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**Background Paper
Roundtable (7)**

**Enhancing Franchising Policies as a Tool
for Market Regulation**

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Granting rents and monopolies is one of the important methods by which governments intervene to regulate economic and business environment. In doing so, governments seek to support productive and service sectors, reinvigorate trade flows, increase state revenues, and help provide services and commodities in an efficient way.

Many countries have controlled monopolies that restrain economic development. Economic theories found that monopolies can do more harm than good to economies. Total, exclusive monopolies were found to impede development due to the absence of competition— driven by privatization, franchising and concessionary monopolies. Best practices of rent management have been developed to regulate business and economic environment so as not to have adverse impacts on markets and society. Many commercial and economic sectors in most countries worldwide are still regulated and managed through franchises and monopolies as well as through privatization, whose level differs across countries. In fact, all developed and developing countries run a system of granting rent management rights and monopolies. In this paper, we discuss commercial franchises in the context of market regulation, but first it is necessary to explain the difference between BOTs, monopolies and commercial franchises, so as to avoid any confusion between franchising and monopoly.

It is difficult to distinguish between monopoly,¹ in its literal sense, and government-granted monopoly (Build, Operate and Transfer (BOT) or legal monopoly).² The laws have clearly distinguished between franchises, BOTs and monopolies.

In general, rent-seeking of all types, arise from the failure of the market economy to produce certain goods and services. The state intervenes directly by granting monopoly concessions to the private sector in order to encourage local investment and attract foreign investment. Alternatively, governments create monopolies run by the state or by the private sector under special conditions. Once a corporation is granted a monopoly status, it receives incentives and exclusive rights to produce a certain product or service. Two types of monopolies can be distinguished in terms of purpose. First, one form of monopoly aims to increase the revenues of the state treasury. In this case, the monopoly is run by the state, such as in tapping natural resources. Second, government-granted monopolies (also called *de jure* monopolies)— which serve the interest of the society as a whole— seek to produce goods and services that are difficult for the state to produce for reasons of administration, efficiency and cost. In the latter case, parties other than the state are entrusted with producing certain goods and services such as the production and distribution of electricity, building and running railways, constructing infrastructure projects, and other projects that serve the general public. These projects are usually managed through monopolistic concession contracts granted by the state (MAS, 2005).

A franchisee, on the other hand, is a contract whereby one of the parties (franchiser) allows the other party (franchisee) to use one or more intellectual, manufacturing or technical/technological know-how rights (with all that is related to trademarks and patents) to produce a commodity or distribute its products/services under the franchiser's name, according to its guidelines and under its supervision, exclusively in a specific geographical area and for a specified period. The franchiser is often obliged to provide technical assistance to the franchisee. In exchange for gaining the franchise, the franchisee

¹ This is a definition derived from different sources. According to some economists, monopoly is an extreme result of capitalism, but with some differences, though the idea lies in the existence of only one party or provider of a commodity or service. In other words, monopoly means the absence of competition, which enables a corporation to control the market, a phenomenon that the governments try to resist. A monopolist becomes big enough to own all or nearly all of the market for a particular type of product or service no matter how good it is, and at the price it wants because competitors cannot compete, which increases the profits of that entity. A monopolist may sometimes develop itself through other companies under its possession. Often profits rise and in some cases prices fall with the increase in production and sales, so that the higher the production, the lower the cost, which enables the monopolist to tighten its control over the market because of its high competitiveness, and in this case the monopolist becomes the sole supplier of that service or product. . <http://www.argaam.com/ar/article/articledetail/id/375064>
<https://ar.wikipedia.org/wiki/%D8%A7%D8%AD%D8%AA%D9%83%D8%A7%D8%B1>
<https://www.google.ps/search?safe=active&q+بحث+عن+الاحتكار+doc&sa> Husam Eisawi

² Build–operate–transfer (BOT) is a form of projects, wherein a private entity receives a concession from the government to run a project in return for some fees. The project will be then transferred to the government at the end of the concession agreement. BOT is used to construct and run a public facility for a specific period of time. The government does this to avoid high costs or budget overload. Examples include infrastructure projects, housing projects, land reclamation, irrigation projects, airports, roads, railways, power stations and other large projects such as the Suez Canal project in Egypt.

usually pays the franchiser license fees. Sole-selling agencies are one form of franchise contracts, but franchise contracts are broader and more comprehensive in terms of powers because they use the concession package in full. Sole-selling agencies are usually constrained by conditions and they do not have the right to use industrial property rights or patents. A car selling agency, for example, does not grant the agent the right to use the patent of the parent company.³

To explain the differences between these terms– with functional implications in the Palestinian context (with the aim of improving regulation of the market)– and discuss the benefits of franchises in enhancing investment and employment opportunities. This is of particular interest as the private sector has reservations about the tax policy that was previously applied to the enterprises which have enjoyed from investment privileges.⁴ Hence the Palestine Economic Policy Research Institute (MAS) convened this Roundtable that brings experts and decision-makers to elucidate the issue of franchising. The related laws and tax policies in particular will be discussed to assess whether they adequately reflect the differences between these terms so as to correct any of the procedures that regulate the market.

The problem of franchising and monopolistic privileges in Palestine

First: The legal problem

The distinction between franchises and BOTs is important because it has practical implications on the implementation of economic, trade and tax policies. This has been the case for the last decades in the Palestinian territory. It started with the British Mandate government and later with the Jordanian government which granted concession contracts in the West Bank under Article 117 of the Jordanian Constitution, providing for developing special laws to govern privileges (rents). To that end, eight concession laws were enacted, including those for oil companies, potash, tanning, transportation, tourism, and other rents inherited from the British Mandate government of Palestine, such as the exclusive rights of the electricity company (Jerusalem). No concession laws were issued under the Egyptian administration of the Gaza Strip.

In the post-1994 period (the Palestinian Authority), the Palestinian Basic Law, amended in 2003, established the constitutional framework for concession contracts and made the rules and procedures for the granting of franchise contingent on laws passed by the Legislative Council (Article 94, Basic Law of 2003). In 2005, a draft concession law was developed, but it was not considered by the Legislative Council. Noticeably, all the concession contracts granted were under different laws related to newly-established units. For example, in the electricity and power sector, the contracts were granted under the law that established the Palestinian Energy Authority in 1995; and in the water sector, the concession was based on the law that established the Palestinian Water Authority in 1996. The latter did not mention concessions, but rather it provided for granting licenses through a system developed by the Water Authority. In the industrial sector, concessions are granted according to the Free Industrial Cities Law of 1998. In the telecommunications sector, the privileges are given under the Telecommunications Law of 1996. Many concession contracts were also granted in the form of licenses based on agreements between the Palestinian Authority and the beneficiary, such as the PALTEL Agreement for the establishment, management and operation of landlines and mobile telecommunications in 1995 (MAS, 2005).⁵

The foregoing discussion suggests that a legal framework for concession rights (both franchising and monopoly) does not exist despite the explicit call in the Palestinian Basic Law. Granted monopoly rights were based on agreements between the Palestinian Authority and the private sector and under special laws, such as the telecommunications law. In this paper, we place a special emphasis on

³ Studies and Research of Administrative Sciences, Al-mowahid al-arabi Website <http://4uarab.com/vb/threads/alfiq-bin-alamtiaz-ualtsrixh-ualtukil.63401>

⁴ Some of these franchises were treated as monopolies in terms of the income tax rate based on the income tax amendments of 2015, which raised income tax for monopolies from 15% to 20%. This rate was applied to some franchise companies. However, in January 2017, the Ministry of Finance was instructed to correct this situation by applying the 20% rate only to the government-granted monopolies (an interview with the Director General of Income Tax Department).

⁵ Qasem, Anis and Milhem, Firas. (2005). A Critical Study of the Palestinian Privileges Law (in Arabic). Ramallah: Palestine Economic Policy Research Institute (MAS).

franchising. Although the Basic Law demanded that the rules for granting franchise rights be defined, the provisions for regulating franchising are totally absent.

Second: The problem of application and market regulation

The problem in the Palestinian market is better demonstrated in the application of certain BOT tax policies to franchising. Certainly, such treatment runs counter to the policies implemented by other countries to encourage franchising and provide incentives to woo investments and employ manpower.⁶

In practice, the expansion of franchising companies in Palestine has been restrained by the legal framework. Between 2015 and 2017, the law treated franchises as monopolistic companies, and thus they were subject to income tax rate of 20 percent, the highest in the range. Article 5 of Decree No. 5 of 2015 concerning the amendment of the Income Tax Law No. 8 of 2011 amended Article 16, paragraph 2 of the original law, to read as follows: Income for any legal person is taxed at a rate of 15 percent, while telecommunications companies and companies that have a concession or monopoly in the Palestinian market are taxed at 20 percent.

Franchises in Palestine were treated as BOTs and monopolies by the tax authorities (for a certain period), reflecting confusion between franchises and monopolies that generate revenues for the treasury. Even after correcting this situation, franchises have not been dealt with from an investment promotion perspective. For example, they have not received special incentives, which discourages SMEs that depend on franchising and runs counter to best practices in neighboring and other countries which have made it easy for SMEs to access franchising. Those countries have managed to promote franchising through conferences and awareness raising workshops that emphasize the official commitment to support the development process using this method.

Each year, many international and regional conferences are held to promote franchises and other commercial concessions (such as agencies), facilitate procedures and build personnel capacity in order to improve the efficiency of contracting. However, in Palestine, we have not yet regulated the legal framework of commercial concessions. Nor have we given them a market identity nor identified the appropriate investment policies for such entities. In 2000, the Palestinian Authority issued a law on the organization of commercial agencies, but it did not address franchises.⁷

Third: PA official authorities' attitude toward franchising vs. franchisee view

The third problem with franchising is the lack of clarity and the absence of clear guidelines for dealing with monopoly and franchises by the relevant official bodies. Worse, official authorities are not responsive to the needs of some private sector companies with commercial privileges granted by the parent companies.⁸

For research validation, we have conducted interviews with officials from the Ministry of Finance, the Ministry of Economy, the Investment Promotion Authority and some franchisees. The interviews focused on one question about the distinction between franchises and BOTs and how to deal with each:

⁶ There is a strong tendency from countries in the region to promote SMEs that depend on franchise contracts. In 2016, a conference was held in Abu Dhabi to discuss methods of encouraging SMEs through franchising. In Muscat, a conference was also held by the International Franchise Association to open up to international markets. In Egypt, the International Franchise Association has laid the foundation of a Development and Commercial Franchise Administration to promote, encourage and grant facilities to franchise companies, with an encouraging policy to attract international companies to set up branches. The sales in Egypt are estimated at LE 12 billion, providing about 800 thousand direct and 500,000 indirect jobs in fashion, food and furniture. In the Arab region, the franchise business is estimated at USD 60 billion.
<http://www.albayan.ae/economy/local-market/2016-12-11-1.2791708>
<http://www.shorouknews.com/news/view.aspx?cdate=09052017&id=3a2ce67d-40cb-4058-9cfb-fd230203c128>

⁷ Law No. 2 of 2000 on regulating commercial agencies.

⁸ There are many franchises in the Palestinian market, such as Coca-Cola, Hardee's, and international brand names in clothing, furniture, restaurants, etc.

1. The Ministry of Finance (interviews with some income tax staff members): It was found that until early 2017, the staff members did not work according to a clear and written law; that the mechanism of action was in accordance with instructions issued by officials in the ministry; that the employees did not have written and clear guidelines about the distinction between monopolistic companies and franchises; and that they implemented the Income Tax Law and its 2015 amendments based on instructions from the Ministry. This approach has continued to the present. We found that transactions of monopolistic companies have also been suspended by the Ministry (instructions from the Director General of Income Tax Department). The MoF affirms that the Ministry of Economy is the unit in charge of defining and clarifying franchises in a formal and legal manner, adding that the way the Department deals with income tax for franchises is based on the ministry's diligence and in accordance with international practices. Accordingly, the system applies only one form of privilege which is subject to the higher income tax bracket; namely the government-granted monopoly. "That is why we have removed franchises from this tax bracket," the MoF official confirms.
2. Ministry of Economy: According to the Ministry of Economy's Intellectual Property Manager, there is a problem in distinguishing between privileges. He said this is a problematic issue that must be raised and made known, because franchising is closely related to intellectual property, manufacturing rights and trademarks. He said there should be rules in place to distinguish between these activities.
3. According to the Director General of the Investment Promotion Authority, his department has not received any clear instructions or laws distinguishing between the different types of concessions. That is why they deal with all companies in the same manner, adding that the method for calculating the exemption is the responsibility of the Ministry of Finance according to the classification of each company under a certain tax bracket.
4. After interviewing private sector franchisees, we found that several have filed formal claims demanding the tax department to treat them like ordinary companies (with an income tax rate of 15 percent). They said the response of the Ministry of Finance was belated, and they still claim reimbursement of the actually paid income tax 5 percent difference, but to no avail.

Conclusion

- Franchises are totally different from BOTs and monopolies. At least, there should be clear boundaries between BOTs and de jure monopoly, on the one hand, and franchise, on the other.
- It is necessary to enact a law that meets the requirements of franchising and defines it to enable the Palestinian business environment, which is an important part of the process of market regulation.
- It is important to identify and define monopolistic companies in the Palestinian market in a clear legal manner. It is also important to prove a clear definition of BOTs.
- The Palestinian public sector has a vital role to play. It can employ policies to protect franchisees; and it can carry out or support studies on possible investment policies and the expected outcomes.
- It is important to hold awareness raising workshops to explain the importance of distinguishing between monopolistic and non-monopolistic privileges and encourage franchising contracts and benefits.

Questions for discussion

- Is the government willing to rethink its investment policy and encourage franchising?
- How can a clear mechanism be developed to deal with franchising in the absence of a concession law?
- Is franchising a competitor to local production?
- What are the obstacles to passing a franchising law?
- How important is the regulation of the Palestinian market in terms of franchising? Can we make do with the 2002 Agency Law in lieu of a franchising law?