



Palestine Economic Policy Research Institute

**Enhancing the Labor Absorptive Capacity
in The West Bank and Gaza Strip :
Options and Policies**

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Abstract

a. Introduction

Structural imbalances within the Palestinian economy make it unable to absorb the available labor force, creating a large surplus of workers and a dangerous growth in unemployment in Palestine. Whilst the establishment of the Palestinian National Authority (PNA) absorbed a large portion of Palestinian surplus labor, public sector employment has limited capacity and there are indications that it cannot absorb more of the labor force. The PNA has attempted to improve the absorption of labor in the West Bank and Gaza Strip (WBGS) through a package of comprehensive economic and labor policies yet these policies have failed to motivate the Palestinian private sector to absorb the burgeoning labor force. This may be attributed in part to objective circumstances such as continued Israeli control of economic resources and border crossings, and the economic challenges brought about by dramatic regional and world changes. Other factors include the modest performance of fledgling government bodies and the weakness of the private sector.

b. Characteristics and performance of labor market in Palestinian Territories

The Palestinian labor market is characterized by a rapid growth in the labor force which outstrips demand. This forces a growing number of Palestinian workers to search for job opportunities outside, particularly in Israel, or to join the ranks of the unemployed. The gap between labor supply and demand in the WBGS is increasing dramatically and indicates that the absorptive capacity of the Palestinian economy is receding with time. Studies of the demand for labor show that industrial labor has fallen in the WBGS. Labor in the construction sector has risen in the West Bank but fallen in the Gaza Strip. In the services sector, hotels and restaurants, transport, storage and communications, there has been a steady demand for employment. While the relative importance of agricultural labor in the West Bank has fallen, there has been a rise in this sector in the Gaza Strip. There was growing Palestinian dependence on the Israeli labor market prior to the outbreak of the Al-Aqsa Intifada in Sept. 2000 but this has now dropped sharply.

The Palestinian Territories have a youthful population with high growth rates. There is a low labor force participation rate, particularly amongst women, and high levels of education. Unemployment fluctuates according to the prevailing economic and political circumstances and according to the policy of closure and siege operated by Israel that limits the flow of Palestinians to the Israeli labor market. Unemployment is higher in the Gaza Strip than in the West Bank and is more prevalent among women than among men. Unemployment is lower amongst those with higher levels of education.

C. Lessons learned from international experiences in active, macroeconomic and sectoral labor policies

Active labor market policies are defined as measures taken to increase opportunities for the unemployed to find work through influencing the demand for labor and/or labor supply. The measures taken comprise direct job creation programs, training and retraining, wage subsidies, employment services, self-employment, and the expansion or establishment of small enterprises. Such direct labor policies have drawbacks which may counteract their potential positive effects due to the effects of displacement, substitution and deadweight, plus possible incompatibility with the prevailing environment. Studies of active labor policies in some OECD countries have shown that, in general, the effect of these policies in combating unemployment was very limited but they do have a social role in fighting poverty, assisting underprivileged groups, and developing a quality labor force. The influence of active labor policies depends largely on macroeconomic conditions and the social and institutional environment. Their positive influence increases as economic performance improves. It was also found that employment services, including employment offices, are the most efficient and least costly measure. When designing active labor policies, the goals need to be identified before choosing tools and programs. In addition, the private sector should be involved in setting up and implementing programs and policy-related activities, a permanent dialogue conducted with the relevant parties, and infrastructure services provided for the labor market. Coordination needs to take place among the relevant government bodies to draft, implement and evaluate labor policies and set in place regulations and mechanisms to execute and evaluate these labor policies.

Sectoral and macroeconomic policies focus on creating employment through investment, which generates economic growth coupled with high employment elasticity. This works in conjunction with policies to lower labor costs, including the lowering of taxes on labor. Absorptive capacity can also be improved through correcting economic structural imbalances such as in price levels, whether in wages or in the price of production factors, interest rates, or exchange rates. Restructuring policies cover the budget and trade deficit, tariff and non-tariff protection measures. Such policies aim to correct these distortions and increase economic growth, expanding employment and freeing and opening the economy to the external world. They also aim to increase investment through the removal of barriers found in input and goods markets. Measures to achieve this can include expanding the role of the private sector, using a realistic rate, decreasing the budget and trade deficit, and developing infrastructure to attract both foreign and local investment.

The most important lessons drawn from the experiences of other countries in macroeconomic policies and their reflection on labor markets can be summed up as follows: the importance of timing the measures required to reduce trade deficits and the balance of payments; the sequence of short and long term economic policies; the absence of official and unofficial institutions to facilitate the work of the labor market and make it flexible; and the importance of removing obstacles to investment in the private sector and identifying and directing investment to leading economic sectors.

D. Labor policies and macroeconomic policies implemented in the Palestinian Territories since 1994

There is a general consensus, reflected by Palestinian developmental plans and programs and in the recommendations of the International Conference for Employment, that unemployment is one of the most important and pressing problems facing the Palestinian economy. To provide new job opportunities, the PNA has strenuously sought to promote private investment in the WBGS through a package of incentives offered to both local and foreign investors. It has also adopted a number of policies, legislation and work programs aimed at expanding the absorptive capacity of the Palestinian economy and reducing unemployment in the Palestinian areas. The following are a survey of some of these policies:

1. Active labor market policies

1.1 Organization of labor market

The Palestinian Ministry of Labor took control in July 1994 in both Jericho and Gaza. In November 1995, the Ministry assumed complete control over labor policies. To contribute effectively to the achievement of economic growth and social justice through organization of the labor market, the Ministry has updated the legal framework, organized the labor sector, clarified general employment policies, and developed vocational training policies as well as a cooperative movement. Labor unions form the second major group concerned with the organization of the labor market. A new stage in the work of labor unions began to emerge following the establishment of the PNA, focusing on labor issues and workers' problems and concerns. However, in spite of the unions' efforts, their role in these issues remains limited.

1.2 Wage policies

Individual contracts are very common in small enterprises as well as in the informal sector of the WBGS and the PNA does not interfere in determining wages in the private sector. Wage levels in the Palestinian Territories are influenced by the flow of Palestinian labor to Israel. In the public sector, wages are determined on the basis of wage and salary scales adopted by the PNA's personnel office. There are also some public and government institutions that work according to their own salary scale. The government salary scale itself suffers from a number of problems.

1.3 Public employment policies

Public employment policy lacks clarity and transparency. Employment in all sectors, except for health and education, is rarely based on professional or employment criteria but rather on political, factional and personal considerations. The Palestinian public sector has numerous problems: overemployment, a slack government apparatus, an imbalance in functional and administrative structures, low efficiency, high costs, low productivity, low quality of public services and the emergence of administrative corruption.

1.4 Vocational training policies

The WBGS is home to 13 vocational training centers wholly funded and supervised by the Palestinian Ministry of Labor. There are also several vocational training centers run by the UNRWA and non-governmental institutions and societies. Yet, these vocational training centers lack financial and human resources or a clear-cut policy for vocational training that matches programs with the different specialization needs of the labor market.

1.5 Employment services offices

According to the Ministry of Labor, there are 26 labor offices belonging to the General Administration for Employment. Their goals are the provision of employment services for Palestinian employers and workers seeking jobs, monitoring and following up demands in the labor market, and the organization of Palestinian employment inside the Green Line and outside Palestine in coordination with the other relevant authorities. In spite of a number of achievements, the main role of the General Administration for Employment is limited, particularly in matching job seekers with available job opportunities. The real reasons for the modest use by job seekers and manufacturers of employment offices are not yet known.

1.6 Legal framework for employment in Palestine

Palestinian Labor Law 16 of 1964 and Jordanian Labor Law 21 of 1960 currently govern labor relations in Palestine. The PNA has shown a keen interest in unifying and updating labor legislation and regulations effective in the WBGS and has introduced a Palestinian labor law. Compared with previous labor legislation, this law has an emphasis on workers' rights but although it has been approved, its provisions have not yet been implemented.

1.7 Emergency employment programs

These programs aimed to alleviate the social and economic effects of unemployment through the implementation of projects in infrastructure, particularly buildings and sidewalks. It was found that these programs, which focus on job creation, had a positive effect on reducing the severity of poverty compared to other programs aimed at creating infrastructure. Yet, the latter have a greater long-term influence in indirect labor employment and the improvement of infrastructure. Emergency employment programs do not contribute significantly to the infrastructure of the WBGS,

which would, in turn, strengthen and support investment and economic development, for most of the projects focus on the creation of pavements or building renovation.

1.8 Medium-term employment strategy in Palestine 2000-2004

The employment program of the Ministry of Labor is a medium-term employment strategy for Palestine during 2000-2004. Primarily, this strategy aimed to lower unemployment rates from 14.4% in 1998 to 8% by 2004. However, the drawback of this strategy, in practical terms, is its dependence on an intuitive descriptive analysis method of estimation. It lacks any quantitative analysis of economic relations influencing employment levels and fails to address the relationship between the size of required investment and the number of job opportunities to be created, or the nature of the relationship between employment and production and the economic growth required to guarantee a set number of job opportunities. The strategy also neglects sectoral differences in the relationship between employment and the factors influencing it and totally fails to take into account the influence of wage level changes and substitution elasticities in employment. As a result, the proposed strategy is isolated from the general context of the Palestinian national political program and is based neither on objective or scientific foundations, nor on realistic attainable goals. As proof of this, during discussions on this strategy, unemployment in the Palestinian Territories fell to 9% after the opening of the Israeli labor market in 1999. The strategy was merely a theoretical exercise that cannot be used as a base to draft labor policies.

2. Macroeconomic policies in the WBGs and their influence on labor market

Macroeconomic policies aim to provide an appropriate investment environment that promotes investment and steady economic growth coupled with the expansion of employment prospects. Intensive efforts to improve the investment climate for employment during the past eight years have not succeeded. The stalling of the political settlement process and Israel's continued attempts to evade its obligations, the frequent and prolonged closure and siege of the Palestinian territories, the lack of experience and poor performance of PNA institutions, and the priority given to political considerations, have all contributed to an atmosphere inappropriate to investment. The experience of

macroeconomic policies in the WBGs since 1994 can be summarized as follows:

2.1 *Population policies*

The failure of the PNA to adopt serious policies geared towards tackling the high rate of population growth has led to severe developmental consequences.

2.2 *Monetary policies*

Given the absence of a Palestinian national currency, the Palestinian Monetary Authority has no means to determine exchange rates, interest rates, or to influence the money supply. As a result, it is unable to adopt a Palestinian monetary policy conducive to attract foreign and local investment. Investors are reluctant to invest and there has also been a flight of local capital overseas.

2.3 *Fiscal policies*

According to the Paris Economic Protocol, the PNA is largely dependent for its revenues on money collected by the Israeli authorities from customs duties and from income taxes taken from Palestinian workers in Israel. Local revenues in the WBGs represent part of Palestinian general revenues but the PNA has only partial control over fiscal policies since an increase in Palestinian revenues, without a substantial change in the structure of the tax system, automatically means an increase in imports from Israel or Palestinian work in Israel. In the long term, this results in increased dependence by the Palestinian economy on its Israeli counterpart. The Palestinian economy is, therefore, at the mercy of the Israeli labor market and economy.

2.4 *Trade policies*

The agreements reached in the Paris Economic Protocol failed to moderate or lift many of the economic and political restrictions imposed on Palestinian foreign trade by Israel. Israel still controls Palestinian border crossings, airports and seaports. Palestinian foreign trade has inevitably remained concentrated on Israel in spite of attempts by the PNA to diversify trade partners and encourage trade with Jordan, Egypt, the European Union and the USA.

2.5 *Laws, legislation and institution building*

Since 1994, the PNA has established a number of new institutions and extended the powers of other existing institutions. It has passed a series of legislation and regulations to organize and activate economic life. Yet, a number of laws which were approved have not been implemented, leading to ambiguity and a negative environment for the investment needed for economic growth and the expansion of employment. There is much duplication of functions in many public sector institutions and their lack of professionalism and objectivity has forced many investors to take their money out of the Palestinian Territories. This necessarily has negative effects on economic development.

On the whole, PNA control over the elements of macroeconomic policies required for an atmosphere conducive to investment is very limited. The use of economic tools is therefore inadequate, particularly in terms of influencing the labor market. This has weakened the PNA's ability to empower the economy and direct it towards expanding employment. Existing arguments in macroeconomic policies in the WBS are based not on how to control a tool, as in other developing countries, but rather on the possibility of running the economy in the absence of control over a number of macroeconomic tools. The PNA, for example, does not fully control movement through border crossings, interest rates, inflation, rates of value-added tax, customs rates, or duties on imports.

e. *Proposals to expand the absorptive capacity of labor in the Palestinian Territories*

1. *Objectives of proposed labor policies*

The limited absorptive capacity of the Palestinian economy in the WBS and the resulting burgeoning unemployment is one of the main and most pressing problems facing the Palestinian economy and has serious economic and social repercussions. The expansion of absorptive capacity is therefore regarded as one of the most essential goals of Palestinian economic and employment policies, particularly in light of the growth rate of the labor force. In the short run, a national strategy needs to be adopted aimed at expanding the absorptive capacity of the Palestinian economy. Several strategies should be set in place to increase job opportunities and work towards matching labor demand and supply. In addition, Palestinian workers who were employed in Israel need to be retrained in response to and in line with the current and future needs of the local labor market. This strategy

would also assist underprivileged groups in society, fight poverty and improve the poor living conditions of the Palestinian people. In the long run, the goal of the strategy would be two-fold. First, it would work towards the creation of new jobs by expanding the local economic base via increased investment and the development of economic sectors with competitive advantages. Second, this strategy would encourage increased efficiency by the Palestinian labor force through the development of education curricula and vocational training programs. This, in turn, would improve the competitive ability of Palestinian firms, raise their efficiency, and lead to greater levels of production, income, and investment in addition to reducing unemployment and poverty.

The following are potential measures and labor policies that could contribute to enhancing labor absorptive capacity in the Palestinian Territories. These policies are divided into two sets: active market labor policies and macroeconomic policies.

2. Active labor market policies

2.1 Public sector employment

It should first be pointed out that labor policies in Palestine must concentrate on the private sector as a major source of new jobs with the role of the government to provide an appropriate environment for investment. This naturally requires support for and development of the competitive advantage of leading sectors in order to increase their employment, productive capacity, and strengthen their potential to absorb the growing labor force. Available data show that it is not possible to expand employment in the public sector further as a means of combating unemployment in the WBGs. Any developed strategy to expand the absorptive capacity of the Palestinian economy requires restructuring of the existing public sector to enable it to carry out its responsibilities and improve the general environment for investment.

2.2 Labor market organization, Ministry of Labor and labor legislation

Greater powers should be given to the bodies responsible for the labor market in the Palestinian Territories. The Ministry of Labor can enhance an improvement of labor absorptive capacity through the following measures:

1. Consolidating the legal framework, regulating the labor market, and building a social protection network to assist the development and establishment of constructive relations among the relevant bodies. Also, speeding up the issuance of regulations and bylaws necessary for the implementation of the Labor Law.
2. Improving the work environment, developing professional relations, and ensuring that most firms implement the clauses of the Labor Law.
3. Following up the approval of the proposed legislation on cooperatives, setting a clear policy on loans and their collection, and drafting detailed plans for the establishment of a cooperative movement.
4. Drafting specific ideas for a proposal on social insurance legislation and also for a national employment fund to implement programs for the unemployed, create jobs through training, and support wages.
5. Speeding up the establishment of a database on the labor market, conducting analytical studies on labor market developments, and suggesting specific measures to increase its effectiveness.
6. Developing a comprehensive vision for a successful Palestinian cooperative movement within a suitable climate, particularly in rural areas. Labor unions and union-related work also need to be enhanced.
7. Speeding up the formation of a three-tier national steering committee to propose policies on labor and employment as stipulated in the Palestinian Labor Law.

2.3 *Emergency employment programs*

1. All these programs must be linked with plans and policies for economic development.
2. Female participation must be given more attention in the design of these programs. Poverty-stricken areas of the WBGS require special consideration but any program must cover all areas in case of closures.
3. The evaluation of these programs is particularly important to establish to what extent the declared objectives were achieved and to improve the design of future programs.
4. In designing emergency employment programs, there has to be a trade-off between the goal of reducing poverty through creating the greatest number of job opportunities and the

building of infrastructure. This trade-off needs to be accepted rather than attempt to achieve these two goals at the same time.

2.4 *Employment service offices*

The efficiency of employment offices should be increased through the following means:

1. Linking labor offices in the Palestinian governorates with an information network via computer and linking them all with the Ministry of Labor.
2. Providing an accurate information system about jobs and vacancies in Palestinian firms and job requirements.
3. Conducting an awareness campaign about the activities of employment offices and the nature of services provided for both job seekers and employers.
4. Producing periodical publications on the labor needs of manufacturers, the skills required, and disseminating these publications to educational and training centers.

2.5 *Small enterprises*

Small enterprise projects are able to absorb large numbers of workers and, as such, their development should be encouraged through a number of measures. These include the following:

1. Encouraging the implementation of legislation pertinent to banking, strengthening the role of the Monetary Authority as an official body supervising the banking sector, and ensuring that banking services provided to the private sector are improved.
2. Establishing specialized credit institutions to develop investment projects and setting up a specialized credit program for small and medium enterprise projects.
3. Developing credit facilities and encouraging insurance companies to insure loans with a law allowing transferred collateral as a guarantee for bank loans. In addition, appropriate registration services need to be created for these collateral and to speed and facilitate land registration. Investment guarantee programs also need to be established. The PNA must participate in these programs.
4. Amending the Investment Promotion Law or introducing a special law that encourages labor-intensive industries and small investment projects.

5. Considering preferential treatment for Palestinian products in government tenders. Incentives and tax exemption for manufacturers who create new jobs or maintain existing levels of employment should also be provided.

2.6 Training

The technical and vocational training system in Palestine needs a comprehensive overhaul. A team of experts in vocational training have drafted a national plan to create a Palestinian technical and vocational training system that would be more efficient, flexible, and linked to the needs of the labor market. For the objectives of the plan to be achieved the following must take place:

1. A study assessing the efficiency of current training programs and the degree to which they contribute to the needs of the labor market.
2. Periodical surveys to identify the needs of the business sector in terms of skills and know-how and to provide training institutions with the findings for the design of future training programs.
3. Encourage technical and vocational institutions to respond more efficiently to the needs of the labor market.
4. Concentrate the efforts of the relevant bodies, namely the Ministry of Labor, Ministry of Higher Education and labor unions, to develop educational curricula and vocational training to match the supply of qualified people with demand.
5. Establish cooperation between the private and public sectors in the creation and implementation of education and training policies.

2.7 Wage policies

The current financial circumstances of the PNA do not allow for the use of a wage subsidy policy (i.e., sharing the burden of the cost of an employee) and other countries' experiences have proved its inefficiency. Wage levels and available job opportunities for Palestinian laborers in Israel influence the success of wage policy in the Palestinian Territories. A minimum wage needs to be set and a wage committee formed, as per the provisions of the Palestinian Labor Law. A study of the economic and social effects resulting from a minimum wage needs to be conducted speedily. It is anticipated that the provisions of the Palestinian Labor Law will increase the cost of labor in the private sector and the law

stipulates a number of measures that force this conclusion. Some of these measures are pertinent to working hours, leave, severance pay, work accidents, and restrictions in cases of unjust dismissal of workers and the possibility of strikes.

3. Macroeconomic policies in the short term

As noted earlier, macroeconomic policy affects employment through its impact on investment. Accordingly, the channels of impact include project finance, taxes, controlling standards, and government expenditure. Since the demand for labor is derived-demand, factors affecting the demand for goods and services all have a great impact on employment. Given the constraints faced by the Palestinian economy, the role of macroeconomic policy centers on encouraging the investment that leads to employment creation. Economic and political stability are the main factors required to attract foreign investment and therefore economic growth. Despite the limited control of the PNA over macroeconomic tools, there are a number of policies that can be pursued to achieve a certain degree of economic growth and increase employment.

3.1 Political and institutional framework.

The role of the PNA should be limited to monitoring the economy and providing a legal and institutional environment and infrastructure conducive to encourage private sector development and growth.

3.2 Legal framework

Since the private sector is the engine to growth and employment creation, every effort should be exerted to encourage this sector. Despite the fact that the PNA has ratified 35 laws, further legislation is still needed focusing on the economic environment, encouraging accountability and transparency, and protecting the rights of the individual.

3.3 Public administration and public finance

Fiscal policy should aim to balance current expenditure and investment expenditure in favor of the latter. The efficient collection and use of revenues should solve many of the problems relating to budget deficit. Revenues should be diversified and dependency on foreign aid limited, especially with respect to the

financing of capital projects. Severe restrictions must be imposed on the expansion of the public sector and a policy adopted on investment spending which reinforces the optional utilization of available resources.

3.4 *Banking sector development*

PNA policies should encourage the banking sector to provide more loans and import guarantees, as well as financing export activities and small projects. Of course, this has to be done in light of the credit-worthiness of the borrowers. The PNA could also establish a program to provide guarantees for banks on behalf of suitable borrowers to encourage investment and growth and therefore employment creation.

3.5 *Development of infrastructure*

The many plans drafted for the development of infrastructure need to be implemented in partnership between the private and public sectors to improve the capacity of the private sector. In addition, the development of the Palestine Telecommunications Company should be continued, the port of Gaza completed, and the airport opened and expanded for trade.

4. Macroeconomic policies proposed for long term expansion of absorptive capacity of Palestinian economy

Of the important tools pertaining to long-term macroeconomic policies, should the PNA adopt the principle of economic freedom and abstention from direct intervention in determining and fixing rates even though this runs counter to the reality faced by the Palestinian economy? This would prevent the PNA facing the problems encountered by other developing countries and the need to restructure policies, which can sometimes have detrimental and destructive social consequences. Prices must not be fixed, whether for goods or for factors of production, but are left to market movements and determined by both supply and demand. To enhance the ability of the leading economic sectors to create jobs in the short and long terms requires the creation of practical plans for the development of economic sectors, increasing productivity efficiency, strengthening competitive advantage, promoting private investment through investment incentives and the establishment of specialized banks. The introduction of up-to-date technology must be encouraged in addition to legislation to encourage individual sectors and reinforce their

marketing efforts, the ratification of agreements providing an outlet for Palestinian products, and opening regional and international markets for Palestinian products. Other measures required include the preparation and implementation of Palestinian standards and specifications for all Palestinian products, the rapid completion of the zone planning project for the Palestinian Territories, an expansion of areas allocated for construction, and coordination between the private and public sectors in the implementation of sectoral policies.

f. Requirements for success

In spite of the difficult current circumstances, strenuous efforts must be made to expand labor absorptive capacity. This requires the following measures:

1. The PNA needs a much clearer economic vision, particularly concerning the theoretical and practical adoption of economic policy. The PNA should adopt a policy of economic development with clear objectives and priorities, in addition to financial, monetary and credit policies capable of achieving the developmental goals effectively and efficiently.
2. Create an appropriate environment to assist the private sector in starting up and expanding its activities.
3. Conduct a critical review of trade and economic agreements signed with a number of countries and implement economic cooperation agreements signed with both Arab and foreign countries.
4. Create effective coordination between the public and private sectors and supporting institutions. This is in addition to coordination among the various bodies of the public sector: ministries, institutions and departments concerned with labor policies.
5. Restructure PNA institutions, namely the ministries, in light of the growing duplication of responsibilities and powers.
6. Set up national plans to market Palestine (promotion of exports, tourism marketing, and investment) and involve the private sector in trade fairs to promote Palestinian products and services in target markets.