



Palestine Economic Policy Research Institute

Critical Review of the Proposed Palestinian Industrial Law

Basim Makhool
Nasr Atyani

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3. The internal scientific committee supervises the work of the researcher or team of researchers through periodic progress reports.
4. The initial draft of the study is reviewed by the scientific committee for objective content-related amendments to be added to the second draft.
5. The second draft is then submitted for evaluation in accordance with the terms of reference to two or three external academic experts specializing in the subject. Provided that there is a positive evaluation by at least two experts, the researcher is asked to review the study taking into consideration the objective recommendations of these experts.
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8. Research papers written in English are translated into Arabic and published in both languages. An executive summary in English is attached to research papers written in Arabic.

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Abstract

In line with its mission, the Palestine Economic Policy Research Institute (MAS) assists official and non-governmental Palestinian decision-makers to evaluate available alternatives and options and strengthen opportunities for sustainable development through appropriate economic legislation and its implementation within a legal framework. This critical and analytical review was conducted to contribute to the development of the proposed industry law. This legislation aims to strengthen the competitiveness of the Palestinian industrial sector locally and internationally and expand its role in economic development.

This study surveyed the characteristics of the Palestinian industrial sector and the structural obstacles hindering improvements in its performance. These characteristics are as follows:

1. Excessive sensitivity to Israeli policies due to heavy dependence (90%) on raw materials imported from or via Israel and the reliance of some branches of Palestinian industry on subcontracting relationships with Israeli firms.
2. Incomplete industrial clusters and the absence or weakness of forward and backward linkages.
3. Small size of firms operating in the industrial sector. About 90% of industrial firms employ less than five workers and the majority are family or individual businesses.
4. High cost and low quality of infrastructure services.
5. Lack of support from relevant bodies, including funding institutions, unions and business associations.
6. More than 90% of existing industrial firms are self-financing, resulting in a low volume of investment in the industrial sector.
7. The lack of an overall industrial policy and a weak investment environment in Palestinian areas.

Some schools of economic thought justify government intervention in the economy, and in the industrial sector in particular, in cases where the market mechanism fails to achieve optimal allocation of economic resources. Many tools are available for government to influence industrial sector activities. These include legislation aimed at price control, the organization of industrial sector activity, trade policies, monetary policies, fiscal policies, labor policies, and labor regulations. These are in addition

to the government's role in determining industrial policies and legislation. The government's role can be indicative, i.e., only drawing up general economic rather than specific policies and relying on the market for the implementation of these policies. Government may also play a supportive role. In this case, the government determines the general trends but at the same time sets out some specific policies that push industrial activity in a certain direction and help companies to move towards specific activities. The state may also invest in certain industries, as in Germany for example. Government can play an active role by directly supporting industrial activities in certain fields. This includes targeting specific firms in some sectors to help them adjust to new changes. The government's role may be also central whereby the government assumes or takes control over all investment and production.

The experiences of other countries in the field of industrial legislation can be summarized as follows:

1. The role of regulations and legislation as a tool of industrial policy is receding due to the requirements of the GATT agreement. This has reinforced the role of financial incentives, particularly credit policies, competitive policies, and institutional support as the preferred tools for industrial policies.
2. The setting up and implementation of effective industrial policies requires the presence of qualified government bodies free from political and party pressures.
3. Permanent trade protection policies may embroil companies in a vicious cycle. Effective protection has to be temporary and removed on a gradual basis.
4. Lack of efficiency among government bodies in charge of implementing industrial policies is one of the main factors for the failure of these policies.

To improve areas of weakness in the proposed law, we suggest the following modifications:

1. Regarding the definition of terms cited in the law

- ✧ The definition of the industrial firm needs to be changed to make it possible to differentiate between firms considered as industrial and those dealing in services. In this regard, we suggest the use of the International Standard of Industrial Classification (ISIC) which classifies firms into specific sectors.

- ✧ Clarification of how to calculate the 35% of value added that has to be created locally to classify a product as “locally made” and the activities that enter into the manufacturing process. For example, are design, finishing, packaging, transportation, and marketing manufacturing processes or not?
- ✧ Identification of the authority responsible for determining this percentage. Will it be the Ministry of Industry, Ministry of Finance, Ministry of Economy, or another authority?
- ✧ Clarification of the definition of several concepts cited in the proposed law, such as imported goods which have similar counterparts locally, national economic interests, convincing reasons, criteria determined by minister, performance of firms, organization of industrial activity, size of firms and the means of measuring them. There are further expressions in the proposed law that are unclear.

2. Regarding ministerial duties and goals

- ✧ It is preferable to restrict the duties of the Ministry to two major areas and leave detailed tasks according to the prevailing circumstances upon application of the law. The main tasks of the Ministry are the preparation of programs and projects to strengthen the competitiveness of Palestinian industry and setting up means to organize the industrial sector.
- ✧ The word “contribution ” needs to be added to the articles stipulating the duties of the Ministry in the field of promotion, upgrading workers’ skills and finding sources of funding.

3. Regarding industrial licenses

- ✧ The level of change in the size of the firm requiring advance approval from the Ministry needs to be determined. That is, does an increase in capital from \$1000 to \$1001, or an increase in the number of workers from 100 to 101, require Ministry approval? This also applies to products. Is approval required only for the introduction of totally new products or is it also needed for a mere change in shape, color or volume of existing products?
- ✧ The period required to obtain a decision on a license application should be reduced from 40 days to 15 days.

- ✧ The reasons for the withdrawal of a license should be made known and the investor given a specific period to correct his status and resort to the judicial authorities prior to the withdrawal of a license.
- ✧ This legislation should be applied to firms which come into being after the law takes effect while existing industrial firms should be given sufficient time to correct their status (at least 6 months).

4. Regarding industrial registration

- ✧ Determining the nature of data required for industrial registration, the privacy of these data, and the authorities that have the right to use them.

5. Regarding the promotion of industrial investment

- ✧ In the absence of an official public policy granting industry preference over other economic sectors, it would be better to cancel the additional incentives in the proposed law and use only the existing incentives provided by the Investment Promotion Law. The criteria for protection needs to be determined in terms of the period protection should last, the level, means of withdrawal, branches of industry requiring protection, and follow-up of protected firms to check performance over time. We therefore suggest the creation of a committee made up of the relevant authorities, including the Ministries of Economy, Industry and Finance. This committee would be responsible for determining protection criteria and evaluating the effects on both producers and consumers.
- ✧ The additional tax exemptions for industrial firms stipulated in the proposed law should be removed since the current value of these exemptions would be minimal and would therefore not affect investment.
- ✧ The establishment of a database on investment opportunities, sources of funding, marketing outlets, international market trends, sources of raw materials, equipment, and technological developments would encourage investment incentives. This would be in addition to the setting up of a body in the Ministry to help investors keep up with and exchange technology.
- ✧ The role of the Ministry should be restricted to decisions on promising projects and sectors and should leave the preparation of feasibility studies to investors.

- ✧ The Ministry cannot provide guarantees for loans provided to the private sector since it would be liable financially if the debtor failed to repay the loan.
- ✧ The provision allocating 0.5% of customs revenues to the development of the industrial sector should be cancelled since it is in violation of Article 6 of the Organization of Budget and Financial Affairs Law of 1998.
- ✧ The provision allocating a portion of donors' funds to Palestine for the development of the industrial sector should be removed since it is better to leave this task to a government body charged with distributing financial aid to different economic sectors.

6. Regarding industrial standards and specifications

- ✧ A further condition should be added requiring industrial firms to meet Palestinian standards and not leave this to the manufacturers' discretion.
- ✧ There should be additional articles to support and encourage Palestinian industrialists to meet standards and specifications required by international markets.

7. Regarding supervision and industrial control

- ✧ The role of other parties in the process of control and inspection needs to be clarified. These include the Ministry for Local Government, Ministry of Health, Ministry of Environment and Ministry of Labor. Industrial firms face many authorities that claim to be in charge of inspection and control.
- ✧ The standards and qualifications of the inspection officer must be specified since his responsibility is of great importance and sensitivity.

8. Regarding penalties

- ✧ Rather than closure as stipulated in the proposed law, other ways should be found to solve the problem of unlicensed firms (about 89% of industrial firms). These could include the creation of appropriate industrial zones, or financial and procedural incentives to encourage them to license or relocate. Financial incentives include tax exemptions and the provision of reliable infrastructure services in new areas at low cost.

