

Introduction

In light of a stalled peace process, intensified Israeli settlement activities, and a tightened chokehold on the occupied Palestinian territory as well as growing settler violence – all of which are restricting economic activity - the Palestinian National Authority is seeking to meet the challenges to economic management with already debilitated powers, worsening economic crisis, market volatility, and endangered social fabric. The harsh conditions for Palestinian decision-makers, businesspeople, and producers have weakened the local market potential to meet the basic needs of different vulnerable groups and produced chronic distortions in the macroeconomic and sectoral performance. Worse, after five decades of the occupation – including more than twenty years of the interim self-government arrangements (which were supposed to end the occupation and lead to national independence in a five-year period) – the Palestinian economy has never been able to integrate into the regional or global economy.

There is widespread awareness of the reasons for failing to reach comprehensive development plans under occupation. While it seems that obstacles to economic development will remain in the medium term, it is imperative to consider what actions are still possible in order to safeguard past achievements and respond to the persistent threats, knowing that unemployment, poverty, inequality in income distribution, and labor market distortions are on the rise due to the decline in economic activity and the absence of balanced development. Therefore, we believe that it is incumbent on us, Palestinians, to deliberate a medium-term national program to meet these urgent challenges. This requires concerted efforts from all Palestinians in the homeland as well as in the Diaspora. Prudent policies are also needed to address these challenges – using the available and potential resources and human talents within a framework of a public, private, and civil society partnership that would contribute to building national resilience and the future independent state.

This book contains a set of studies that the Palestine Economic Policy Research Institute (MAS) has conducted in preparation for “MAS Economic Conference 2016”. The studies provide insights into the policies that should be adopted to help cope with the key economic and social challenges. The short- or medium-term measures, which can be taken to meet or alleviate the impact of these challenges, would in the first place focus on specific outputs in some selected fields before designing sound policies and implementation mechanisms. As we are fully aware of the need for a large-scale national partnership to achieve this goal, we have brought those issues in the spotlight through symposia and discussion meetings held between April and June 2016 as groundwork for the Conference, which will be convened on 31 August under the auspices of the Prime Minister. The Conference is expected to produce policy recommendations to the government – the decision-making body – as well as other stakeholders from the private and civil society sectors.

Through thematic sessions and enhanced discussions, the Conference will provide answers to questions about the role of the economy at this stage: Will Palestinians focus on addressing the impact of the current situation on national resilience? Or will they work to enhance the role of the economy towards building of the state? Or, alternatively, will the economy serve to realize other political and social goals? Do Palestinians still seek to achieve comprehensive and sustainable development, knowing that this is not possible

under the Israeli occupation? The Conference does not, however, aim to deliberate a long-term vision for the economy, nor does it build on the assumption that the occupation will end within a short period. Instead, it tackles pressing problems and tries to provide answers in the short term apart from the unwaived long-term aspirations of the Palestinian people to be rid of the occupation and to exercise fully their inalienable rights.

With a full understanding of this action-restraining context, the studies in this book provide a review of the current political situation implications on the economy, with heavy dependence on the already declining volatile foreign aid, together with weak investments, deteriorations in main economic sectors, increased unemployment – and thus poverty– and stalled development, brought about by Israeli obstacles as well as an internal divide. The studies also examine the role of the current socio-economic development and reform plans/policies in addressing these problems. Part of the effort is geared towards bringing into focus the key challenges that weaken economic growth in the business/trade environment as well as the main productive sectors and infrastructure. The book includes analyses of weaknesses, possible future shocks, and priority issues, so that decision-makers would be able to build medium-term management plans and sound policies that can address such challenges and mitigate their impact.

To set the stage for the Conference, MAS launched a panel discussion in order to reach a national approach to addressing the worsening economic and social conditions. The discussion focused on the following issues:

- A. The features of the current political and economic context, particularly the economic challenges as well as the existing plans/policies to confront them;
- B. The Palestinian vision to address the pressing economic and social challenges, declining productivity, and weak business environment;
- C. The economic and social policies necessary for responding to the challenges and realizing the national vision; and
- D. The mechanisms, tools, and programs required for the implementation of the policies.

These issues are discussed in the four chapters of the book. Chapter I, by Mr. Raja Khalidi, is a diagnostic one as outlines the features of the current economic situation, focusing on the assessment of economic performance and the most important challenges facing the economy, as well as the present plans/policies designed to meet such challenges. Subsequently, Chapters II, III, and IV present remedial analyses. In specific, Chapter II, by Dr. Luay Shabaneh, examines the implications of unemployment and development gaps on poverty and welfare indicators. It also discusses structural reforms in the relevant social sectors. In Chapter III, Dr. Mahmoud El-Jafari looks at the obstacles to trade and analyzes the business environment, particularly the legal/regulatory reforms necessary for the development of business activities. In Chapter IV, Dr. Samir Abdullah studies the challenges of economic growth and the constraints to the productive sectors and infrastructure. The book also contains an appendix which summarizes the most important Palestinian economic and social indicators in 2016.

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Key Features of the Palestinian Economy: Challenges to Endurance and Existing Visions to Address Them

Raja Khaldi

Summary

This paper, prepared for the MAS Economic Conference 2016, examines the main features of the Palestinian economy and the most important macro-economic challenges it faces. The study aims to help identify the most appropriate socio-economic policies needed in a country that is still under occupation while the long-awaited political solution– that leads to an independent Palestinian state in the medium term– is becoming more elusive. The analysis is based on the premise that since 1967 the occupation has created numerous long-lasting obstacles that have plagued the Palestinian economy and national resources and has impaired communal cohesion. This remains the main reason behind the distortion of economic structure and the volatility of economic performance, and has thwarted efforts to translate growth into a comprehensive process of sustainable development. The paper examines setbacks to economic performance which adversely impact the economy as a whole and create different subsidiary problems and distortions, all of which create stubborn interdependent challenges that cannot be ignored, even though the prospects for addressing such challenges are currently highly constrained.

Today after 20 years of Palestinian efforts to achieve ‘unrealizable’ development goals and to enact laws and regulatory reforms to govern the economy(that are considered briefly later in this paper), it has become imperative to address chronic macroeconomic and sectoral challenges even in the short term. The focus is on increasing the space for policy action that may be possible within the terms of the existing interim autonomy arrangements. A draft of this paper was presented at the first preparatory seminar for the MAS Economic Conference 2016, generating discussions and constructive feedback from participants that added further insights that were taken into consideration in revising the draft.

The first section summarizes key indicators of macroeconomic and sectoral performance as well as weaknesses and shortcomings that can be addressed or mitigated in the quest to build a more productive and effective economy in the medium term that provides the main components for community resilience in the coming phase. The paper highlights some inherent problems, such as the instability of growth, chronic stagnation in per capita income growth despite positive aggregate economic growth, and high rates of unemployment and poverty despite continuous efforts to lower these rates through programs, funds and social safety net policies. Along with these challenges, the share of consumer spending is increasing (implying negative savings), thus hindering the effectiveness of domestic investment, which is concentrated in the real estate sector with public sector investment negligible in a contractionary investment climate. Today, fiscal policy is the key economic tool available to the Palestinian Authority, but it still lacks the most important complementary policy foundations: the ability to implement an independent monetary and trade policy.

Nevertheless, the Palestinian government's endeavors to reform, control and develop the available resources have improved fiscal performance, thus coming close to sustainability despite the gap between current and developmental budgets, on the one hand, and inadequate finance to cover key public current developmental and service needs, on the other. Such basic needs are effectively public goods, especially for poor and middle-income classes that rely on public finances to provide education, health, environmental protection, water and electricity services as well as other basic needs for a nation struggling for independence.

The analysis discusses five key challenges originating from, and perpetuating, structural distortions in a cycle of so-called “uneven development” or “de-development”, with the most unfavorable of these distortions to be found in the main productive sectors. Agriculture’s share, which used to be a major source of income, employment and family resilience, has declined; manufacturing has weakened in the absence of a national policy to build a modern industrial base; and public and private sectors services (some of which are nonproductive and rather intermediary) dominate the structure of the economy, GDP and employment (with a big share constituted by public administration). Together with these distortions—which are not all necessarily a product of the occupation— Israel and its settlers’ control of the Palestinian land and natural resources (especially water and energy) remain the key determinants of Palestinian development and the most serious challenges to economic policy making. One of the obstacles that can be addressed with relative ease is Israel’s control of trade revenue and commodity flows with international markets, satisfactory solutions to which could be quite promising. The paper also examines the functional and geographic fragmentation of local markets as well as their weak regulation and inadequate oversight by the public authorities.

The second section reviews the existing frameworks of economic goals and public policies in areas that have the potential to develop the economy, protect social cohesion and support resilience. Many national plans since 1994 have incorporated different sets of goals and policies depending on the phase and its needs and assumptions. Though all plans aimed to include prudent goals and expectations, they were not always realistic or doable. Despite the progress that has been made in the process of developing and implementing economic and social policies, the existing framework (constituted by goals set out in the development plans, laws and regulations, government decisions, and actual procedures/ programs) still has some shortcomings. Policy goals are not necessarily suitable to adequately address the main challenges mentioned above; and there are no well-defined statutory tools that can compel the government to work towards realizing stated goals through laws, regulations, decisions and programs.

It is also important to acknowledge that a gap exists between plans’ expected socioeconomic medium/long term goals and the limited instruments of economic policy available to the PA to achieve such goals(which is largely restricted by occupation). Additional or alternative policies as well as specific procedures are thus needed to achieve the same goals, as introduced in the third section of this paper and in the subsequent papers, which discuss in depth the main aspects of the required joint socio-economic action.

Socio-Economic Scene: Curbing Unemployment, Combatting Poverty and Bridging Social Gaps.

Luay Shabaneh

Summary

This paper maps the social landscape in the occupied Palestinian territory in the wider economic context and explores practical methods beyond the theoretical framework and long-term visions. The effort is undertaken in a context of new international developments, particularly the adoption of the Sustainable Development Goals (SDGs). Three features of Palestinian economic performance are particularly evident. With regard to poverty and unemployment indicators, past meager achievements in macroeconomic performance were not enough to produce tangible social prosperity. The economic gains achieved so far have not led to social well-being of the population. Furthermore there is an inequality gap at all levels, which requires more equitable socioeconomic development efforts. The paper notes that during the Millennium Development Goals (MDGs) phase, the real progress generated from economic recovery was particularly evident in economic activities but not in social prosperity. However, there is still a potential to achieve development justice and incorporate this principle in the general framework of policies and plans. There is a pressing need to examine social sector governance and the relationship between the government and the private and civil sectors in addressing the challenges of unemployment, poverty and inequality gaps.

The study concludes with a set of recommendations regarding the most important policies and interventions:

1. It is essential to design and implement an anti-poverty policy based on improving education and health services, increasing access of the poor to education, putting in place an effective social protection system and narrowing the gender gap. In combating poverty, focus should be placed on the premise that jobs—not aid and subsidies—must be the source of income.
2. It is important to promote an environment where the fight against poverty is not restricted to one Ministry, but rather is treated as a collective responsibility by the public, private and civil society sectors. These should work within a general framework that incorporates all policies and plans of the government within an approach that targets the poor and increases the efficiency of social protection programs in alleviating poverty in the short term and reducing the number of the poor in the longer term.
3. It is timely to address the causes of the inequality gap by improving the access of poor/vulnerable groups to quality education, health, decent housing and clean water; adopting standards that ensure equality of opportunity for all, and tapping all available resources for the general welfare of the population.
4. Reforms of existing regulations are needed to enhance justice, provide protection to informal employment, comply with minimum wage and fight inequality. Of

- particular importance is improving training to develop human capital and enhance access to information and knowledge, as well as allocating gender-sensitive budgets and child/youth/poor responsive budgets.
5. Programs promoting life skills (such as negotiating, problem solving and creative thinking) should be implemented as a lever to formal education in managing the risks associated with the first entry to the labor market.
 6. Incentives should be developed for companies to address the weaknesses in social capital by enabling skilled labor to participate in building educational models for vocational education and allowing poor skilled labor to participate in training programs, which are often restricted to elites.
 7. The private sector should be encouraged to take part in efforts to address unemployment within creative partnerships that enable the private sector to influence the content of the education curricula, which should keep pace with the growing demand for labor in the private sector.
 8. Job search tools should be enhanced, including those used by the employment offices in the Ministry of Labor. Entrepreneurial activity should be stimulated by encouraging more young people to start businesses by providing them with proper training and facilitating their access to loans from banks to set up small and medium enterprises. Tripartite dialogue between the government, employers and workers should be strengthened to institutionalize social dialogue mechanisms.
 9. Financing mechanisms should be developed based on training and financially supervising first time entry of youth into the labor market in order to avert failure. Banks should promote lending programs and increase the number of borrowers in line with successful experiences and best practices. Young people's knowledge of business management should be enhanced to maximize success.
 10. Tax relief should be available for companies to encourage employment expansion and for businesses active in poor areas with high unemployment rates.
 11. Population policies suitable for Palestine (a country in its early stages of demographic transition) should be designed based on the integration of the population dimension and its dynamics within plans and budgets. Programs on family planning and reproductive health issues should be strengthened. Generation of productive employment should be accelerated and barriers to women's participation in the labor market alleviated.
 12. A national dialogue should be initiated on linking the 2030 SDGs with the Palestinian national vision (taking into account the peculiar context in Palestine and the restrictions imposed by the occupying power), so as to improve the targets and indicators of Palestinian performance in the coming years.
 13. Social responsibility should be institutionalized as a source of finance with an expected positive impact on the social sector. This could become possible through coordinating efforts by all the social sector players, and defining mechanisms for the governance of social responsibility as an integral part of corporate governance and as an essential component that supports and guides sustainable development.
 14. Implementing the social agenda in a creative way just like the approaches used to address poverty and unemployment; improving access to vulnerable groups based on accurate local data; and designing new ways of action based on innovative ideas on the factors that impact the outcomes depending on the theory of change.

15. It is important to develop innovative partnerships that can enhance resilience and overcome obstacles to creation of new jobs for the labor force in Palestine (taking into account the Israeli closure system) and open new opportunities in overseas markets that allow access for Palestinian labor while remaining resident in Palestine. An employment fund could be an incubator for initiatives involving innovative partnerships and could also function as a relief fund for small household enterprises (especially in the Gaza Strip, Jerusalem and Area C) and guarantee banking facilities for vulnerable groups seeking investment opportunities.
16. It is equally important to initiate a dialogue that produces a national social compact underpinning the relationship between politics, economy and civil society. Such a compact could act as a lever to narrow the inequality gap, allowing all citizens to realize their rights to development, employment and protection. This way, the system may be brought in line with global trends in social security, with allocations for social services and with standards that service providers must maintain. To be effective, the dialogue and the ensuing compact must include guidelines that target vulnerable groups through upholding the private sector's social responsibility.

Prospects and Potential for Enhancing the Palestinian Business and Trade Environment

Mahmoud Jaafari

Summary

Strengthening the business and trade environment in the occupied Palestinian territory depends on the ability of the public, private and civil sectors to leverage limited potentials to cope with the multiple challenges of creating a transparent, conducive-to-investment environment. These key challenges are:

1. Providing the requisite economic and social protection to strata that suffer poverty, unemployment and lack of resources; such strata must be integrated in the labor force and involved in production activities.
2. Creating the conditions that enable private and public investment.
3. Developing economic sectors: internal trade, manufacturing, agriculture and tourism.
4. Designing laws and regulations and developing procedures that stimulate investment and stabilize the markets.
5. Linking higher education output with labor market needs to lower the unemployment rate among university graduates (which exceeds 40 percent), with unemployed graduates representing 50 percent of the total unemployed persons aged 20-30 years.

To meet these challenges, a number of goals are identified: each goal is linked to a set of policies and tools that correspond to the intervention mechanisms necessary to achieve that specific goal. To enhance the legal and investment climate in a way that improves domestic production, a set of tax policies should be put in place to stimulate SMEs in infrastructure, particularly in Areas B and C. The main interventions comprise the government's obligations towards amending tax laws, speeding up the payment of tax rebates, providing Blue tax exemption on fuel used for industrial purposes, and fighting dumping and smuggling, thus helping achieve greater equity and ensuring price stability and market efficiency in supplying raw and intermediate materials, as well as water and electricity services at low prices and in the quantities needed for production.

As the wheels of the judiciary turn slowly and because no teeth have been put into the court rulings against offenders— who commit forgery and deceptive business practices or sell expired and damaged products in local markets— it is essential to build a judicial and legislative system that can motivate Palestinian investors. It is important to establish specialized courts for economic matters, and to reconsider the procedures in place in the land and real estate court. In terms of capacity building, there is a need for diversifying investment in education and developing human capital, which will require a change in current educational policies in a way that enables students to acquire the skills that the labor market demands. The higher education system should be restructured, making this a prerequisite before accrediting new universities, institutes and programs, while benefiting from well-established international universities in building and construction as well as in international and local engineering designs and marketing.

Due to the decline in the share of the productive sectors (agriculture, industry and construction) in employment and GDP, diversifying economic structures that can produce new goods for export and for import substitution is vital to enhancing the business environment in the occupied Palestinian territory. This in turn depends on the available policies and tools, particularly those regulating industrial and agricultural activities as well as their complementary fiscal and trade policies. A number of intervention instruments can be used: supporting SMEs; providing financial incentives (such as tax exemptions) to exporters and producers (which will facilitate the export of agricultural and industrial products); seeking technical expertise from countries importing Palestinian products; helping manufacturers to be more innovative by producing new products for new markets or improving existing products to meet export standards.

As part of the fight against dumping, smuggling and marketing of unsafe food and other products, efforts are needed to raise Palestinian consumers' awareness and confidence in the locally-produced goods. This requires marketing policies and awareness-raising programs designed to encourage competition and reduce monopolistic practices, which will be possible through well-defined specifications/standards and strict control over local and international products. This way, unfair competition and distortion of prices in commodity markets may be reduced, so that the Palestinian consumer will be the real assessor of the performance of the markets that should adopt the Global Trade Item Number in retail markets. The establishment of industrial zones will further attract Palestinian investments from abroad, but this depends on the ability of the Palestinian Investment Promotion Agency to reach Palestinians and non-Palestinians abroad and to provide them with incentives to invest in the occupied Palestinian territory. This will be more feasible once the Palestinian market works efficiently and transparently, with a data base that helps potential investors to take the right decisions.

Because the Palestinian economy is directly affected by Israeli financial and monetary policies and partially influenced by Jordanian policies, the incentives that could be offered to investments in the agricultural and industrial sectors must measure up to those available to competing Israeli and Jordanian producers. In the case of failure to do so, the Israeli economy will continue to dominate its Palestinian counterpart, forcing the Palestinian businessmen to seek investment opportunities abroad.

The reduction of forces that deter investors and the strengthening of factors that attract investment constitute the first step in creating a business environment that takes into account fair competition and price stability in the market. Palestinian authorities can intervene to curb factors unfavorable to investment by reconsidering several existing laws, especially the 2014 amended Investment Law. Tax and customs breaks for exporters and provision of inputs at subsidized prices are likely to enhance the vertical and horizontal growth of facilities that manufacture export-oriented products.

An Agenda for Developing Productive Capacities

Samir Abdullah

Summary

Over the past five decades, the Palestinian economy saw some short episodes of recovery; yet the predominant feature which repeatedly marked the economy's general development was recession. The economy has always been susceptible to changes in Israel's economic cycle as well as the hostile policies and practices of the occupier. Yet the current state of recession looks deeper and more overarching, which is likely to continue for a long time given the nature of the factors that produced it. Apart from the continued impact of the fluctuations in the Israeli economy and the inimical behavior of the Israeli government, the Palestinian economy suffers an acute scarcity of sources for growth as the already limited resources that the Oslo interim agreements put at the disposal of the Palestinian people and the Palestinian Authority have been depleted. The dire situation has worsened when the donors reneged on previous pledges to finance the deficit in the PA budget, let alone the non-conducive investment climate which is adversely affected by the unfavorable political context, with the prospects of political settlement negligible.

This paper outlines possible actions/policies that can be taken in this miserable context to recover from the recession or, at least, to mitigate the impact of economic contraction on the population's welfare and resilience. The paper thus suggests policies and interventions that are practical, workable and capable of improving the main economic growth indicators quantitatively - especially GDP per capita growth rates, increasing employment and reducing poverty and unemployment rates - and qualitatively. The latter especially include reducing dependency on the Israeli market in goods and labor employment, restoring equilibrium in the structure of the economy so that the productive sectors have a fair share, developing products with high knowledge content and high value-added - particularly in export-oriented sectors - as well as narrowing income gaps horizontally between governorates and vertically between different income groups.

The paper first diagnoses the pressing challenges that hinder the development of key economic sectors, and then defines the policies and practical interventions to meet these challenges. Particular focus is made on the shortage of the registered land for development, scarcity of potable water and water resources for other uses and unreliable electricity (especially in the Gaza Strip), which constitutes a drain on the PA treasury owing to unprofessional management of contracts with the Israeli supplier, poor distribution, high losses due to theft and depreciation of grids.

Furthermore, there is an urgent need for reforming the public transport sector, which will ensure heavy reliance on public transport system. The sector needs to be more effective and more organized, with operators showing compliance to comfort and safety requirements and meeting deadlines. The Palestinian Authority needs to seek donor support to upgrade road networks, water and electricity systems, and collection and

treatment of solid waste to meet the growing needs of the population and businesses. The private resident and nonresident sector should be encouraged to invest in the economy. This will be possible through competitive bidding for franchises in infrastructure services, particularly in the production, transmission and distribution of electricity; production of electricity from alternative and sustainable sources of energy; the collection and treatment of solid waste; better wastewater treatment; construction of wholesale markets and industrial zones as well as other investment-driving facilities.

In economic sectors, it is necessary to leverage the Palestinian unique comparative advantages in several sectors, most importantly agriculture, tourism and human capital. The industrial sector needs to be restructured to be able to manufacture high added value products. Greater reliance on direct import of intermediate and final goods will be needed. Equally important is the issue of building the export capacity of enterprises. It is also necessary to develop the construction and housing industry, as an important employment sector with intensive forward and backward integration. This sector has a social role as well, because decent housing has an impact on the quality of life and is an incubator of human capital. No less significant is reform of the landlord and tenant law to encourage investment in building housing units for different income classes, with governmental intervention needed to help provide housing for families that cannot afford to build or buy a house, particularly families in East Jerusalem as well as those in Gaza whose homes were destroyed by Israeli attacks.

It will be necessary as well to develop the telecommunications and information technology industry, transforming it into an export sector. This entails reforms in education curricula and improving the quality of education so as to stop the brain drain. Together with reforms, other actions are needed: encouraging investments in the sector; preparing the sector to meet the requirements of foreign contracts; and improving the capacity of its developers to provide solutions to meet the needs of other sectors and increase their productivity and competitiveness of their products/ services. The Palestinian financial banking and non-banking sector is in a good health but further improvements are possible, so that the sector will be able to function properly and provide effective financial brokerage services to support investment and manage risks wisely.

The agenda for the development of economic self-capacity will remain open for additions and modifications so as to accommodate further ideas for development and enrichment. After gaining development partners' approval, the agenda should be a joint effort which requires harnessing all resources to implement projects with transparency. It is important to design and develop the necessary large-scale institutional arrangements to institutionalize this national partnership and define the party responsible for supervising the implementation of the national agenda.