network to provide wireless communications for the television, radio and transport sectors.

A notable example of locally-financed investment initiatives designed to complement and diversify the emerging corporate structure in the territory is found in a holding company established by a group of West Bank investors. The Palestine Investment and Development Company (PIDCO, not to be confused with the above-mentioned PADICO) was started in 1993 with a relatively modest capital base of around $8 million, with the intention of encouraging investment in industry, real estate, tourism, finance and trade. 50/ In what appears as an advanced corporate form in the territory, the initial subscription to half of the 6 million shares of the company was made by a local insurance company and 34 major shareholders, with the rest sold directly to the public by the company (in the absence of a securities exchange market). PIDCO has since invested in a range of ventures, in partnership with other individual and corporate investors. This has included a local construction contracting company (in Ramallah), the first Palestinian aluminium processing company producing for the local and export markets (in Al-Bireh), a tourism investment company (in Jerusalem) which aims at developing hotels, tourist sites and resorts and a locally-based investment bank (in Gaza and Jericho).

As is indicated by these developments, a major emerging trend in regard to the organizational modes of investment activities in the Palestinian territory is the growing involvement of Palestinian diaspora businessmen in the rapidly growing enterprise sector. This is especially true in the case of businessmen based in Jordan, and to a lesser extent in Egypt and the Arab countries of the Gulf, mainly because of proximity and easier communications and interaction with the Palestinian territory. The fact that many of these businessmen have numerous acquaintances and family connections in the territory has facilitated their business contacts. The tangibly relaxed regulations and procedures since 1993 affecting traffic across border crossings at the bridges and Israeli airports has reinforced motivations to return to the Palestinian territory, even if only for purposes of doing business. Furthermore, this trend has also gained momentum as a consequence to the resumption of banking activity in the territory under semi-normal circumstances. In fact, many diaspora investors have opted to join forces with newly-opened banks when deciding to do business in the territory. Such partnerships afford greater security and institutional clarity to new investors, most of whom are unfamiliar with local conditions.

The influx of diaspora investors has been warmly welcomed by local Palestinian political and public institutions, and it is widely perceived as an overdue development. But there has been some concern voiced by the local business community about inequitable competition with incoming investors, who are believed to have much larger financial resources and considerably superior capacity. Local investors are apprehensive that they will be unable to match incoming investors should they be forced to compete with them in the business arena. In one example of such problems, a $6.5 million tender issued in March 1995 by the Palestinian Authority for the printing of schoolbooks received bids from Jordanian printing companies and from a conglomerate of 14 Palestinian printers, none of whom could meet the requirements of the contract on their own. 51/ The Palestinian group could not submit a competitive bid and was $2 million above the 15 per cent leeway conventionally allowed to local bidders. The significant labour, raw material and related cost advantages enjoyed by producers in neighbouring Arab countries poses a serious constraint on local production, exports and investment. The joint investment models proposed by PADICO and others is intended to allay these concerns and to provide secure and effective vehicles for mobilizing domestic and foreign resources for investment in areas of mutual concern, with a view to enhanced competitiveness and efficiency.

The reaction of local investors to evolving regulatory and political developments during the past two years has been somewhat different from that of expatriate investors. It is quite clear that their thorough acquaintance with the intricacies of local circumstances has greatly reduced their risk perceptions. Furthermore, their legal status as holders of local identity cards has been an important asset on their side, especially for those engaged in real estate business. Accordingly, what local investors may lack in terms of financial resources and modern business methods and contacts, they make up for in terms of familiarity with the local market, political acumen and legal status. Such complementary attributes offer an excellent basis for successful partnerships in the future.

A promising area for investment, in addition to construction which is discussed separately below, covers international trade, which seems poised to benefit from relaxed regulatory restrictions and from high expectations for the role of the Palestinian economy in a vibrant regional market. So far, most of the international trade activities have focused on acquiring and establishing agency rights for some transnational corporations, which perceive promising market potentials in the Palestinian territory. This has included, for example, some automobile manufacturing firms, mainly German, French, and Japanese. Trading activities have also included more undocumented forms of business in some areas related to public sector projects. Inadequate transparency and ill-defined regulatory frameworks until 1995 have shadowed such forms of trade, especially those related to imports of major commodities (e.g. cement, building materials and fuel products), with inefficiencies and dubious business conduct reported by local sources. However, as Palestinian public sector institutional development proceeds and the legal and regulatory framework is increasingly clarified, such informal business arrangements are expected to become redundant and disfavoured.

Overall, investment in capital stock has not kept pace with depreciation, hence resulting in decreasing capacity utilization (estimated in industry at around 60 per cent). The reluctance to modernize machinery and productive assets has been prompted by limited market potential and extremely constrained banking credit facilities. Private sector firms are obsessed by the urge to minimize overheads and operating costs, even those invested in human resources. Such negative forms of adjustment have come to bear adversely on quality and cost competitiveness. Furthermore, the Palestinian economy has emerged from occupation with a depreciated capital base, which will undermine its future potential, more so in the advent of open trade in the region.

The investment euphoria of the past two years has so far entailed only a modest impact on the labour market. Senior officials at the Palestinian Ministry of Economy and Trade estimate that business start-ups in the private sector may have absorbed during the 1994-1995 period around 2,500 white collar workers at different levels (technical, professional and administrative). The number of recruited staff in the enterprise sector is expected to rise more sharply once obstacles to other forms of investment are removed. Among the key institutions which have employed white collar personnel are banks and insurance firms, which is a reflection of the dramatic expansion in both types of institutions during the past two years. The investment process may then begin to generate employment on a wider scale as new projects commence operations.

Rising demand for skilled manpower in the new generation of business enterprises has stimulated a marked rise in the pay scale available to people with the right qualifications. This trend has been further reinforced by the soaring demand for the same kinds of technocrats by NGOs and Palestinian Authority organizations. On the other hand, it has become increasingly clear that graduates from local universities in business-related disciplines suffer from mediocre professional standards, which are below the levels deemed essential for modern business activities. The deficiency was most clear in regard to their English proficiency and computer skills, as well as in regard to their quantitative analysis capabilities. Such deficiencies, if unrectified, are likely to entail important implications for the competitive standing of Palestinian enterprises within a regional free trade perspective.

3. Housing and construction: still the predominant form of investment

Since 1993, private investment in real property and house construction has remained a natural investment priority. In view of the large number of returning expatriate Palestinians, the uncertain political and economic situation and the lack of publicly financed housing, such investments continue to account for the bulk of private investment. The demand for certain types of construction rose sharply as a consequence of the high rate of population growth in the territory (estimated at over 4 per cent in the early 1990s), and the pressing need to improve housing conditions, especially in refugee camps and rural areas. But the demand for new constructions has gained considerable momentum during the past two years as a consequence of the influx of diaspora Palestinians returning with the setting up of the Palestinian Authority's institutions, and the subsequent expansion of Palestinian institutions, all in need of office premises. The demand for office space has also accelerated in response to the sharp increase in the number of NGOs and political missions seeking to open offices in the Palestinian territory, as a prelude to commencing their aid and other operations in the emerging Palestinian entity.

In addition to the above-mentioned real shifts in the demand for new constructions, there are projections of still greater demand in the near future as the peace process continues to gain momentum. As a net outcome of present and anticipated shifts on the demand for buildings, the price of real estate and rent levels have risen even further during the past two years, reaching abnormal rates for a developing economy. High prices are the result of distortions in the input market for housing and land. For instance, cement and iron bars are respectively 2 times and 3.5 times higher in the West Bank than in Jordan. Overall, the supply of urban land has not increased because of rigid restrictions imposed on expansion in municipal boundaries. On the other hand, there are tough restrictions on building activities outside municipal boundaries, despite the relatively abundant supply of land suitable for construction.

The vast majority of new construction initiated since 1993 is privately owned, more so that the Israeli Civil Administration has since then avoided allocating resources to public construction for which it has relinquished responsibility to the Palestinian Authority as of 1994 (in Gaza and Jericho) and 1995 (in the rest of the West Bank). The high pace of construction is evident in such conventional branches as small residential and commercial buildings. But there has been a growth in construction of multi-storey apartment buildings, which are used for residential and commercial purposes, especially in the Gaza Strip. Thirty such high-rise buildings had been built or were under construction in the Gaza Strip in late 1995. 52/ This trend has been bolstered by the high cost of land and the fairly relaxed regulatory framework and zoning conditions adopted by municipal authorities.

No comprehensive data have yet been published on the magnitude of the ongoing construction boom in the Palestinian territory. According to information derived from the files of two large West Bank municipalities, the area licensed for construction has increased by around three times during the period 1992-1994 (see table 9). It should be noted that already in 1992, the base year for these calculations, construction activities had reached much higher levels than in the five previous years. As shown by the data in table 9 for two major West Bank commercial/residential centres, this trend continued in the first half of 1995 and is expected to proceed at the same pace subsequently.

The question of ownership of the large number of new buildings deserves special notice. Based on information obtained from chambers of commerce and local municipalities, new constructions are owned mainly by local investors, occasionally in partnership with expatriate investors. The flow of foreign investment is particularly visible in the Ramallah area from where a large number of Palestinians have emigrated to North America over the past decades. In this case, investors are eligible to own real estate even if they do not have local identity cards.

The capitalization sources of construction activities, as assessed from information obtained from local banks and chambers of commerce, are mainly from household equity. The funds used for this purpose are mobilized from liquid savings (in Jordanian dinar and United States dollars) which seem to have been hoarded inside the territory, in addition to deposits withdrawn from savings in foreign banks. Borrowing from banks, on the other hand, is minimal and is resorted to in emergencies and rarely for home financing. The main obstacle to such a source of funding is its high cost, since ruling interest rates are in excess of 12 per cent, which is deemed too high for real estate projects. In addition to equity funding, much of the funding used in Ramallah district is derived from transfers made by Palestinians residing in the United States. This has been possible by virtue of the legal status of investors in this case, as they are eligible for legal ownership of real estate on account of possessing United States passports, even if they do not have local identity cards.

Soaring growth in private construction has helped stimulate domestic economic activity and generate a fairly substantial number of jobs. This has been of critical significance to the Palestinian labour force in the territory, for whom job opportunities have been constrained by Israeli closure policies. Unemployment in the West Bank and Gaza Strip has dropped from a record high estimated at 48 per cent and 57 per cent, respectively, in January 1995 to less critical levels of 27 per cent and 33 per cent by July 1995. 53/ The fact that the bulk of the unemployed labour force was until recently involved in construction inside Israel has made its transfer to the Palestinian construction sector relatively easy. And because of this sector’s strong horizontal and vertical linkages, the recent boom in the construction sector has begun to create positive spin-offs on other economic sectors.

4. Investment in joint ventures with Israeli partners

Despite intensive business dealings with Israeli firms since 1967, Palestinian firms refrained from establishing full-fledged joint ventures with Israelis that involved sharing capital and management. Until 1993, some forms of joint ventures have in effect been established which did not involve joint ownership of capital and real estate. Mostly, this related to subcontracting in the textile industry, which experienced a substantial expansion during the occupation period, taking advantage of several forms of cooperation and complementarities with Israeli counterpart firms.

The Palestinian attitude towards joint ventures with Israelis witnessed a major shift following the signing of the Declaration of Principles in September 1993, which included specific provisions to encourage such cooperative projects. The Palestine leadership has recognized joint ventures with Israel, both at the commercial and public sector levels, as integral components of the peace process. This position was translated in early 1994 into some forms of joint economic cooperation between Israeli and Palestinian firms, mainly affiliated to prominent Palestinian personalities or officials.

The attitude since 1993 of the private sector in the West Bank and Gaza Strip towards joint ventures with Israelis is much more reserved than that of the Palestinian Authority leadership. A study conducted in 1994 has revealed that Palestinian businessmen surveyed are well aware of the potential gains accruing to joint ventures with Israeli neighbours, capitalizing on existing complementarities and areas of cooperation. 54/ But 75 per cent of those surveyed consider that joint ventures constitute an "unacceptable level of normalization of relations with Israel", and 41 per cent of them believe that "local public opinion will refuse joint ventures even if the PLO accepts them". This attitude may have toughened further during 1995, in view of the increasing bitterness and frustration in regard to the deteriorating economic conditions and protraction in the peace process. However, subsequent developments in the peace process should dissipate residual reticence and aversion to such initiatives. Similarly, growing market pressures and considerations of competitiveness may begin to override factors which have influenced Palestinian business attitudes to date.

Accordingly, in September 1995 the first official meeting was convened under the auspices of Palestinian Authority, between representatives of the Israeli and Palestinian business communities. 55/ The Israeli Chambers of Commerce, the Federation of Palestinian Chambers of Commerce and several prominent Israeli and Palestinian businessmen agreed to establish two joint committees to promote cooperation in order to facilitate problem-solving. The first of these committees, convened every month on an ad hoc basis, will attempt to solve immediate day-to-day problems which prevent the two sides from doing business, such as closures, denial of entry permits to Israel, lack of transportation infrastructure and difficulties in truck passage. The second committee, comprising the Palestinian Authority and the Israel Chambers of Commerce, will have a similar focus, taking up issues that could not be resolved by the ad hoc structure.

The aforementioned divergence in Palestinian views on cooperation and joint ventures with Israel constitutes an important impediment to many growth opportunities emanating from closer Palestinian-Israeli economic cooperation. Palestinian firms will be denied access to a major source of capital, technology, and access to foreign markets. Furthermore, it is likely that expatriate investors, including diaspora Palestinians, who are in general much less sensitive to the politics of joint ventures, may take a more forthcoming attitude on joint ventures with Israelis. Such a development may be noted in regard to the borderline industrial parks project which has been recently approved by Israel and the Palestinian Authority as a form of joint venture. While PADICO is reported to have offered to contract the establishment and operation of one of the parks, some local businessmen have expressed reservations about the project, which they fear will create highly competitive enclaves which will infringe on existing market shares of Palestinian firms in the territory. In the light of such concerns and other considerations, it is important that this first major venture in the still-short history of Israeli-Palestinian cooperation be successful for all concerned and impart the benefits intended.

Chapter IV

FUTURE PROSPECTS AND POLICIES FOR STRENGTHENING PRIVATE INVESTMENT IN THE PALESTINIAN ECONOMY

Drawing on the discussion in the preceding chapters, this concluding chapter examines the prospects for strengthening the role of private investment in the Palestinian economy and the requisite policies and measures towards that end. The following sections analyse the economic policy environment needed to encourage investment, including relevant aspects of trade policy. This leads to a review of major sectoral prospects and corresponding opportunities for investment. The final section focuses on the legal and institutional reforms deemed necessary for modernizing and streamlining investment and related business transactions.

A. Economic policy framework

1. Savings and investment in the national economy 56/

As noted in chapter II, savings in the Palestinian economy have for a considerable period depended heavily on external sources of income, in particular from labour in Israel and transfers/remittances from abroad. Certainly, in the present and near future the problem in the labour market could be eased considerably by the availability of employment in the Israeli economy. Similarly, the shortages in savings and foreign exchange could be reduced substantially by external aid, appropriately channelled to complement, not substitute, domestic savings and investments. In the long run, however, the economy should be able to function without the support of these two sources. Employment in Israel cannot be sustained at the current level, and external aid will eventually decrease to less significant levels than the immediate post-1993 period.

Accordingly, the Palestinian development effort should utilize these two external sources in such a manner that ensures the creation of replacements. In other words, these two sources should be used to increase the capacity of the productive sector, and enhance savings and exports, rather than to finance consumption and imports. Indeed, fiscal and monetary policy should be directed towards providing incentives for increased savings and investments, and for restraining uncurtailed consumption, in particular the consumption of imported luxury goods. Employment in Israel needs to be treated as a temporary remedy, and, as the development effort advances, be relegated to the status of a residual in the labour market.

Guided by these considerations, which constitute elements of a national development strategy, the general aim of development policies would be to boost the productive capacity of the economy, and its domestic demand, while preventing consumption, and hence imports, from increasing in importance. This general aim is translated into the following specific requirements: accelerating private investment, promoting exports, reducing imports by selective and appropriate substitution rather than compression, encouraging the switching of demand from consumption toward investment, and expanding particular forms of government consumption and investment expenditures.

As regards the latter, the role of the public sector as the supplier of public goods assumes in the Palestinian context a greater importance because of the massive neglect of the public infrastructure and social services over the last 27 years. A huge improvement in these areas is essential for creating a supportive environment within which the private sector can expand, and this in turn requires an effective and strong fiscal system. The role of the public sector in redistributing income among individuals and regions is essential in the Palestinian context because of the great disparity between the standard of living in the West Bank and Gaza Strip, and the general problem of poverty caused by high and rising unemployment, especially in the last few years. These redistribution functions require an appropriately reformed system that promotes both horizontal and vertical equity.

Of equal importance is the need to reduce income inequality among groups and individuals. This objective necessitates the creation of a safety net by which the Government subsidizes food, housing, education, health care, and energy for lowest income families, as well as assistance to the unemployed, aged and disabled persons with low income. The role of fiscal policy as a tool to support the development effort, by stabilizing short-run fluctuations, and achieving growth-oriented adjustment, becomes critical in the Palestinian context due to the fact that the monetary policy tools will not be as effective during the interim period.

The proper functioning of the tax system is especially important in the present and immediate future, because taxes are likely to be the only source of raising revenue, aside from external resource transfer. Borrowing from the local market will tend to crowd out the fragile and embryonic private investment market, and impede the growth of the private sector. On the other hand, accumulating debts from abroad is neither possible nor desirable at this stage. Taxes, therefore, have to play the double role of raising a reasonable amount of revenue, that increases with the growth of income, and encouraging private saving, which also grows with income. Only if the sum of private and public saving grows with income, and gradually finances a greater part of total investment, will the need for external aid be reduced.

As outlined above, the reconstruction of the Palestinian economy, facilitating the achievement of rapid and sustainable growth, requires the successful completion of two major tasks. The first is removal of the harmful restrictions and inefficiencies characterizing the policy and regulatory environment affecting business activities. The second is the building of infrastructure and public services, thus creating a support system conducive to investments, production, and trade activities in the private sector.

Essential to the success of carrying out these two tasks is the effective use of external aid available from the international community. The aid will play two important roles in the reconstruction effort. It will supply the funds required to finance the investments needed in the absence of adequate national savings, which have declined in the last few years. Public saving, on the other hand, cannot be significantly increased prior to the Palestinian Authority developing an effective tax and expenditure system, consistent with the large public investment requirements of the reconstruction phase. The second role of external aid is to fill the trade gap by supplying enough foreign exchange to pay for imported capital and intermediate goods needed in the reconstruction stage.

By its very nature, external aid can only be a temporary remedy, and its success is measured by the extent to which the economy is stimulated to create substitutes in the form of increased productive capacity, national savings, and exports. Foreign investment also could substitute foreign aid, but experience elsewhere has shown that foreign investment is not attracted to countries that suffer from chronic disequilibrium in their external and internal balances. If external aid is to play this catalytic role, it needs to help generate not only economic growth, but rates of growth in investment and exports which outpace the rates of growth of consumption and imports. Indeed, it has been demonstrated elsewhere that positive results ensue as a direct result of adopting appropriate macroeconomic policies consistent with these relations among growth rates. 57/

Intensifying investment, and raising exports, requires substantial expansion of the productive capacity of the economy, and restraint on increases in consumption and imports. Thus, there is a need for macroeconomic policies to affect the supply side, and others to affect the demand side. The former deals with policies generating savings and their allocation among competing investment projects. The latter deals with policies controlling the level and composition of aggregate demand, so as to prevent inflation or harmful changes in relative prices.

The Palestinian economy, like that of most less-developed economies, is largely "supply determined", implying that productive capacity, rather than aggregate demand, constrains economic activities. This is due to shortage of capital, outdated technology, and low skills. Investment in both capital equipment and human capital are therefore needed to reduce the constraints on capacity. This requires an increase in the share of investment in GNP, and two sets of policies to bring it about. The first raises savings needed to finance investments, and the second ensures that the savings will be allocated optimally among investment projects.

Monetary policy cannot be depended upon to encourage saving. The money supply in the transitional period is an endogenous variable related to the balance of payments, and tight money with a high interest rate is not an effective tool for stimulating saving in less developed countries. 58/ Fiscal tools, taxes and expenditures, therefore, are the main instruments available to achieve the objective of high saving. Since national saving is equal to GNP minus consumption (private and public), it can be increased by any measure that reduces consumption without causing a fall in production (GNP). Taxes could be used to discourage private consumption, which would increase private saving provided they do not produce a disincentive to work. In this regard, tax reform which emphasizes the importance of reducing rates of income tax, and increased reliance on consumption taxation, is a major step toward creating appropriate incentives. 59/ The use of neutral lump-sum taxes in agriculture and small business could serve the same purpose of discouraging consumption without reducing production. 60/ At a later stage, schemes could be introduced to target certain types of savers. Examples of such schemes which have been used very successfully in many countries are registered retirement saving plans, and home ownership saving plans. 61/

Public saving could also be increased by reducing some items of public consumption. In the Middle East, national defence and State security are two major items in every government budget. The Palestinian Authority does not have to allocate resources for defence, and it should seek to minimize the resources devoted to security. The same is true for some other public expenditures which serve political, rather than economic, interests. In particular, the bureaucratic apparatus of the Palestinian Authority, and the future Palestinian political entity, should grow with the needs of the economy, and should not become autonomous.

In addition to policies geared towards generating savings, policies are needed to influence the pattern of investments. During the next few years, the majority of investment projects will be public, but this could induce private capital (domestic and foreign) to invest in unessential industries (luxuries). This would be harmful for two reasons. First, it would raise the price of necessities, and cause a redistribution of income in favour of higher-income groups. Second, it threatens to create production bottlenecks and sectoral imbalances. To avoid these harmful effects, fiscal incentives should be directed toward investment in projects catering to basic needs. For example, private capital interested in building small houses for people of limited income should be given more fiscal inducement than private capital interested in building luxury hotels.

Traditionally, development banks are used as an instrument to affect the pattern of investment. Small farmers, and firms who lack access to commercial banks, are provided with a source of cheap subsidized loans to help them invest. A problem often encountered with such banks, as demonstrated by the experience of many developing countries which have used them, is that they often end up serving the wrong clients; large land-owner farmers, and well-endowed business establishments. 62/ If the Palestinian Authority is to permit the establishment of some development banks, with the aim of affecting patterns of investment, it has to provide an institutional framework containing safeguards against abuse.

Generally speaking, demand constraints are of less importance in less-developed economies than those affecting supply. Nevertheless, during the reconstruction period, with increased investment financed mainly by external resource transfer, demand issues will assume importance in the Palestinian economy. Precipitous changes in either the general level of aggregate demand or its composition, might trigger inflation or changes in relative prices, which could retard growth. The danger of a rise in the general level of prices is a very real one, since the building of infrastructure generates an increase in income while it does not immediately generate an increase in consumption goods.

The situation would also be exacerbated if political changes and the positive prospects of peace trigger a large speculative capital flow from Palestinian expatriates and others. Indeed, the increase in land prices in 1994 can be attributed in great part to such speculation, and this will not facilitate productive investment and growth. 63/

While monetary policy cannot be used at the macro level to reduce aggregate demand for reasons already outlined, it can be used to restrain speculation. The PMA, as a controller and supervisor of financial institutions, could discourage financial activities involved in facilitating speculative pursuits. Fiscal measures could, perhaps, be even more effective. Taxation of speculative activities, while sparing real investments, may also be appropriate. 64/

The availability of external financial aid, and the hope of increased foreign investment in the future as a result of stability and peace, could encourage the perception that domestic saving will cease to be the primary source of capital accumulation. If this results in abandoning policies needed to stimulate domestic savings and constrain consumption and imports, it will have severe long-term consequences. Foreign assistance, by its very nature, is a very short term remedy, and cannot be relied upon for more than a few years. More importantly, foreign investment has not yet become the major factor in capital accumulation in the majority of less developed countries. Most of the international capital is of short-term character, and cannot sensibly be used to finance long-term investment. Recent international experience has highlighted the unreliability of foreign capital in sustaining a domestic investment programme. It is also no coincidence that the fast growing Asian countries, which do attract substantial flows of foreign capital, also have the highest rates of national saving in the world.

2. An enabling environment for private investment

The only comprehensive recent statement of Palestinian economic and social development policies and programmes is found in the Palestinian Development Programme (PDP), prepared in 1993 by the Palestine Department of Economic Affairs and Planning. Though predating the Israel-Palestine accords and the subsequent self-government arrangements, the PDP espouses a range of liberal and dynamic economic policy principles which have been since endorsed in practice by the Palestinian Authority and its reconstruction programmes. Table 10 presents a sectoral distribution of total (public and private) investment envisaged in the PDP for the period 1994-2000. While estimates of such needs by other sources imply more or less aggregate investment and different sectoral shares than in the PDP, by all accounts Palestinian investment needs will remain considerable until the end of the decade at least. 65/

One of the basic underpinnings of attracting investments and creating a vigorous private sector is demonstrating strong commitment to fostering a genuine market economy in the emerging Palestinian entity. Although such commitment has been frequently made at the highest levels, many officials involved in policy-making within the Palestinian Authority have not had adequate experience relevant to management of the public sector in a market economy. There is a clear need to support and promote greater understanding and consensus among public officials concerning the primacy of developing market institutions. The Palestinian Authority’s commitment to a market economy needs to be tangibly reflected in a number of economic policies, many of which are alluded to in this chapter. But the nature and relative size of the public sector in the economy lies at the centre of all efforts aimed at attracting investment.

As regards the thrust of development policy, much of current Palestinian development policy debate encourages shifting to a pattern of autonomous growth based on expansion of domestic production, increased trade in goods and reduced exports of labour. But this policy depends on providing the institutional basis for a large expansion in the services/goods provided by the public sector, as well as providing adequate incentives and security for major investments in productive activities by the private sector.

Investment promotion policies should be clearly targeted at giving greater emphasis to productive activities in the Palestinian economy. This is going to be particularly important in the light of anticipated boom in non-productive business transactions, such as those in land speculation and in the stock market. An important instrument in this policy is having a relatively free and outward-oriented exchange regime, conducive to the encouragement of exports and the appropriate investments in import substitution. Furthermore, specific policies have to be formulated in order to encourage the demand for the goods and services produced locally. As noted previously, the Palestinian economy could be subject to strong inflationary pressures during the next few years. This will make it increasingly difficult to maintain a stable yet open exchange regime, and could undermine the incentives for private savings and investments while also eroding public sector savings. It is therefore essential that fiscal and monetary policies are made overly sensitive to inflationary pressures, and that appropriate corrective measures are taken.

The ability of the Palestinian economy to absorb a relatively substantial inflow of investment at an acceptable rate of return is heavily contingent on introducing major sectoral transformations in the domestic economy. Such transformations are of course dictated by the heritage of inherited distortions. But they are also deemed essential if the Palestinian economy is to adjust effectively to the consequences of open regional and freer international trade. Furthermore, some forms of economic reorientation are deemed essential in order to reduce the vulnerability of the Palestinian economy to exogenous shocks.

The Palestinian commodity producing and services sectors have to undergo major adaptations targeted at maximizing their competitiveness, both in regard to quality and cost levels. Furthermore, Palestinian economic sectors have to be gradually restructured so that they incorporate an increasing technology component, and rely less heavily on the lower wage level advantage. It is of course true that generating employment is a very high priority on the Palestinian agenda, but it would be mistaken to take this as an excuse to compromise on production technology. Reliance on the labour cost advantage will be much less promising in the future once restrictions on crossborder trade and labour mobility are removed.

In their drive to promote investment flows and labour employment capacity, the Palestinians have to display excessive awareness to optimizing returns from scarce resources, most importantly, land and water. This is certainly true in both territories, but much more so in the Gaza Strip, where the supply of both resources is far smaller than the most modest projections of future demand. Unavoidably, allocation of such scarce resources has to account for the real opportunity cost of various patterns of use. Palestinian planning and investment policies should display strong sensitivity to environmental issues. This should be reflected in a variety of regulations relating to licensing of industrial and construction activities. Similarly, there are several areas of potential environmental hazards accruing to wrong agricultural practices, e.g. using sewage water in irrigation, uncontrolled use of chemicals, and plastic leftovers in greenhouse farming.

Finally, the Palestinian stand on joint ventures with Israeli firms needs to be explicitly and clearly defined on publicly acceptable political grounds, with displaying adequate sensitivity to clear long-term economic interests. The presently hesitant attitude of the local private sector (in contrast to that of expatriate Palestinians), can be remoulded in more positive terms, should the Palestinian leadership establish an internal dialogue aimed at compromising divergent views on this vital issue. The benefits to be gained on various levels (scale, market access, finance, security of investments, managerial expertise, etc) from new forms of partnership with Israeli investors, producers and exporters appear to justify developing closer relations with Israel in this respect. The proposed border industrial estates (export processing zones) between the Palestinian territory and Israel could serve as an appropriate context for initiating such cooperation in a systematic and structured framework.

3. Trade policies and market orientation

Given the small size of the Palestinian economy and the territory’s scarcity in natural resources, and assuming that Palestinians are keen on raising their living standards markedly beyond their present levels, then commitment to free trade and liberal economic policies should become a strategic long-term policy. In addition to the direct positive impact on economic growth and entrepreneurship, a free trade regime provides strong incentive for investors, especially those engaged in industrial development and international trade. The implications of free trade, however, bear in different ways on the relations of Palestine with Israel, Arab neighbours, and with other countries. The following section examines aspects of Palestinian trade policy with a bearing on the prospects for private investment in the Palestinian economy.

(a) Trade with Israel

Trade relations with Israel should be restructured on the basis of a delicate political and economic mix of interests. Open borders with Israel in the context of a customs union, as has already been agreed in the Paris Protocol, should still be regarded as the most practical option for trade between the two entities in the interim period. On the other hand, a scenario of free trade with Israel could help promote investment flows from foreign sources, more so if inhibitions on joint ventures with Israelis are resolved. Free trade with Israel will provide Palestinians access to a relatively huge market, something they will badly need in view of their questionable trade potential with other neighbours. Furthermore, open borders with Israel will facilitate access to EU and American markets, taking advantage of Israel's preferential trade agreements with those markets, and its experienced international trade support institutions. Recent policy debate on the issue has increasingly focused on free trade with Israel as an equally attractive option as the prevailing customs union; the Palestinian Authority is reportedly interested in moving away from the customs union towards free trade arrangements. 66/

As a prelude to promoting trade with Israel on an equitable basis, the Palestinian Authority should seek to remove gaps in the subsidy systems on both sides of the "green line". This may involve hard negotiations with Israel on some forms of subsidy which are still accorded to Israeli agriculture, but that should not be a major obstacle in view of Israel's strong and growing commitment to liberalize economic and trade policies, both with the Palestinian economy and globally.

In a similar vein, the Palestinian Authority needs to negotiate a more detailed practical protocol in relation to quality control issues and trade-related security measures. The ultimate goal for such negotiations is to arrive at arrangements which would delegate the assignment of issuing needed certificates, including to the extent possible those relating to security inspection, to authorized Palestinian institutions. This would help to expedite trade operations and diffuse risk perceptions within the private sector, especially among those elements which envisage major involvement with or through Israel.

Ultimately, free trade with Israel, within a customs union agreement, should also address labour flows across the "green line" within a more defined and contractual arrangement. The bottom line on the Palestinian side is that during the interim period, West Bank and Gaza Strip workers should maintain access to the Israeli labour market, at a minimum level of some 60,000 workers, i.e. around half the peak level reached during the pre-1993 period. Continued disruptions in labour mobility across the "green line", and attempting unilateral "separation" with Israel entail severe hardships for Palestinians and is likely to undermine and distort investment flows.

(b) Trade with Arab countries

There are also strong economic and political justifications to a free trade area with Arab countries, particularly Jordan. But unless a free trade agreement addresses the wide range of protectionist and subsidy-oriented policies followed in those countries, a free trade arrangement with the Palestinian territory is likely to cause serious shocks to the latter, with ramifications for Palestinian economic and socio-political stability. However, Jordan constitutes one of the emerging exceptions to the regional pattern of trade and industrial policy and consequently could be an appropriate partner in trade liberalization programmes than other countries in the region.

Free trade with Jordan might entail some relocation of industries from the Palestinian territory to Jordan. The fact that Jordanian firms are relatively much larger in size and operate at below capacity might deter Palestinians in the West Bank and Gaza Strip from taking the risk of expanding their production facilities, or it may even encourage them to relocate their plants, or merge with existing Jordanian firms. Relocation motives will be further reinforced should the support system available to Palestinian industrialists and uncertainties about the future remain as they are at the present. The strong and deep-rooted connections between business communities on both sides of the river may facilitate the transfer of industrial plants to Jordan.

Recent political developments and ensuing trade negotiations between the Palestinian Authority and Jordan have entailed significant consequences for the Palestinian economy. In lieu of previous arrangements when solidarity implications constituted a major justification for the entry of Palestinian goods, Jordanian authorities sought a more formal and mutually negotiated trade agreement with the Palestinian Authority. It was in this spirit that the two sides concluded in May 1995 a protocol on the commodity lists which will be traded bilaterally free of tariff duties. The said agreement has since become the basis for developing trade relations between Jordan and the Palestinian Authority.

Examining the brief record of its implementation, the new trade agreement with Jordan seems to have had mixed consequences to date. Although agricultural trade was phrased in the agreement in a positive tone, it was made "subject to the recommendation of concerned bodies" on both sides, which in many cases may be opposed to the unrestricted entry of goods from the other side owing to a range of domestic market and producers' considerations. Furthermore, the trade agreement does not yet allow the duty-free entry to Jordan of major Palestinian commodities such as textiles and pharmaceuticals. By contrast, Jordanian pharmaceuticals are permitted free entry to the Palestinian territory. Similarly, although stones are generally regarded as a leading Palestinian industrial export, the agreement refers to free entry of "sand" stone, and for unexplained reasons it fails to mention calcium stone, which is the kind of stone exported to Jordan. This has permitted Jordanian authorities to impose a variety of taxes and tariff duties on stone shipments from the Palestinian territory, with unfavourable consequences for major stone quarrying and cutting operations in the West Bank.

Trade relations with Egypt can also be structured in a way which can serve the better interests of both sides. Egypt can be a major supplier of cheaper inputs and fuel to the Palestinian economy, which is vital for gaining higher competitiveness should industry become a major attraction of investment flows. Furthermore, Egypt can possibly supply a range of consumer goods, while also presenting a large market potential for certain Palestinian exports. This would serve as another incentive for investment flows into the Palestinian economy.

But trade with Egypt will continue to be stalled until Israeli security restrictions on the movement of goods through Rafah are eased. Even then, it will be nearly impossible to establish normal trade relations between the two sides before Egyptian regulations relative to the flow of goods and passengers through border points are substantially simplified and streamlined.

Palestinian customs authorities should consider prompt and effective measures aimed at preventing the uncontrolled flow of consumer goods across border points with Jordan and Egypt. The rapidly growing scale of this undocumented trade has already affected manufacturing firms, and in some cases, such as pharmaceuticals, it may entail serious health hazards.

(c) Trade with other countries

The track record to date of direct trade relations between the Palestinian territory and prime markets in Europe and North America is not very impressive, despite preferential policies accorded to Palestinian producers and manufacturers. Furthermore, export operations have been severely constrained by the poor domestic support system. Until now, direct exports to Europe have been restricted largely to a few varieties of farm produce, attempted mainly within an NGO framework with an inbuilt subsidy component. Such kinds of transactions have little chance of success to begin with, and in most cases they involve inappropriate products, insignificant foreign exchange earnings and limited employment or income effects.

Direct exporting to European and American markets can be set on a different course if handled by firms with adequate financial resources, established international connections and high calibre technical expertise. The range of exportable commodities can include more than those attempted so far. In particular, vigorous efforts should be made to go beyond labour intensive products, and attempt instead to engage in increasingly technology-intensive products.

Assuming that the political barriers to joint ventures are removed, direct exports of agricultural products to Europe and the United States (during the interim period at least) can be greatly facilitated if Palestinian firms are accorded access to the support system existing in Israel, instead of allocating scarce resources to creating the full range of needed infrastructure. This should not be very difficult to negotiate through a business-oriented arrangement serving the interests of both sides. The fact that the Israeli agricultural export infrastructure is becoming increasingly underutilized should make arriving at a collaborative relation more easy. In order to succeed, this kind of cooperation has to be conducted on business grounds, with minimal intervention from respective political echelons. One of the important issues which may prove difficult to reconcile is that relating to certification of the products' origin. Going by previous experience, this problem is not unsurmountable, especially in the light of anticipated benefits to both sides.

Establishing direct import relations with industrial countries and suppliers of raw materials can entail positive consequences for growth and the employment generation potential. Some action has already been taken in that direction, but reaping the full potential of direct import trade requires more real support on the Israeli side, and a more efficient regulatory system on the Palestinian side.

Direct involvement of public figures and institutions in this form of trade can be particularly damaging.

B. Major sectoral prospects and investment opportunities

1. Agriculture

The agricultural sector is expected to play a more dynamic role in the Palestinian economy in the coming years, especially by coping with the rapidly rising demand for food and by reducing deficits in the commodity balance of trade. Moreover, employment patterns in agriculture should develop in such ways that drain of labour from this sector is halted, and employment capacity is expanded, though not at the expense of productivity gains which may be realised through continued adoption of new agricultural technologies. As a fundamental prerequisite, Palestinian farmers are expected to have a more secure and better regulated access to land and water resources, and enjoy the benefits of a more developed infrastructure and institutional support system.

In order to be able to play a tangible and relatively secure role in the Palestinian economy, the agricultural sector should undergo fundamental adjustments, most notably the following:

- The citrus branch is becoming increasingly large-scale, costly and uncompetitive, though it is still the primary user of water and prime land resources. This branch will have to be trimmed in size, while productivity and marketing services have to be considerably improved;

- Similarly, substantial improvements have to be introduced with regard to olive production and marketing operations, more so that the export potential of olive oil is undergoing a steady and tangible decline;

- Current patterns of greenhouse farming are dominated by relatively low value surplus varieties largely destined for domestic markets. Greenhouse farming has to shift towards higher value (and possibly more technology-intensive) crops. This may include cut-flowers, medicinal herbs, strawberry, asparagus, and early seedless grapes;

- A vigorous effort has to be exerted in order to identify and introduce new farming patterns. There are already several examples on crops and livestock which seem to possess an attractive potential (e.g. avocados, persimmons, dates, peaches, apples, marine fishing, fish ponds, turkey production, rabbits, hatcheries, bee culture). Yet it is recommended that a major project on diversification of farming patterns be launched in collaboration between FAO, the World Bank, and the Palestinian Ministry of Agriculture.

A fundamental prerequisite to building an efficient and highly competitive agricultural sector is the formulation of a wide range of organizational and investment policies. The policies and projects proposed for this purpose are identified in a recent study sponsored by PECDAR and the World Bank. 67/ They bear on such areas as research and development, extension and education, credit facilities, irrigation projects and water pricing policies, marketing infrastructure, and negotiating equitable trade agreements, especially with immediate neighbours.

In order to achieve the primary target of creating a highly competitive agricultural sector with minimum or no direct and indirect subsidies, production and marketing operations should be entrusted to the private sector. Obviously, the success of this endeavour depends in the final analysis on the massive infusion of investments. The following is a list of high priority investment opportunities:

- Renovation of wells (deepening, cleaning, replacing old pumps, connecting with the electric grid, replacing distribution nets), construction of storage towers, and wider dissemination of modern irrigation techniques. Lending for these purposes should be accorded on similar conditions as prevailing in neighbouring countries;

- Establishing modern custom machinery units which provide such services as ploughing, harvesting, and spraying of chemicals at reasonable (commercial) rates;

- Establishing agricultural marketing firms which are well equipped and staffed to handle agricultural trade with Europe;

- Considerable investment could be channelled to expansion in greenhouse farming. Lending and investment policies should be accompanied by a vigorous shift in farming patterns.

2. Industry

Industrial development in the Palestinian territory has been severely constrained by a wide range of inherent and exogenous obstacles. Not surprisingly, this sector has been among the least to develop during the past three decades. And in their effort to survive against tough odds, Palestinian industrial firms have been obsessed by an over-riding urge to minimize overheads and direct costs, by establishing small production units, using improper construction facilities, buying used machinery, and pursuing compromising staff recruitment policies (both in regard to number of workers and qualifications). Such adaptations, however necessary they might have been in the past, have led to grave consequences for the competitive standing of Palestinian industries, especially in regard to quality of products.

A development strategy for this industry should have a strong export orientation, but with constant monitoring and evaluation of import substitution possibilities. The experience acquired in the context of subcontracting arrangements in manufacturing industries with Israeli firms can provide wider opportunities. Subcontracting can be expanded to new branches, such as diamond cutting, provided that the skills needed for this purpose are properly transferred. There is an important potential role for transnational corporations in building upon the Palestinian experience in subcontracting, through transforming these industries into fully-fledged production units which are well-integrated within a global production and trade network.

Sectoral adjustments in industry should target expansion in the following subsectors:

- Chemicals: Detergents and cosmetics are being manufactured in small units. Much could be achieved by merging existing firms. More importantly, it is now possible to explore the prospects of establishing full-fledged chemical industries along the Dead Sea, possibly in the context of regional joint ventures;

- Pharmaceuticals: This industry also suffers from proliferation of small units, hence reducing its competitiveness. Here as well, economies of scale, specialisation and greater efficiency could ensue from consolidation of existing firms, including those engaged in producing veterinary products. Some kinds of paramedical products and industrial gases can possibly be feasible (e.g. oxygen and nitrogen);

- Agro-industries: The potential for this kind of industries has been barely tapped. Potential areas of expansion include: modern processing and tinning of olive oil, pickling of olives, citrus juice extraction, wine and grape juice, pickling of vegetables, jams, dairy products, poultry and livestock slaughterhouses, feed concentrates, hide tanning, and manufacturing of tin cans and cardboard boxes;

- Food industries: In addition to those mentioned above, these could include chocolates, biscuits, soft drinks, and tobacco. Such industries are fairly common in the Palestinian territory, but their competitiveness is low in international standards;

- Textiles and leather (shoes, leather brief cases and wallets) industries: Palestinians have acquired wide experience in these branches, and they can now move towards establishing special niches in international markets. Vigorous expansion can possibly be accelerated through joint ventures with Israeli firms, more so in view of their long experience and privileged rights in the American and European markets;

- Car parts and accessories: tyres (new and/or refurbished), batteries, brakes.

3. Construction

The present high growth rate in the construction sector is expected to proceed at the same pace, at least until the end of the decade. This is clearly reflected in the fact that this sector has been allocated $5.8 billion in the Palestinian Development Plan, i.e. around 50 per cent of total planned investment allocation for the period 1994-2000 (see table 10). Other, lower, estimates confirm the important position that construction will occupy in the reconstruction effort and, hence, in public and private investment flows. By all accounts, the construction sector will remain at the centre of economic activity for many years to come.

Growth in the construction sector should be redressed on grounds which are much more responsive to Palestinian needs and priorities. Despite its profound impact on overall economic activity, asymmetrical growth in construction branches as compared to growth in other sectors, should be viewed with great caution. Conscious efforts are needed to ensure that the Palestinian economy does not drift into a real estate speculation spiral, like that which hit Jordan during the 1970s and again in the 1980s. The dangers of excessive speculation could become more serious in the West Bank and Gaza Strip, on account of extremely small supply of land on which building is possible. Excessive focus on land and real estate speculation is likely to dampen investment incentives in other sectors, particularly in industry, which could be more vital to healthy Palestinian economic growth in the long term.

The cost structure in the construction sector should be markedly lowered. This will help reduce rent rates, both for residential and commercial purposes, and conserve scarce land and capital resources. This can be achieved by promulgating significant changes in relation to construction, most notably the following:

- Permitting and encouraging higher storey buildings;
- Formulating a satisfactory legal framework for the acquisition of apartments;
- Expanding the area within municipal boundaries, and relaxing restrictions on construction activities outside municipal areas;
- Encouraging more economical practices in regard to design of constructions, and types of materials used. Effective measures should be taken to discourage the increasing use of luxurious and conspicuous internal finishing in private residential construction. This practice adds significantly to the overall cost and price level of new dwellings, including those for lower-income earners.

Growth in the construction sector should be accompanied by vigorous efforts aimed at maximizing its value added. Construction-related industries can include a wide range of activities, reflecting the strong linkages which characterize this sector. Such industries would include quarrying and stone cutting, cement, cement blocks, tiles, iron bars, doors, glass, ceramics, solar heaters, aluminum, paints, and a wide range of insulant chemicals.

While every effort should be exerted in order to simplify and streamline regulations relating to the construction sector, it is very important that stringent precautions are taken so that no violations are made in regard to zoning and safety requirements. Such violations are now more imminent, given the extraordinary boom in construction activities and the unavoidable loopholes in the legal system during the ongoing transition of authority in the Palestinian territory.

4. Services, including tourism

The Palestinian services sector offers a range of new and promising areas for investment and growth. 68/ A Palestinian services policy needs to be elaborated, which would increase opportunities for business entry, define priorities for investment, assure a smooth and secure environment for services activity, attract international services providers in the framework of a national services policy and enhance direct and indirect links between services and other economic and social sectors. The Palestinian economy can offer a range of existing and future services, the investment in which needs to be carefully studied in the light of domestic and international market considerations. There are a number of choices facing policy makers and entrepreneurs alike; a balanced and innovative assessment of the potentials of each option will help guide investment decisions and optimise their impact. The policy formulation process will lay the substantive basis and determine the orientation of the legal framework covering the key areas affecting services branches. The establishment of a clear, modern and liberal regulatory framework for domestic and international services activity will help to define relationships among the concerned branches and institutions and provide the necessary frame of reference for the day-to-day operation of the sector’s institutions and personnel on the national, regional and local levels.

Such a framework will also help to determine the public and private institutional needs of the services sector, on sectoral and branch levels. It remains to be seen to what extent, and for what duration, Palestinian public agencies will be required to help launch or promote Palestinian services. This issue might be especially important with regard to those services which are also traded internationally (such as transport, finance, engineering and tourism) and those in which Palestinian suppliers have less experience. In any case, given the existing low level of public ownership of services enterprises, government involvement in direct investment or operation of services enterprises appears unadvisable. This is notwithstanding the need for the wide-scale upgrading of public utilities and communications networks and ancillary infrastructures upon which efficient services depend.

Palestinian distributive and personal services branches will most likely remain predominant in the sector for some time more, at least until the manufacturing sector begins to show signs of reversing its many years of stagnation. In the meantime, further well-targeted investments in crucial links of the existing active services branches (especially transport, trade and tourism) could help to streamline and enhance their performance. In the longer term, increased efficiency in the economy and in the services sector is closely related to the availability of producer services of adequate quality. This includes such important services which are currently weak or lacking in the territory: quality control and standardization; labelling, packaging and promotion; storage and handling; management services; informatics; equipment maintenance; and legal services.

The development of these new services in the Palestinian economy is a prerequisite for the emergence of a modern services sector and for the healthy functioning of other sectors. Inadequacy in those services or in the regulatory framework governing them can create serious bottlenecks in the production and distribution process. For example, public sector support schemes could be considered to provide the lead towards the optimum design of small-and medium-sized business services, appropriate to the particular needs generated by the Palestinian situation. In other words, there is no standard format for organizational design. The key issue here is the coordination of different types of support services for different functions and branches.

The tourism sector could play an important role in the Palestinian economy. Even under the adverse setting of 1990, the tourism sector was estimated to have contributed around 10 per cent of the West Bank's GDP, which is higher than that of the industrial sector. 69/ Tourism is likely to emerge as one of the fastest growing economic sectors, once the peace process proceeds to a more advanced stage of genuine normalization of relations between major regional partners, Palestine, Jordan, Egypt and Israel. This will be exemplified in the number of incoming tourists and the share of this sector in gross national product. The significance of this sector is widely recognized by local development activists, business firms, and senior Palestinian officials, all of whom attach high expectations to the role of this sector in the Palestinian economy.

A Palestinian entity comprising the West Bank and Gaza Strip is certainly uniquely endowed with historical, religious, and natural touristic attractions. The massive influx of Moslem and Arab tourists prompted by emotional and patriotic motives, as well as other denominations from the rest of the world, will also constitute a major new source of tourists. Yet, other neighbouring countries, such as Egypt, Jordan and Israel are also endowed with rich and varied touristic features. So it is to be expected that cooperation between those neighbours would make of the Near East one of the most attractive touristic areas in the world. This of course requires that effective regulatory measures are taken to facilitate mobility of tourists between the countries of the region.

The Palestinian territory is well placed to play a central role in regional cooperative tourism efforts. But this can be possible only if radical improvements are introduced in the investment climate, as it relates to the tourism sector. Otherwise, it is possible that growth in regional tourism will be accompanied by the marginalization of the Palestinian share in the tourism income basket. In this case tourists will be tempted to visit Palestinian touristic attractions, but will prefer to use the complementary facilities of immediate neighbours.

The investment absorption potential of the tourism sector is among the highest in the Palestinian economy, and probably one of the most rewarding. Large capital outlays are required in order to modernize and expand such sub-branches as hotels, restaurants, transportation facilities, and handicraft industries. The mechanism of channelling capital to this sector is facilitated by the fact that the local institutional framework relating to this industry is far more developed and differentiated than those catering for other economic sectors. 70/ It is evident that tourism will constitute one of the most attractive and relatively renumerative opportunities for domestic and foreign investment, provided the necessary reforms affecting investment are effected (see below).

C. Legal and institutional reform

1. Overall legal framework affecting private enterprise development

Longer-term competitiveness in the Palestinian economy, especially in such sectors as industry, tourism and agriculture, depends, inter alia, on the availability of investment at a scale adequate to improve productivity and increase output, and on the ability of firms to develop a strong human resource base, and on securing adequate skills in regional and international marketing operations. The success in this endeavour is contingent on providing a number of prerequisites.

The development of the financial system in the West Bank and Gaza Strip requires significant reform in several aspects. The objectives of such reforms would be to encourage entry of new institutions and expansion of existing ones, promote competition, instill confidence in the financial system and improve intermediation. Expectedly, the progress in the peace process and changes in risk perceptions play a critical role in determining the nature and pace of transformations of this sector.

The existing patchwork of British Mandate, Jordanian, Egyptian and Israeli legislation bearing on Palestinian financial institutions should be replaced with a transparent and coherent regulatory framework covering the Palestinian territory in an integrated manner. The new legal framework should define clear criteria for licensing banks, insurance companies and other financial intermediaries. Entry barriers should be removed and existing banks should be allowed to expand. These measures and policies should continue to be addressed by the PMA, which has already embarked on the path of financial reform. Even if all areas cannot be acted upon simultaneously, a comprehensive reform must be envisioned first and designed so as to be implemented as and when political, legal and other considerations permit.

The pool of available credit for the private sector must be expanded through facilitative intervention from donor countries and from international and regional banking institutions. Such arrangements should be synchronized with donor countries' programmes of support of their own private sector institutions. Important first steps in this direction have already been taken in the context of the international assistance programme launched since 1993.

The Palestinian public and quasi-public and private sector agencies should engage in the planning for broad-based insurance needs. Technical assistance and training should be made available as needed. It is also necessary to establish appropriate accounting standards and financial disclosure rules so as to improve the credibility of the information released by business firms in the Palestinian territory. This calls for the development of a strong auditing profession which is capable of playing an independent role.

The imminent establishment of a stock exchange market is a well-conceived and timely addition to the emerging Palestinian financial sector. It should eventually comprise a fairly complete and diversified range of financial institutions and instruments, as well as competent intermediaries which operate within a well-structured framework. This is necessary to promote a more balanced financial system where the channelling of savings into equities has an equal opportunity vis-à-vis activity of banking in the business of promoting deposit-type savings from the public.

On another level, there is the need for promulgating a system that protects property rights and defines a fair mechanism of economic exchange. This suggests introducing two major reforms, namely, the reactivation of the land registration system, and the creation of an acceptable dispute resolution mechanism. Reforms in the real property system should be identified and pursued to the extent possible, given overriding political constraints. Such reforms are imperative for initiating and accelerating developments in finance, industry, and housing. However, the scope and pace of improvements in this area will be heavily sensitive to the progress achieved in the peace process. This should allow improvements in urban and rural areas, including those still under direct Israeli jurisdiction.

Improving the infrastructure of courts and related legal professions, easier public access to legal information and developing capacities of legal professionals and judges would increase the transparency and regularity of the system and reduce the transaction costs associated with business activities. This would require making available more reliable information in various forms, and the provision of professional training for judicial manpower.

Informal methods of arbitration are increasingly becoming a source of insecurity to individuals and business firms, since they could be conducive to unfair compromises and outright corruption. In any case, such methods are unacceptable to business partners coming from abroad. Hence, it is important that a professional arbitration system is developed, with well-defined procedures, expert arbitrators, and facilities.

The immediate commercial reform priorities for Palestinian Authority policy makers include the following:

- Working out appropriate trade and customs arrangements under the Paris Economic Protocol;

- Formulation and implementation of an incentive structure for new investments (see below);

- Harmonizing legal systems in the different areas of the Palestinian territory;

- Modernizing tax laws and administration;

- Drafting the necessary regulations for the functioning of the Palestinian Monetary Authority, and coaching it through the early days of the implementation process.

There are a number of company registration issues which any new legal system will have to deal with, most importantly the following:

- The most fundamental legal deficiency bearing on foreign investors is that of not having the legal security accorded to holders of local identity cards. In this case, investors are denied such basic facilities as routine entry to the territory, official recognition as owner of equity (especially of real estate) and recourse to local courts in case of need. Consequently, the legal status of non-resident investors has to be satisfactorily addressed.

- The Palestinian Authority should have a single organization in charge of company registration. At the present, there are different registries in the Gaza Strip, Jericho and elsewhere in the West Bank. Furthermore, both the Ministry of Trade and Economy and Industry and the Ministry of Justice have established separate company registration facilities;

- Palestinians holding Jerusalem identity cards are not allowed to form companies in the West Bank;

- Licensing obstacles relevant to new (and existing) companies have to be dealt with and relaxed. This does not relate to the legal registration of companies, as much as to subsequent licensing needed for construction of premises, connecting with the power grid and utilities network, and securing approval from the Custodian of Absentee Property, as may be required.

In view of a long heritage of excessive sensitivity to disputes bearing on land equity, foreclosure has become legally impossible and socially unacceptable. Consequently, legal changes will not help so long as the Palestinian society does not tolerate foreclosures. As a substitute to direct mortgage arrangements between commercial banks and borrowers, the Palestinian Authority could create a national body, perhaps known as "Palestine Mortgage Corporation" (PMC), to act as an intermediary between banks and borrowers. PMC would agree to act as a last resort guarantor of borrowers vis-à-vis local lending banks, in return for a set fee. But against that, PMC would seek real estate mortgage of a market value that is adequate to cover guaranteed loans. By virtue of its rules and regulations, PMC will be able to take possession of land when the owner defaults on a loan for which the land served as security. It is expected that Palestinian society will be much more tolerant to foreclosures undertaken by such a national institution.

2. Legal framework affecting private investment 71/

Given the Palestinian economy's current low level of infrastructural development, the establishment of an attractive investment regime and appropriate supportive institutions is a crucial determinant of inward investment. Both the general regime as well as particular regimes of exception applying to export processing zones (EPZs) or off-shore banking facilities (OBF) require close consideration in order to develop an optimal investment framework beneficial to Palestinian and foreign investors. While the investment regime is only one determinant of the investment climate, it is a factor which can be addressed immediately and which constitutes the basis for further economic development.

The new Investment Encouragement Law effectively constitutes a first step towards the development of a comprehensive investment regime which is conducive to attracting private domestic and foreign investment. While covering a number of important areas, the current Law will need to be re-examined in the light of all other laws and regulations affecting the foreign investment regime in the territory and to ensure that existing legislation is comprehensive and adequate. Furthermore, implementing regulations need to be effective and should correspond to the respective legislation. It is not clear, for example, to what extent regulations affecting trade-related investment measures (TRIMs), intellectual property rights or non-equity arrangements (including management contracts, licensing and build-operate-transfer agreements) are in place and are effective.

At a stage when the Palestinian economy is opening up to world markets, there is also insufficient clarity with regard to: (a) existing bilateral and multilateral agreements affecting foreign investment and the investment climate in general (e.g. Investment protection agreements, financial protocols, taxation agreements, etc.); and, (b) the extent to which such agreements can be entered into. A study of these issues should clarify the extent to which existing laws and regulations need to be adjusted and consolidated.

One precondition for investment is that companies willing to invest and operate are assured adequate finance. Therefore, current financing mechanisms should be studied in order to improve access to finance. For example, establishing an OBF system could have the following beneficial effects: new sources and lower cost finance; fewer banking formalities; increased bank competition; transfers of banking know-how; and, an increased coherence of the monetary policy targets of banks.

At present, there is no specific legal framework for the proposed EPZs and the OBF system. Furthermore, a suitable package of incentives for domestic and foreign investors has not yet been established. Although the EPZs are still at the planning stage, these issues need to be addressed urgently in order to clarify the position for potential investors who frequently require long lead times in making investment decisions.

In order to administer and promote investment in general as well as in the regimes of exception in the Palestinian economy, appropriate institutions need to be established. Existing institutions, such as the Agency established under the new Law, are in their infancy and require considerable know-how and a supporting database in order to be able to function efficiently. Furthermore, a Palestinian Export Zones Authority (EPZA) will need to be established to administer the EPZs, notwithstanding the largely private sector involvement in these zones.

In view of the fact that the participation of foreign investment in the Palestinian economy will be a new phenomenon, the staff of the new institutions, as well as officials and private sector managers dealing with foreign investment will require extensive training on the developmental role of foreign investment in general. This includes know-how in investment data-gathering, monitoring and assessing the impact of foreign investment, promotional and marketing techniques, as well as how to manage information databases. Furthermore, officials and private sector managers will need training in drafting and negotiating contractual and other legal agreements related to foreign investment.

3. Institutional development: government and private sector

Faced with the challenge of reconstruction and development, the need could not be greater for appropriate and effective public and private sector institutions dealing with business and investment activities. The Palestinian Authority should introduce major changes in its economic management policies, mainly in the direction of minimizing the role of the political echelon in private sector activities. Project identification and evaluation and funding arrangements can be shouldered increasingly by private firms and local institutions rather than government bureaucracies. Similarly, the Palestinian Authority’s role in arranging business transactions and disbursing concessions, presumably in an effort to generate government revenues, should be strictly avoided, because of its adverse impact on private sector performance.

Public services bearing on investment relate in various degrees to the performance of all governmental agencies, even those which are not directly involved in the economy. Raising the level of services rendered by these institutions and establishing a clear division of authority between them is one of the highest priorities. Evidently, this is a complex and long-term undertaking which cannot be delineated in this study. The process of reorganization of the public institutions could benefit from the expertise of public administration consulting firms. The following is a list of the major issues which have to be addressed in this respect:

- Relations between the role of PECDAR and the economy-related Ministries;

- Respective roles of the Ministries of Trade and Economy, Industry, Planning and International Cooperation, Finance, and Justice;

- The division of labour between the Ministry of Finance and the Palestinian Monetary Authority;

- Formulating a civil service recruitment code, which defines effective mechanisms to safeguard against factionalism and favouritism in the recruitment process.

Due to the particularly high expectations attached to clarifying the above and related issues affecting public sector institution-building, it is important that any proposed reforms are implemented in full by concerned Palestinian officials.

In the private sector, chambers of commerce are well placed to play a vital role in facilitating private investment and cultivating a healthy investment climate. They can play a central role in catering for the following services:

- Providing a venue for procuring and exchanging market information solicited from international and local firms and commercial attachés;

- Monitoring the implementation of the trade agreements concluded between the Palestinian Authority and its trading partners, especially Israel and Jordan. A detailed feedback on trade flows has to be constantly relayed to appropriate official Palestinian agencies. Chambers of commerce should be particularly sensitive to identifying and exposing non-tariff trade barriers which might be resorted to by foreign trading partners;

- Maintaining constant surveillance of the legal and regulatory frameworks, especially in regard to the ways they are implemented. Inefficiencies and irregularities should be promptly dealt with in collaboration with appropriate Palestinian organizations;

- Playing an active role in organizing and hosting trade fairs, both locally and abroad;

- Performing useful functions in establishing constructive relations between their members and the local banking community.

Chambers of commerce can also play a vital role in generating a stream of investment ideas, and evaluating them at a pre-feasibility level. Project proposals should be made available to potential investors on an open basis against reasonable fees. Provision of such services by chambers of commerce, however, should be viewed as a complement to, and not a substitute for, specialist enterprises engaged in economic and market research.

Most Palestinian chambers of commerce are qualified to play a considerably more active role, both in terms of the calibre of their board members and the size of their office premises. But chambers of commerce have had inadequate exposure to modern means and modalities of operation within a modern and competitive international setting. As a prelude to assumption of a more dynamic role, it is strongly recommended that in-depth research be conducted on the role and capacities of Palestinian chambers of commerce, including recommendations for enhancing their role in business- and investment-promotion activities. As an important prerequisite for taking up a higher profile in the Palestinian economy, district chambers of commerce should be encouraged to give greater weight and credibility to the Federation of Chambers of Commerce, based in east Jerusalem.

The organizational issues and potential range of functions to be undertaken by this institution should also be delineated in the study mentioned above.

The great interest in the growth prospects of the Palestinian economy can be mobilized into more concrete directions by establishing economic and marketing research facilities which are capable of providing sound advice to firms on commercial grounds. Interest in establishing such institutions is already strong, and concrete steps have been taken by some banking and investment facilities in that direction, mostly in collaboration with expatriate enterprises. The performance of such enterprises will be heavily affected by the nature of services provided by NGO-affiliated "private sector" supporting programmes. The emergence of business-oriented consultancy firms will be hampered if NGOs provide free consulting services to enterprises doing business in the territory.

4. Human resources and technical assistance needs

Technical assistance and training needs are apparent in all sectors of the Palestinian economy. Technical assistance, in the form of short-term training, occasional consultation, and appropriate software should be provided to local banks, other credit institutions and insurance companies in order to strengthen their capacity to plan, manage and evaluate their activities. Technical assistance is particularly needed in regard to the management of policy instruments for financial regulation and standardized credit applications.

Regional and international trade is of fundamental long-term significance to the Palestinian economy. In the light of the brief experience of the past few years, it is clear that the Palestinian side badly needs greater skills and experience if they are to engage in equitable competition in domestic and external markets. In addition, since a sizeable proportion of the technologies used in modern services are embodied in people, the development of indigenous modern services is conditional on the infusion of appropriate human skills in a wide range of occupations including scientific and technical personnel, as well as economists, statisticians, accountants, lawyers, managers, administrators and other science/skill-intensive occupations. In the long run, the development of a dynamic Palestinian services sector will require policies aimed at upgrading domestic technical and educational infrastructures and programmes across the board.

Awareness of the high priority of training needs in the Palestinian territory is felt at all levels of the public and private sector. This is abundantly exemplified by the pronounced growth in the scope of training activities which are being sponsored by Palestinian institutions, international organizations and NGOs. The proliferation in such activities has in fact reached the point where the relevance and the quality of sponsored training activities are being questioned. One of the highest priorities, therefore, is to structure an efficient mechanism for planning and coordinating all training and manpower development activities.

The range of areas in need of more advanced training is far too wide to ascertain in this report, and they extend much beyond those related to the economy. In the field of investment, technology acquisition, financial management and external trade, the UNCTAD secretariat has proposed an integrated programme of technical cooperation activities, including group training at different managerial levels. 72/ In addition, the following is a partial list of additional training needs with a direct bearing on economic activities:

- Training of manpower employed in all government institutions bearing on the economy (e.g. planning, tax administration, trade fairs, trade negotiations, legal infrastructure);

- Identification and evaluation of new projects;

- Business management skills as they are practised in modern market economies;

- Advanced technical training in all facets of production and marketing. This need is felt to various degrees in all economic branches, including agriculture;

- Maintenance of modern machinery and equipment. This is gaining increasing priority in view of the accelerated pace of mechanization and the introduction of new technologies.

Notes

1/ This has been documented in studies and annual reports by the UNCTAD secretariat since 1986, as well as in subsequent research on the issue by the World Bank, "Developing the occupied territories: an investment in peace" (Washington, D.C., 1993).

2/ Basil Jardaneh, "Prospects for closer integration of banking in the region", a paper presented at the Conference on Financial Markets in the Middle East, London, May 1994. Also see "The Palestinian financial sector under Israeli occupation" (UNCTAD/ST/SEU/Rev.1), p. 45, for a detailed account of banking and credit institutions in the occupied territory.

3/ This has been documented in various non-Palestinian sources, such as "The Palestinian financial sector ..." (UNCTAD/ST/SEU/3/Rev.1) op. cit., the annual reports of the West Bank Data Base Project (1986, 1987, 1988) and World Bank "Developing ..." op. cit. A large number of studies, reports and other documents by Palestinian researchers have added to the coverage of this issue.

4/ For comprehensive review of trade issues, see: "Palestinian external trade under Israeli occupation" (UNCTAD/RDP/SEU/1), 1989; and "Main features of domestic and external merchandise trade of the West Bank and Gaza Strip" (UNCTAD/ECDC/SEU/5), 1994.

5/ The new lines of Israeli thinking on economic policy in the territory were most effectively articulated in a report submitted by a committee of experts commissioned by the Government, and headed by Haim Ben Shahar, the former President of Tel Aviv University. Many of the findings and recommendations of the report were gradually implemented by the authorities as of 1991.

6/ For a review of developments in this regard between 1991 and 1993, see "Developments in the economy of the occupied Palestinian territory" (TD/B/40(1)/8), paras. 4-7.

7/ As assessed through structured interviews in mid-1995 at the field level with Palestinian and Arab officials, bankers and businessmen.

8/ As assessed from interviews with local experts and from views expressed in local seminars and media.

9/ Mohammed Doofesh, "The intellectual property system in Gaza and the West Bank", presented at the Seminar on Intellectual Property in the Arab World, N.Y., December 1995.

10/ Some of these points have been discussed in: Basim Makhoul and Hisham Shakhshir, "The Palestinian investment encouragement law - an economic and legal analysis", in Palestine Policy, No. 7, Summer 1995.

11/ Al-Sharq al Awsat, 11 November 1995 (in Arabic).

12/ These are the working terms by which new bank branches have been permitted to open in the territory by the Israeli authorities, as effectively endorsed by the terms of the Israel-Palestine Economic Protocol of 1994.

13/ For an in-depth analysis of the issues relating to monetary policy in the interim period, see "Prospects for sustained development of the Palestinian economy: policies and strategies for reconstruction and development" (UNCTAD, forthcoming 1996).

14/ Nasr Abdel Karim, "The feasibility of a Palestinian Security Market", 1994 (unpublished report).

15/ Al-Quds al-Arabi, 22 March 1995 and interviews with officials of PADICO, Amman, April 1995.

16/ An interview with the Under-Secretary of the Ministry of Finance.

17/ See Economist Intelligence Unit, "Country report: Israel and the occupied territories", 1st and 2nd quarters 1995; Judy Maltz, "The Paris economic protocol one year on: an Israeli perspective" in Peace economics, (EIU Newsletter), 3rd quarter, 1995.

18/ As reported by the Governor of the Palestine Monetary Authority in Middle East Economic Survey, (MEES 39:8), 20 November 1995, p. B3.

19/ Economist Intelligence Unit, "Country report: Israel, the occupied territories", 3rd Quarter 1995, p. 41.

20/ Ibid.

21/ "Palestinian banking sector: statistical review" (Jerusalem: Palestinian Economic Policy Research Institute - MAS), June 1995. Similar figures and ratios are indicated in statistics provided by the Central Bank of Jordan, Research Department, April 1995, covering Jordanian bank branches’ activities in the territories.

22/ MEES, 39:8, op. cit.

23/ World Bank, "Developing ...", op. cit., Vol. III, p. 74.

24/ MEES, 39:8, op. cit.

25/ Nasr Abdel Karim, "The accounting profession in the West Bank and Gaza Strip: current status and prospects for development", Journal of Certified Accountants, Amman, June 1994.

26/ Interviews with Palestinian insurance brokers, Al-Hayat, 27 December 1995 (in Arabic).

27/ Ibid.

28/ Ibid.

29/ As reported by major money-changers interviewed in Nablus.

30/ See Harris, L., "Money and finance with underdeveloped banking", in G. Abed (ed.), The Palestinian economy - studies in development under prolonged occupation, London, Routledge, 1988, p. 196.

31/ Unless otherwise indicated, data quoted in this section are UNCTAD secretariat estimates, based on its Economic Time Series (ETS) statistical database for the period 1967-1990.

32/ Private savings are generally greater than national savings owing to inclusion of private transfers when calculating the former and the deduction of government consumption when calculating the latter.

33/ See, Israel, CBS, Statistical abstract of Israel, (Jerusalem, CBS, 1991) p. 723.

34/ Quoted in World Bank, "Developing ..." op. cit., Vol. III, p. 85.

35/ UNCTAD secretariat estimates are derived from the calculations in "Prospects for sustained development of the Palestinian economy in the West Bank and Gaza Strip, 1990-2010: a quantitative framework" (UNCTAD/ECDC/SEU/6 and Add.1). World Bank estimates indicate investment ratios in the middle of this range in the post-1987 period, at an annual average of 26 per cent, in World Bank, "Developing ...", op. cit., Vol. II.

36/ UNCTAD secretariat estimates and other sources, in "Developments in the economy of the occupied Palestinian territory" (TD/B/1305).

37/ World Bank, "Developing ...", op. cit., Vol. III, p. 86.

38/ World Bank, "Developing ...", op. cit., Vol. III, p. 95.

39/ An ICOR of 3 is the historical average obtained by dividing total investment by change in GDP, excluding negative and inordinately high values. This is a slightly lower ICOR than the values quoted by the Jordan Ministry of Planning in Programme for economic and social development in the occupied homeland, 1986-1990, (Amman, The Ministry, 1986). According to that document, the historical value of ICOR equalled 5, but an ICOR of 4 was chosen for programming purposes. On the other hand, Dr. A. Kubursi utilized an ICOR of 3 in his study entitled "The economic viability of an independent Palestinian State" (prepared for the International Conference on the Question of Palestine, Geneva, 1983), p. 12.

40/ See "Sources of socio-economic statistics on the West Bank and Gaza Strip" (UNCTAD/ECDC/SEU/10) for an in-depth examination of the problems encountered in statistical collection and published series since 1988.

41/ See Ibid.

42/ See Jerusalem Post Magazine, 10 November 1995.

43/ World Bank staff mission estimates, quoted in EIU, "Country report ... 3rd Quarter and 4th Quarter 1995", op. cit.

44/ UNCTAD secretariat estimates, as calculated in "Prospects for sustained development ..." (UNCTAD/ECDC/SEU/6) op. cit., pp. 40-43 and 55-61.

45/ Palestine Development and Investment Ltd. "PADICO", "Investing in rebuilding Palestine", brochure, 1995.

46/ Jerusalem Post Magazine, 6 January 1996.

47/ EIU, "Country report ... 3rd Quarter 1995", op. cit. p. 41.

48/ Al-Quds al-Arabi, 27 October 1995 (in Arabic); Jerusalem Post Magazine, 3 January 1996.

49/ Middle East Economic Digest, 1 December 1995, p. 12.

50/ Economist Intelligence Unit, Peace economics, (Newsletter, 2nd quarter 1995), pp. 15-17.

51/ Ibid., p. 18.

52/ Ibid.

53/ Nadir Said and Basim Makhoul, "A study of unemployment in the West Bank and Gaza Strip", Nablus, Centre for Palestine Research and Studies, 1995.

54/ Samir Awad and Hisham Awartani, "Palestinian-Israeli joint ventures-constraints and prospects", Nablus, Centre for Palestine Research and Studies, 1994.

55/ Jerusalem Post, 11 September 1995.

56/ This section draws upon the contribution of Prof. Fadle Naqib in "Prospects for sustained development ... policies and strategies", op. cit.

57/ "Prospects ... a quantitative framework (UNCTAD/ECDC/SEU/6)", op. cit., Alternative Scenarios III and V.

58/. See Gersovitz, M., "Saving and Development", in Hollis Chenery (ed.), Handbook of Development Economics, Vol. 1, Chapter 10 (North Holland, 1988).

59/ A tax reform implies changing the tax base and/or the tax rate while keeping the tax revenue the same.

60/ In both agriculture and small businesses, it is very hard to collect income tax with graduated tax rate. On the other hand, the lump sum tax is neutral to incentives.

61/ In the United States those schemes are called Individual Retirement Account (IRA) and in Canada, Registered Retirement Saving Plan (RRSP). There is some evidence that those schemes tend to increase personal saving see, Venti, S.F. and Wise, D. A., "Have IRAs increased U.S. saving? Evidence from consumer survey," Quarterly Journal of Economics, August 1990, pp. 661-698.

62/ See Todaro, M., Economic Development, Longman 1994, p. 605.

63/ World Bank, "Developing ... ", op. cit., Vol. II, p. 61.

64/ The other major danger during a period of large flows of external aid is an appreciation of the real exchange rate, leading to a decline in external competitiveness. This phenomenon can accompany a transfer of external resources. See "Prospects ... policies and strategies" op. cit., for an analysis of the implications of this phenomenon in the Palestinian context.

65/ See "Prospects ... quantitative framework" (UNCTAD/ECDC/SEU/6) op. cit., and the World Bank estimates in "Developing ..." op. cit., Vol. I.

66/ International Monetary Fund, "West Bank-Gaza Strip: tariff, trade and customs administration issues" (staff mission report), September 1995.

67/ Hisham Awartani, "West Bank and Gaza agriculture - an institutional and policy study", (Jerusalem, PECDAR), January 1995.

68/ See "Developments in the services sector in the West Bank and the Gaza Strip, 1967-1990" (UNCTAD/SEU/ECDC/7).

69/ "The tourism sector and related services in the Palestinian territory under Israeli occupation" (UNCTAD/RDP/SEU/7), p. 37.

70/ For a detailed discussion of tourism-related institutions, refer to ibid.

71/ This section draws on the findings of an UNCTAD secretariat advisory mission report (prepared by Mr. Antoine Basile, ASIT/DTCI), October 1995.

72/ "A programme of technical cooperation activities in support of Palestinian trade, finance and related services" (UNCTAD/ECDC/SEU/11).

Table 1. Companies in the West Bank
By type and year of registration

Type of company	Until 1992	1993	1994	Jan-May 95	Total
Ordinary unlimited	574	55	75	76	780
Ordinary limited	10	-	1	2	13
Foreign	-	-	1	-	1
Private (local)	1 025	297	607	271	2 200
Private (foreign)	2	-	3	10	15
Public share holding	29	9	3	12	53
Foreign share holding	1	-	10	2	13
TOTAL	1 641	361	700	373	3 075

Source: The Companies Registrar, Ramallah, 1995.

Table 2. Companies in Gaza Strip
By type and year of registration

Type of company	Until 31/5/1994	From 31/5/94 until 20/12/95	Total
Ordinary domestic	569	498	1 067
Ordinary foreign	-	6	6
Private shareholding	274	976	1 250
Public shareholding	6	8	14
Foreign shareholding	18	50	68
TOTAL	867	1 538	2 405

Source: The Companies Registrar, Ministry of Justice, Palestinian Authority, Gaza Strip, 1995

Table 3. Selected services establishments in the Palestinian territory, 1994

	West Bank		Gaza Strip	
	Establ.	Employed	Establ.	Employed
All types of establishments				
Total:	37 408	102 298	19 412	44 920
Thereof:				
Land transport	93	693	59	389
Sea transport	4	15	-	-
Financial services	183	1 017	71	507
Insurance services	35	87	19	104
Computer services	18	106	8	74
Research and development	11	58	2	17

<u>Source</u>: <u>The establishment census, 1994</u>, (Jerusalem, Palestinian Central Bureau of Statistics, 1995) pp. 30-33.

Table 4. Bank branches in the Palestinian territory
(Spring, 1995)

Name of bank	Number of branches West Bank	Gaza Strip	Total
Cairo-Amman Bank	11	4	15
Bank of Palestine	1	7	8
Arab Bank	4	1	5
Arab Land Bank	2	1	3
Bank of Jordan	4	1	5
Jordan-Gulf Bank	1	0	1
Commercial Bank of Palestine	1	0	1
Palestine Investment Bank	0	1	1
Jordan National Bank	1	0	1
ANZ Grindlays	1	0	1
Total	26	15	41

Source: Palestinian banking sector: statistical review (Jerusalem: Palestinian Economic Policy Research Institute - MAS) June 1995.

Table 5. Volume of loans provided by Palestinian credit NGOs, October 1995, (US$ million)

Credit institution	Loans
Economic Development Group	9.78
Technical Development Company	6.60
Agricultural Development and Credit Comp.	6.50
Total	22.88

Source: Interviews with senior NGO officials, 1995.

Table 6. Motor vehicles in the Palestinian territory, by type, 1970 and 1993

	West Bank*		Gaza Strip	
Type of vehicle	1970	1993	1970	1993
Private vehicles	1 626	67 942	1 293	20 434
Trucks & commercial vehicles	1 299	19 984	1 053	4 518
Buses & minibuses	394	739	28	121
Taxis	828	1 258	750	772
Motocycles & scooters	134	684	175	70
Tractors	459	4 935	36	887
Special service & other vehicles	153	964	13	145
Total	4 893	96 506	3 348	26 947

<u>Source</u>: Israel, Central Bureau of Statistics, <u>Statistical abstract of Israel, 1978</u>, Jerusalem (CBS), p. 802; <u>1994</u>, p. 826.

* Excluding east Jerusalem

Table 7. West Bank and Gaza Strip,
main national income aggregates, selected years, 1972-1990
(US$ million at 1990 prices)

	1972	1975	1980	1987	1990
West Bank & Gaza Strip					
GDP	559.8	939.5	1 155.9	1 881.4	1 302
GNP	746.6	1 280.9	1 561.0	2 613.9	1 850
Private invest.	90.9	167.4	344.9	491.4	414
Govt. invest.	26.6	61.9	32.4	100.7	36
West Bank					
GDP	376.3	646.6	809.6	1 400.2	1 002
GNP	490.1	855.9	1 033.4	1 785.1	1 356
Private invest.	63.4	104.1	241.8	349.1	276
Govt. invest.	10.9	28.4	18.0	72.2	19
Gaza Strip					
GDP	183.5	292.9	346.3	481.2	300
GNP	256.5	425.0	527.6	828.8	494
Private invest.	27.5	63.3	103.1	142.3	138
Govt. invest.	15.7	33.5	14.4	28.5	17

Source: "Prospects for sustained development of the Palestinian economy, West Bank and Gaza Strip, 1990-2010: a quantitative framework", (UNCTAD/ECDC/SEU/6), p. 17.

Table 8. Gross domestic capital formation, by major sector and asset,
selected years, 1970-1991
(NIS million at 1986 prices)

	Private sector			Government	Total
	Construction	Machinery	Total	Total	GDCF
West Bank & Gaza Strip					
1970	35.1	89.6	91.9	38.0	138.9
1975	256.2	60.5	322.6	75.3	403.1
1980	410.6	74.5	481.6	43.0	518.9
1987	473.5	131.3	604.8	121.9	726.7
1991	..	..	..	83.0	..
West Bank					
1970	25.7	80.9	68.1	19.7	91.7
1975	186.3	42.1	227.6	36.2	263.6
1980	264.8	60.9	325.4	24.9	345.0
1987	344.5	91.7	436.1	89.3	525.4
1991	..	..	..	69.0	..
Gaza Strip					
1970	9.4	8.7	23.8	18.3	47.2
1975	69.9	18.4	95.0	39.1	193.5
1980	145.8	13.6	156.2	18.1	173.9
1987	129.0	39.6	168.7	32.6	201.3
1991	132.0	15.0	149.0	14.0	156.0

<u>Source</u>: <u>Statistical abstracts of Israel</u>, quoted in World Bank, <u>Developing the occupied territories: an investment in peace</u>, (Washington D.C. 1993), Vol. 2, 1993, p. 146.

Table 9. Construction indicators: area initiated and permits issued, Ramallah and Al-Bireh, 1992-1995

	Al-Bireh		Ramallah	
Year	Area (m2)	Permits	Area (m2)	Permits
1992	64 064	120	49 167	94
1993	100 112	186	77 529	94
1994	207 240	232	119 056	125
1995 (Jan-March)	39 883	46	78 199	49

Source: Samir Abdullah, "The construction sector in the occupied Palestinian territories", a paper submitted to the conference between Jordanian and Palestinian businessmen, 5-7 June 1995, Amman.

Table 10. The Palestinian Development Programme (1994-2000), sectoral distribution of investment - US$ million at 1991 prices

Sector	$ million	Per cent
Water resources & agriculture	1 198	10.3
Industry	405	3.5
Energy	625	5.4
Construction	5 789	49.7
Infrastructure	2 906	24.9
Other services	725	6.2
Total	11 648	100.0

Source: The Palestinian development programme, (Tunis, The Palestine Liberation Organization, Department of Economic Affairs and Planning, 1993) p. 1121.
